

**UNITED STATES – RULES OF ORIGIN
FOR TEXTILES AND APPAREL PRODUCTS**

Report of the Panel

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I. INTRODUCTION

1.1 On 11 January 2002, India requested consultations with the United States pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (hereafter the "DSU"), Article XXII of the General Agreement on Tariffs and Trade 1994 (hereafter the "GATT 1994"), Article 7 of the Agreement on Rules of Origin (hereafter the "*RO Agreement*") ... regarding section 334 of the United States Uruguay Round Agreements Act of 1994 (hereafter "section 334") and section 405 of the United States Trade and Development Act of 2000 (hereafter "section 405") and the customs regulations implementing these provisions.¹

1.2 Consultations were held in Geneva on 7 and 28 February and 26 March 2002, but did not lead to a mutually satisfactory resolution of the matter.

1.3 On 7 May 2002, India requested² the Dispute Settlement Body (hereafter the "DSB") to establish a panel pursuant to Article 6 of the DSU, Article XXIII of the GATT 1994 and Article 8 of the *RO Agreement*. India's panel request referenced the rules of origin for textiles and apparel products set out in section 334 and the Statement of Administrative Action accompanying the Uruguay Round Agreements Act (hereafter the "URAA"), the subsequent modifications made by section 405 of the Trade and Development Act, the customs regulations implementing these Acts as well as the administration of these Acts and regulations, as the measures at issue. India claimed that the United States' rules of origin for textiles and apparel products were inconsistent with paragraphs (b), (c), (d) and (e)³ of Article 2 of the *RO Agreement*.⁴

1.4 At its meeting on 24 June 2002, the DSB established a Panel pursuant to the request of India, in accordance with Article 6 of the DSU. The Panel was established with standard terms of reference. The terms of reference are the following:

"To examine, in the light of the relevant provisions of the covered agreements cited by India in document WT/DS243/5/Rev.1, the matter referred to the DSB by India in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."⁵

1.5 On 10 October 2002, the Panel was constituted as follows:

Chairperson: Mr Lars Anell

Members: Ms Mary Elizabeth Chelliah
Mr Donald McRae⁶

1.6 Bangladesh, China, the European Communities, Pakistan and the Philippines reserved their third party rights to participate in the Panel's proceedings. China, the European Communities and the Philippines presented written and oral arguments to the Panel.

¹ WT/DS243/1.

² India had originally submitted its request on 7 May 2002 but omitted reference to Article 2. On 3 June India submitted a corrected panel request, and it is on the basis of this request that the Panel was established.

³ India has decided to refrain from further pursuing its claim that the administration of the United States rules of origin is inconsistent with Article 2(e) of the *RO Agreement* because India considers that the DSU does not provide an effective remedy against WTO-inconsistent actions that have been taken in the past. Therefore, any finding of violation of this provision would not result in an effective remedy for India.

⁴ WT/DS243/5/Rev.1.

⁵ WT/DS243/6.

⁶ *Ibid.*

1.7 The Panel met with the parties on 12 and 13 December 2002 as well as on 23 January 2003. It met with the third parties on 13 December 2002. The Panel issued its interim report to the parties on 11 April 2003. The Panel issued its final report to the parties on 25 April 2003.

II. FACTUAL ASPECTS

2.1 This dispute concerns the rules of origin which the United States applies to textiles and apparel products under section 334 of the URAA of 1994 and the subsequent modifications made thereto by section 405 of the Trade and Development Act of 2000 as well as the implementing customs regulations set out in 19 CFR § 102.21.

A. SECTION 334 OF THE URUGUAY ROUND AGREEMENTS ACT

2.2 Section 334 provides, in relevant part, that:

"(b) Principles.—

(1) In general.-- Except as otherwise provided for by statute, a textile or apparel product, for purposes of the customs laws and the administration of quantitative restrictions, originates in a country, territory, or insular possession, and is the growth, product, or manufacture of that country, territory, or insular possession, if--

(A) the product is wholly obtained or produced in that country, territory, or possession;

(B) the product is a yarn, thread, twine, cordage, rope, cable, or braiding and--

(i) the constituent staple fibers are spun in that country, territory, or possession, or

(ii) the continuous filament is extruded in that country, territory, or possession,

(C) the product is a fabric, including a fabric classified under chapter 59 of the HTS, and the constituent fibers, filaments, or yarns are woven, knitted, needled, tufted, felted, entangled, or transformed by any other fabric-making process in that country, territory, or possession; or

(D) the product is any other textile or apparel product that is wholly assembled in that country, territory, or possession from its component pieces.

(2) Special rules.-- Notwithstanding paragraph (1)(D)--

(A) the origin of a good that is classified under one of the following HTS headings or subheadings shall be determined under subparagraph (A), (B), or (C) of paragraph (1), as appropriate: 5609, 5807, 5811, 6209.20.50.40, 6213, 6214, 6301, 6302, 6303, 6304, 6305, 6306, 6307.10, 6307.90, 6308, or 9404.90; and

(B) a textile or apparel product which is knit to shape shall be considered to originate in, and be the growth, product, or manufacture of, the country, territory, or possession in which it is knit.

(3) Multicountry rule.-- If the origin of a good cannot be determined under paragraph (1) or (2), then that good shall be considered to originate in, and be the growth, product, or manufacture of--

(A) the country, territory, or possession in which the most important assembly or manufacturing process occurs, or

(B) if the origin of the good cannot be determined under subparagraph (A), the last country, territory, or possession in which important assembly or manufacturing occurs."

2.3 The descriptions of goods classifiable under HTS headings and subheadings referred to in section 334 quoted above are as follows:

| <u>HTS heading</u> | <u>Description</u> |
|--------------------|--|
| 5609 | Articles of yarn, strip or the like of heading No. 54.04 or 54.05, twine, cordage, rope or cables, not elsewhere specified or included. |
| 5807 | Labels, badges and similar articles of textile materials, in the piece, in strips or cut to shape or size, not embroidered. |
| 5811 | Quilted textile products in the piece, composed of one or more layers of textile materials assembled with padding by stitching or otherwise, other than embroidery of heading No. 58.10. |
| 6209.20.50.40 | Infants' woven cotton diapers. |
| 6213 | Handkerchiefs. |
| 6214 | Shawls, scarves, mufflers, mantillas, veils and the like. |
| 6301 | Blankets and travelling rugs. |
| 6302 | Bed linen, table linen, toilet linen and kitchen linen. |
| 6303 | Curtains (including drapes) and interior blinds; curtain or bed valances. |
| 6304 | Other furnishing articles, excluding those of heading No. 94.04. |
| 6305 | Sacks and bags, of a kind used for the packing of goods. |
| 6306 | Tarpaulins, awnings and sunblinds; tents; sails for boats, sailboards or landcraft; camping goods |
| 6307.10 | Floor-cloths, dish-cloths, dusters and similar cleaning cloths. |
| 6307.90 | Other made-up articles. |
| 6308 | Sets consisting of woven fabric and yarn, whether or not with accessories, for making up into rugs, tapestries, embroidered table cloths or serviettes, or similar textile articles, put up in packings for retail sale. |
| 9404.90 | Other articles of bedding. |

B. SECTION 405 OF THE TRADE AND DEVELOPMENT ACT OF 2000

2.4 Section 405 amended section 334 of the Uruguay Round Agreements Act. Of particular relevance to this dispute are two exceptions which section 405 created from the "fabric formation" rule established by section 334. Specifically, section 405 provides that:

- for silk, cotton, man-made or vegetable fibre fabric, origin is conferred by dyeing and printing and two or more specified finishing operations; and that

- for certain textile products excepted from the assembly rule, origin is also conferred by dyeing and printing and two or more specified finishing operations, subject to certain exceptions.

2.5 Section 405(a) reads as follows:

"In General. Section 334(b)(2) of the Uruguay Round Agreements Act (19 U.S.C. 3592(b)(2)) is amended-

(1) by redesignating subparagraphs (A) and (B) as clauses (i) and (ii), respectively;

(2) in the matter preceding clause (i) (as redesignated), by striking "Notwithstanding paragraph (1)(D)" and inserting "(A) Notwithstanding paragraph (1)(D) and except as provided in subparagraphs (B) and (C)"; and

(3) by adding at the end the following:

"(B) Notwithstanding paragraph (1)(C), fabric classified under the HTS as of silk, cotton, man-made fiber, or vegetable fiber shall be considered to originate in, and be the growth, product, or manufacture of, the country, territory, or possession in which the fabric is both dyed and printed when accompanied by 2 or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing.

"(C) Notwithstanding paragraph (1)(D), goods classified under HTS heading 6117.10, 6213.00, 6214.00, 6302.22, 6302.29, 6302.52, 6302.53, 6302.59, 6302.92, 6302.93, 6302.99, 6303.92, 6303.99, 6304.19, 6304.93, 6304.99, 9404.90.85, or 9404.90.95, except for goods classified under such headings as of cotton or of wool or consisting of fiber blends containing 16 percent or more by weight of cotton, shall be considered to originate in, and be the growth, product, or manufacture of, the country, territory, or possession in which the fabric is both dyed and printed when accompanied by 2 or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing."

2.6 The consolidated text of section 334 as amended by section 405 can be found in 19 U.S.C. § 3592.

2.7 The descriptions of goods classifiable under HTS headings, subheadings and sub-subheadings referred to in section 405 quoted above are as follows:

| <u>HTS heading</u> | <u>Description</u> |
|--------------------|--|
| 61.17 | Other made up clothing accessories, knitted or crocheted; knitted or crocheted parts of garments or of clothing accessories. |
| 6117.10 | Shawls, scarves, mufflers, mantillas, veils and the like. |
| 62.13 | Handkerchiefs. |
| 62.14 | Shawls, scarves, mufflers, mantillas, veils and the like. |
| 63.02 | Bed linen, table linen, toilet linen and kitchen linen. |
| 6302.22 | Bed linen, not knitted or crocheted, printed, of man-made fibres. |
| 6302.29 | Bed linen, not knitted or crocheted, printed, of other textile materials, excluding cotton. |

| | |
|------------|---|
| 6302.52 | Table linen, not knitted or crocheted, of flax. |
| 6302.53 | Table linen, not knitted or crocheted, of man-made fibres. |
| 6302.59 | Table linen, not knitted or crocheted, of other textile materials, excluding cotton. |
| 6302.92 | Toilet linen and kitchen linen, other than terry towelling, of flax. |
| 6302.93 | Toilet linen and kitchen linen, other than terry towelling, of man-made fibres. |
| 6302.99 | Toilet linen and kitchen linen, other than terry towelling, of other textile materials. |
| 63.03 | Curtains (including drapes) and interior blinds; curtain or bed valances. |
| 6303.92 | -- Not knitted or crocheted, of synthetic fibres. |
| 6303.99 | -- Not knitted or crocheted, of other textile materials. |
| 63.04 | Other furnishing articles, excluding those of heading No. 94.04. |
| 6304.19 | -- Bedspread, not knitted or crocheted. |
| 6304.93 | -- Other, not knitted or crocheted, of synthetic fibres. |
| 6304.99 | -- Other, not knitted or crocheted, of other textile materials. |
| 9404.90 | Other articles of bedding. |
| 9404.90.85 | Quilts, eiderdowns, comforters and similar articles. |
| 9404.90.95 | Other articles of bedding. |

C. 19 CFR § 102.21

2.8 Paragraph (a) of section 334 directed the Secretary of Treasury to prescribe rules to implement the principles contained in section 334 of the URAA for determining the origin of textiles and apparel products. The regulations set forth in 19 CFR § 102.21 reflect the exercise of that authority. The section 102.21 regulations contain amendments, adopted on an interim basis, to align the regulatory text with the statutory amendments to section 334 as set forth in section 405. 19 CFR § 102.21 is annexed to this report (Annex C).

III. ARGUMENTS OF THE PARTIES

3.1 The arguments presented by the parties in their written submissions and oral statements are reflected below.⁷ The parties' answers to questions and comments on each other's responses are reproduced in Annex A.

A. FIRST WRITTEN SUBMISSION OF INDIA

1. Introduction

3.2 As the United States International Trade Commission ("ITC") noted, "rules of origin have a particularly significant impact in the textiles area because the manufacture of such products involves many production processes often performed in more than one country."⁸ The temptation to use rules of origin as a means of protectionism is therefore particularly great in this area. The United States could not resist this temptation. Despite its advocacy of trade-neutral rules of origin, the United States included in its legislation implementing the results of the Uruguay Round negotiations, new rules for the determination of the origin of textiles and apparel products that changed the criteria to determine the origin of products covered by a transitional regime of country-specific quotas established under the Agreement on Textiles and Clothing ("ATC") in such a way that trade which had previously been quota-free was now subjected to quantitative limits.

⁷ The summaries of the parties' arguments are based on the executive summaries submitted by the parties to the Panel.

⁸United States International Trade Commission, "The Impact of Rules of Origin on US Imports and Exports," Report to the President on Investigation No. 332-192 under section 332 of the Tariff Act of 1930, Publication No. 1695, May 1985, p. xi.

3.3 Many WTO Members, both developing and developed countries, registered their concern about these new United States rules of origin. The European Communities also complained about the WTO-inconsistency of the new United States rules of origin and their effects on its textile and apparel industry; in 1997, it initiated WTO dispute settlement proceedings against the United States. The European Communities withdrew its complaint after it entered into a bilateral agreement with the United States according to which the United States Administration was to propose amendments to Congress to address the issues of concern to the European Communities. However, when the European Communities realized that the draft legislation proposed did not fulfil adequately the terms of the bilateral agreement, the European Communities initiated new WTO dispute settlement proceedings against the United States. A second settlement agreement was concluded and the United States Congress upon a recommendation from the United States Administration, then further amended the United States rules of origin addressing the concerns of the European Communities.

3.4 The United States rules of origin set out in section 334 of the Uruguay Round Agreements Act ("section 334" or the "1996 rules of origin"), and modified in section 405 of the Trade and Development Act of 2000 ("section 405" or the "2000 rules of origin"), and the customs regulations implementing these statutory provisions, and their application, are inconsistent with the United States obligations under Article 2 (b), (c), (d) and (e) of the Agreement on Rules of Origin ("*RO Agreement*").

2. Factual background

(a) Section 334 of the Uruguay Round Agreements Act

3.5 In December 1994, the United States Congress enacted legislation relating to textiles in Subtitle D of Title III of the URAA. This was the first time that product-specific non-preferential rules of origin were created in the United States by legislation rather than by executive action or by the courts. Subtitle D of Title III of the URAA contains five sections related to textiles and apparel, namely sections 331 to 335. Section 334 required the Department of Treasury to develop regulations that incorporated certain principles on rules of origin for textiles and apparel products.

3.6 Section 334 establishes three basic sets of origin rules for textiles and apparel products:

- a set of "general rules", as provided for in section 334(b)(1);
- "special rules" applicable to certain classes of textiles and apparel, as provided for in section 334(b)(2); and
- a "multicountry rule" as provided for in section 334 (b)(3), designed to determine the origin of goods whose origin is not fixed by the general or special rules.

3.7 Section 334(b)(1)(A) establishes a "single country" rule of origin, which provides, quite logically, that if a product is "wholly obtained or produced" in a single country - that is, manufactured in a country entirely from materials or components originating in that country - it will be deemed to originate in that country. This rule follows the principle that applied under the previously applicable customs regulations in 19 CFR section 12.130.

3.8 Section 334(b)(1)(B) establishes what is known as the "yarn" or "yarn forward" rule of origin, under which yarns, threads, cordage, twine and similar products are deemed to originate in the country where they are spun from their constituent fibres, or (in the case of synthetic filaments produced by extrusion), in the country where they are extruded. Here again, these rules are consistent with those obtained under the previously applicable customs regulations.

3.9 However, section 334(b)(1)(C) establishes a new rule, which fixes the origin of a fabric in the country where it is woven, knitted or otherwise formed in the "greige" state. No recognition of origin

is given for any operations which follow the forming of the fabric, such as dyeing, printing or other finishing steps. This is a major departure from the previous rule, under which dyeing and printing, as well as at least two additional finishing operations, were deemed sufficient to transform "greige" fabric formed in one country into a new product of the country where the finishing operations were performed. Greige fabric is "a term used to describe textile products prior to bleaching, dyeing or finishing."

3.10 Finally, section 334(b)(1)(D) contains the "single country assembly" rule. It provides that, where a textile product (except for those product headings specified in the section 334(b)(2) "Special Rule") is wholly assembled in a single country, that is its country of origin. The mere cutting of fabric to form garment parts is no longer sufficient to confer origin on an assembled textile good.

3.11 The initial section 334(b)(2) provides "Special Rules" of origin for goods which are not covered by the "single country assembly" rule of section 334(b)(1)(D). Under section 334 (b)(2)(A), except for the Harmonized Tariff Schedule ("HTS") heading 5609 which deals with yarn, *those products under the other listed HTS headings would be conferred origin based on where their greige fabric was formed, not where they were assembled.* The second exception under section 334 (b)(2)(B) was for products that were knit to shape. Section 334(b)(2)(B) provides that where textile goods are "knit to shape" in a particular country, that country will be the country of origin.

3.12 In many cases, the section 334(b)(1) "General Rules" and the section 334(b)(2) "Special Rules" will not yield a definitive country of origin for an imported textile or apparel article. To address these situations, section 334(b)(3) contains a "Multicountry Rule" of origin.

(b) The Amendments to section 334 in section 405 of the Trade and Development Act of 2000

3.13 The United States Congress amended section 334 through section 405 of the Trade and Development Act of 2000. The purpose of this amendment was to implement the bilateral agreement settling the WTO case brought by the European Communities against the United States on section 334.

3.14 Section 405 establishes two exceptions to the special rules contained in section 334(b)(2). First, although the origin of fabric was to be determined where the greige fabric was formed, fabric classified under the HTS as of silk, cotton, man-made fibre, or vegetable fibre shall be considered to originate in, and be the growth, product, or manufacture of, the country, territory, or possession in which the fabric is dyed and printed when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moreing.

3.15 Second, goods that would normally be subject to the wholly assembled rule in section 334(b)(2)(D) but that were classified under specifically listed HTS headings shall be considered to originate in, and be the growth, product, or manufacture of, the country, territory, or possession in which the fabric is both dyed and printed when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moreing. This exception does not apply to those products classified under these headings when they are made of cotton or of wool or consisting of fibre blends containing 16% or more by weight of cotton.

3. Legal argument

(a) The measures at issue

3.16 The specific measures challenged by India ("measures at issue") are the United States rules of origin set out in section 334 of the URAA and modified in section 405 of the Trade and Development

Act of 2000 and the customs regulations implementing these statutory provisions, and their application.

(b) The measures at issue are rules of origin within the meaning of Article 1 of the *RO Agreement*

3.17 Article 1 of the *RO Agreement* defines the term "rules of origin" as "laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods provided such rules of origin are not related to contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of paragraph 1 of Article I of GATT 1994." The measures at issue are the United States rules applied to determine country of origin and do not relate to a preferential trade arrangement and consequently, fall within the definition of rules of origin as set out in Article 1.1.

(c) The measures at issue are subject to the disciplines set out in Article 2 of the *RO Agreement*

3.18 The *RO Agreement* divides the disciplines to guide the application of origin determinations into two phases: (1) disciplines during a transitional period until the work programme for the harmonization of origin rules is completed and; (2) disciplines that will apply after the harmonization period is completed. Article 2 of the *RO Agreement* provides that, until the work programme for the harmonization of rules of origin (as set out in Part IV) is completed, Members shall abide by the disciplines set out in Article 2. Upon the implementation of the results of the harmonized work programme, the disciplines in Article 3 will be applicable. As of the date of the establishment of the panel, the work programme for the harmonization of rules of origin has not been completed. Therefore, the United States is bound by the disciplines set out in Article 2.

(d) The measures at issue are inconsistent with Article 2(b) of the *RO Agreement*

3.19 The operative clause of Article 2(b) is the obligation that rules of origin shall not be used "as instruments to pursue trade objectives." Given the critical importance of ensuring that rules of origin are not used as instruments to pursue trade objectives, the drafters of this provision chose to strengthen the operative clause of Article 2(b) by the text that precedes it ("notwithstanding the measure or instrument of commercial policy to which they are linked") and that follows it ("directly or indirectly").

3.20 The preceding clause "notwithstanding the measure or commercial policy instrument to which they are linked" recognizes that rules of origin will be "linked" to a measure or instrument of commercial policy, and consequently to a measure or instrument that is, by definition, not "trade-neutral". The clause therefore implies that, while commercial policy measures and instruments may be applied for commercial policy purposes, rules of origin should be used exclusively as a mechanism to implement those measures and instruments.

3.21 Article 1.2 of the *RO Agreement* sets out a non-exhaustive list of commercial policy instruments. This includes the application of "most-favoured-nation treatment under Articles I, II, III and XI and XIII of GATT 1994; anti-dumping and countervailing duties under Article VI of GATT 1994; safeguard measures under Article XIX of GATT 1994; origin marking requirements under Article IX of GATT 1994; and any discriminatory quantitative restrictions or tariff quotas." It may therefore be concluded that WTO Members may use rules of origin to implement commercial policy instruments of the kind listed in Article 1.2 but that they may not use rules of origin to pursue policy objectives of the kind commonly pursued with these policy instruments, in particular, the objective of protecting the domestic industry against import competition or of favouring imports from one country over imports from another.

3.22 As noted above, the succeeding clause in Article 2(b) states: "rules of origin are not [to be] used as instruments to pursue trade objectives directly or indirectly." The critical importance of

separating rules of origin determinations from trade objectives manifests itself in the Article 2(b) enumeration that the prohibition applies whether or not the Member uses its rules of origin to pursue a trade objective directly or indirectly. The placement of the adverbs "directly" or "indirectly" supports the interpretation that they modify the verb "pursue" in the clause "to pursue trade objectives." This interpretation is supported by both the French and Spanish versions.

3.23 The *New Shorter Oxford English Dictionary* defines "instrument" as "a thing used in or for performing an action; a means" and "objective" as the "thing aimed at or sought; a target, a goal, an aim." Therefore, the ordinary meaning of the term "trade objective" in the context of Article 2(b) is an aim, goal, or object related to trade. An instrument is therefore the means by which to pursue trade objectives. One way of assessing whether a rule of origin is being used as an instrument to pursue a trade objective is to assess whether it achieves the same results as a measure or instrument of commercial policy. As pointed out above, trade objectives include the objective of protecting the domestic industry against import competition or of favouring imports from one country over imports from another. Any rule of origin that is used as an instrument to protect a domestic industry or to favour imports from one country over imports from another country is, by definition, an instrument to pursue trade objectives.

3.24 While Members may use measures or commercial policy instruments to pursue trade objectives, they are prohibited from using their rules of origin to achieve such trade objectives. In other words, rules of origin as such should not be used as a policy instrument. This interpretation is supported by the context. The use of the term "notwithstanding" in the preceding clause implies a contrast between this clause and the prohibition that rules of origin must not be used to pursue trade objectives. Thus, measures or commercial policy instruments may pursue aims, goals or objects related to trade, but rules of origin may not do so. And they may not do so either directly or indirectly.

3.25 The object and purpose of the *RO Agreement* also supports this interpretive approach. The seventh recital of the Preamble states that Members desire through the *RO Agreement*, "to ensure that rules of origin are prepared and applied in an impartial, transparent, predictable, consistent and neutral manner."

3.26 To determine whether rules of origin are used as an instrument to pursue trade objectives it is useful to examine the design, architecture, and structure of the rules of origin. The Appellate Body has noted that "[a]lthough it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the *design*, the *architecture*, and the revealing *structure* of a measure."⁹

3.27 An examination of the design, architecture, and structure of section 334 shows that it is used as an instrument to pursue trade objectives. There are essentially three different methods for determining origin. All these methods have one common element, namely, that the product is conferred the origin of the country where value is added and the nature of the product is modified.

3.28 Section 334 confers origin on the basis of criteria that are unrelated to the value added operations or the change in the nature of the product. Instead, the criteria are those that are commonly used in the application of commercial policy instruments.

3.29 Section 334(b)(1)(C) contains the principle that origin would be determined based on where the greige fabric was woven. Furthermore, section 334(b)(2) provides the special rule that, "notwithstanding" the wholly assembled rule, the origin of certain flat goods under certain headings would be determined where the greige fabric was woven. On fabrics, the new rules of origin moved

⁹Appellate Body Report, *Japan – Taxes on Alcoholic Beverages* ("Japan – Alcoholic Beverages II"), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97, p. 29.

the United States away from those used by its major trading partners such as the European Communities and Canada. To India's knowledge, no other country determines the origin of fabric as the place where the greige fabric was formed, if that fabric was further processed and made into a flat good. The fact that no other country determines origin based on where the greige fabric is woven reflects the importance of cutting and sewing to produce a finished product. Greige fabric can be put to a variety of uses. Even dyed and printed greige fabric can be put to a variety of uses. However, once the fabric is cut and sewn into a pillowcase, no one can use that fabric for anything other than a pillow case.

3.30 To use the "fabric forward rule" that section 334 imposed on a wide variety of non-apparel textile articles such as bedding articles (quilts, comforters, mattresses, blankets) home furnishings (wall hangings, table linens) and fashion accessories such as scarves, shows that they are being used as instruments to pursue trade objectives. For home textiles, beddings, furnishings, and miscellaneous made up articles, the section 334 rules work a significant change in the determination of the country of origin. Under the "fabric forward" rule, these products were deemed to originate in the country where their constituent fabric was formed (woven or knitted) in the greige state. No account was taken of any subsequent value-added operations such as the dyeing, printing or finishing of the fabric, the cutting of the fabric into components, the assembly of those components into finished articles or any other operations.

3.31 The majority of India's exports are in greige fabric. India exports its greige fabrics to other countries where they are further processed and then exported to the United States. Under the old rules these finished products were not deemed to originate in India. However, according to section 334, the same finished products would be counted as India's exports to the United States and subject to quantitative restrictions established for textiles.

3.32 The legislative history confirms that section 334 was used as an instrument to protect the domestic textiles and apparel industry. As noted earlier, this was the first time that the United States Congress became directly involved in the passage of legislation dictating how rules of origin were to be determined in a particular sector. Both the Reports by the House Committee on Ways and Means and the Senate Committees that eventually accompanied the Uruguay Round Agreements Act reveal that section 334 was intended by Congress to be used as an instrument to pursue trade objectives.

3.33 According to the Statement of Administrative Action (SAA) that accompanied the URAA, the purpose of section 334 was to:

- help combat transshipment and other circumvention of textile and apparel quotas;
- bring the United States rules of origin in line with the rules employed by other major textile and apparel importing countries;
- advance the goal of harmonizing international rules of origin set out in the WTO *RO Agreement*;
- more accurately reflect where the most significant production activity occurs.

3.34 With respect to the first listed objective, it is difficult to see how the provisions of section 334 "help to combat transshipment and "other circumvention of textile and apparel quotas"". The definition of transshipment is "the action or process of transshipping", and the verb tranship is to "transfer (cargo, etc.) from one ship or form of transport to another." The definition of circumvention as a "deceitful or fraudulent conduct perpetrated against a ... person." There is a specific provision in Article 5 of the ATC which enables countries to address the problem of "circumvention by transshipment, re-routing, false declaration concerning country or place of origin, and falsification of official documents". Article 5.2 specifically provides that "should any Member believe that [the ATC] is being circumvented by transshipment, re-routing, false declaration concerning country or

place of origin, and falsification of official documents, and that no, or inadequate, measures are being applied to address and/or take action against such circumvention, that Member should consult with the Member or Members concerned with a view to seeking a mutually satisfactory solution." The section 334 changes in determining the rules of origin do not assist the United States in combating transshipment.¹⁰

3.35 Second, the section 334 rules on fabric did not bring the United States rules of origin in line with the rules employed by other major textile and apparel importing countries or United States trading partners. To the contrary, section 334 was the subject of criticism in the WTO Committee on Rules of Origin. For example, at the 1 February 1996 meeting, the representatives of Canada, the European Communities and Switzerland expressed concern with respect to the recent unilateral changes of origin rules for certain textiles and apparel by the United States.

3.36 India submits that if United States had changed its rules of origin in order to harmonize them with those of its major trading partners such as the European Communities and Canada, those very trading partners would not have expressed concern over those changes. Indeed, the fact that the European Communities challenged the United States rules of origin in the WTO indicated that it considered the United States rules to be fundamentally different from those of the European Communities.

3.37 Third, section 334 did not advance the goal of harmonizing the international rules of origin set out in the *RO Agreement*. Article 3 of the *RO Agreement* recognises the aim of WTO Members to achieve the establishment of harmonized rules of origin, and in this regard, sets forth in subparagraph (b) that "Members shall ensure, upon the implementation of the results of the harmonization work programme, that: ... (b) under their rules of origin, the country to be determined as the origin of a particular good is either the country where the good has been wholly obtained or, when more than one country is concerned in the production of the good, the country where the last substantial transformation has been carried out." Section 334 represents a step away from the basis of substantial transformation.

3.38 Fourth, it is unclear how the principle of determining origin as set out in section 334 (b)(2)(A), i.e., that the origin for certain made-up articles is determined where the greige fabric is woven, would help the United States "more accurately reflect where the production activity takes place." The production activity would more accurately be determined where the value is added or the last substantial transformation takes place, rather than where the greige fabric is woven.

3.39 Members of the United States Congress criticized the section 334 rules as being protectionist. Senator Charles E. Grassley and Senator Bill Bradley presented the harshest criticism of the trade protectionist effects of section 334, which they referred to as a "very significant change in rules of origin."¹¹

3.40 The 2000 rules of origin are being used as an instrument to pursue trade objectives. An examination of the design, architecture, and structure of section 405 shows that it is used as an instrument to pursue trade objectives. As noted above, section 405 was designed and structured to favour imports from the European Communities over imports from developing countries such as

¹⁰Indeed, the question arises that if the United States believed the application of the principle of substantial transformation did not discourage "transshipment or other circumvention of textile and apparel quotas" and sought therefore to move away from this principle in section 334, why did it revert to the substantial transformation principle to determine origin for some of the products listed in the specified HTS heading in section 405, *but not all products*, when it settled the dispute with the EC?

¹¹ Questions on New Rules of Origin for Rita Hayes, Chief Textile Negotiator Submitted by Senator Charles E. Grassley and Senator Bill Bradley on 6 March 1996, reprinted in *Inside US Trade*, "Text: Hayes Responses to Bradley, Grassley Questions," 29 March 1996.

India. As noted above, one way of assessing whether a rule of origin is being used as an instrument to pursue a trade objective is to assess whether it achieves the same results as a measure or instrument of commercial policy. Trade objectives include the objective of favouring imports from one country over imports from another. Any rule of origin that is used as an instrument to protect a domestic industry or to favour imports from one country over imports from another country is, by definition, an instrument to pursue trade objectives.

3.41 The legislative history of section 405 confirms that it was used as an instrument to favour imports from the European Communities. When the European Communities complained about the WTO-consistency of section 334 it cited the adverse effects on certain textile and apparel products of concern to the European Communities. The United States is the largest export market for the European Communities textile and apparel industry, in particular, for its silk products. The European Communities registered its concerns with the new United States rules of origin on the grounds of diminution of market access. The European Communities claimed that European Communities exporters no longer benefited from free access to the United States market, but rather were subject to the quantitative restrictions the United States maintained against the third country where the greige fabric was woven.

3.42 On 22 May 1997, the European Communities requested WTO consultations with the United States on the section 334 rules of origin. The European Communities stated in its request for consultations that the United States rules of origin "adversely affected exports of European Community fabrics, scarves and other flat textile products to the United States of America. As a result of this change, European Community products are no longer recognized in the USA as being of European Communities origin and lose the free access to the US market that they enjoyed before."¹²

3.43 Prior to the holding of formal WTO dispute settlement consultations, the United States and the European Communities entered into a bilateral agreement. The United States Administration agreed to propose an amendment to Congress for its rules of origin for those products of concern to the European Communities, namely, silk scarves, silk accessories, dyed and printed cotton fabrics.

3.44 In July 1998, at the request of the United States Administration, draft legislation was introduced in the United States Senate to implement the EC-US *procès-verbal*. However, the European Communities claimed the draft legislation did not meet the terms of the *procès-verbal*, and therefore initiated new dispute settlement proceedings against the United States.

3.45 Once again, in order to avoid a WTO dispute settlement case with the European Communities in this sector, the United States agreed to settle the case. In August 1999, an amendment to the *procès-verbal* was concluded whereby the United States Administration agreed to submit legislation to Congress to amend the rules of origin set out in section 334. To ensure that there were no gaps between what the *procès-verbal* called for and what the draft legislation would actually include, the European Communities and the United States agreed upon specific language that the United States Administration would propose to Congress. The United States and the European Communities also agreed on the amendment of export visa and quota requirements.

3.46 In May 2000, the United States Congress passed section 405 of the Trade and Development Act. Section 405 was virtually identical to the text agreed in the second *procès-verbal* between the European Communities and the United States.

3.47 The United States thus modified its rules of origin in 2000 for the sole purpose of providing favourable market access to the European Communities in order to settle the WTO case with the European Communities. Section 405 amended section 334 to create certain exceptions to the general

¹²*United States – Measures Affecting Textiles and Apparel Products*, WT/DS85/1, G/RO/D/1, G/TBT/D/13, 3 June 1997.

rules on determining origin for fabrics and made-up articles. These exceptions resulted in absurd cases. If cotton fabric is woven in India and exported to Portugal where it is dyed, printed and subject to two or more finishing operations, that fabric is now considered a product of Portugal. If, however, the same cotton fabric is now used in Portugal to produce a finished sheet, the origin reverts back to India. Therefore, even though operations were performed in Portugal on a Portuguese product, the origin of that product would be determined as Indian. The absurdity of this case is that the determination of origin differs depending on the type of product. For cotton fabric, the country in which it is dyed and printed and subjected to two further finishing operations is determined to be the country of origin. Paradoxically, for cotton fabric which is dyed and printed and subjected to two further finishing operations and which is subsequently made into a bed sheet (which has more value-added operations) in Portugal, that bed sheet will be determined as a product of India.

3.48 The section 405 amendment created arbitrary reversions to the 1996 rules of origin. First, section 334 had established origin based on the country where the greige fabric was formed by weaving or knitting, regardless of any further finishing operations, such as dyeing and printing. However, in order to address the European Communities concerns, the 2000 rules provide an exception to this rule for fabrics classified under the HTS as silk, cotton, man-made fibres or vegetable fibres. Such fabrics are now considered to originate in the country in which the fabric is both dyed and printed and subjected to two or more finishing operations: bleaching, shrinking, fulling, napping, decatizing, permanent stiffening, weighting, permanent embossing or moireing. However, the same rule does not apply to fabrics made of wool. The origin of fabrics made of wool, whether or not they are subject to two or more finishing operations, will be determined where the basic wool fabric is formed.

3.49 Second, the 1996 rules established that origin would be determined based on where the product was wholly assembled. There were exceptions to the "wholly assembled rule" for specified products falling under 16 HTS four-digit headings or sub-headings so that they would be conferred origin based on where the greige fabric was formed. The European Communities expressed its concerns about some of these products when it requested WTO consultations. For the products of concern to the European Communities, the United States provided in the 2000 amendment that the rule for determining their origin would revert to the pre-1996 rules for seven out of the 16 HTS four-digit headings. India submits that the listed seven HTS four-digit headings are for those products that are of particular export interest to the European Communities. For products under these seven four-digit headings, the origin will be determined where the product is dyed and printed and subject to two further finishing operations.

3.50 Third, although the 2000 amendment provided that the determination of certain products under these seven HTS headings would be determined based on where the product was dyed and printed when accompanied by two further finishing operations, additional exceptions were made. However, these exceptions do not apply to products under these seven HTS headings where they are made of (a) cotton, (b) wool or (c) fibre blends with more than 16% cotton. For these products under these HTS headings when they are made of cotton, wool, and fibre blends with over 16% of cotton, the origin will be determined where the greige fabric is formed.

3.51 It is clear that the only reason for the United States to change its rules of origin in 2000 was to favour imports from the European Communities over imports from other countries. As mentioned above, the text agreed to in the procès-verbal ended up almost word-for-word in the United States section 405 legislation. The sole objective of these rules of origin was to settle the trade dispute between the United States and the European Communities in a manner that singles out products of export interest to the European Communities for more favourable treatment. There was no other reason for the United States to pass section 405. India submits that the clarifications made through section 405 were the result of the United States recognition that section 334 was in violation of its WTO obligations.

(e) The measures at issue are inconsistent with Article 2(c) of the *RO Agreement*

3.52 The language that rules of origin shall not "*themselves*" create restrictive, distorting or disruptive effects should be read together with the language of the preceding clause in Article 2(b) that "notwithstanding the measure or instrument of commercial policy to which they are linked, [Members shall ensure that] their rules of origin are not used as instruments to pursue trade objectives." Therefore, reading the provisions in Article 2(b) and Article 2(c) together, a measure or instrument of commercial policy may have restrictive, distorting or disruptive effects on international trade, but that rules of origin in and of themselves should not have such adverse effects.

3.53 Article 2(c) uses the term "*create*" rather than "*have*". The *New Shorter English Oxford Dictionary* defines "*create*" as to "cause, occasion, produce, give rise to", and it defines "*have*" as to "possess as an attribute, function, position, etc." In the Import Licensing Agreement, Article 3.2, which addresses itself to trade-restrictive or trade-distorting effects, states that "non-automatic licensing shall not have trade-restrictive or distorting effects on imports additional to those caused by the imposition of the restriction." In contrast, the corresponding provision in the *RO Agreement* uses the term "*create*", which implies that WTO Members must refrain from adopting rules of origin that create a framework capable of producing such adverse effects.

3.54 Article 2(c) contains the prohibition that Members must ensure that their rules of origin do not create *restrictive, distorting or disruptive* effects on international trade. According to the *New Shorter Oxford English Dictionary*, the definition of "*restrictive*" is "implying, conveying, or expressing restriction or limitation...having the nature or effect of a restriction; imposing a restriction." The definition of distorting is "tending to distort; constituting distortion. The meaning of "*disruptive*" is "causing or tending to cause disruption or disorder."

3.55 The effects of the challenged measure have to be "*on international trade*" and not only on imports in the United States. We note the difference between the wording used in Article 2(c) of the *RO Agreement* and that used in Article 3.2 of the Import Licensing Agreement. Article 2(c) does not limit the trade distorting effects to imports but rather refers to restrictive, distorting or disruptive effects on international trade generally. On the other hand, Article 3.2 of the Import Licensing Agreement requires that "non-automatic licensing shall not have trade-restrictive or trade-distorting effects on imports additional to those caused by the imposition of the restriction."

3.56 The measures at issue create conditions of competition that are restrictive, distorting or disruptive. Rules of origin create "*restrictive*" effects on international trade if they reduce the level of international trade. Rules of origin create "*distorting*" effects on international trade if they modify the pattern of international trade by changing either the type of product traded in international trade or the direction of international trade flows.

3.57 India cites examples illustrating the restrictive, distorting and disruptive effects on international trade created by the measures at issue. The United States rules of origin create trade restrictive effects because they entail new quantitative restrictions on Indian products exported to third countries, which had previously never been subject to any restrictions. They create distorting effects because they shifted origin from a third country where the fabric was dyed and printed and subjected to two further finishing operations to the country where the greige fabric was formed and because they favoured products of export interest to the European Communities over products of export interest to developing countries. They create trade disruptive effects because of their sheer complexity and the arbitrary nature of the criteria used. The measures at issue allow more favourable access to certain products over trade in other products. An example is the different treatment being accorded to products based on their fibre composition, such as, silk, cotton and wool. The measures at issue favour the products of export interest to the European Communities over products of export interest to developing countries. The measures at issue consequently create distorting effects on international trade.

(f) The measures at issue are inconsistent with Article 2(d) of the *RO Agreement*

3.58 The rules of origin adopted in 2000 only provide that products under specific HTS headings would be conferred origin based on where they are dyed, printed, and subjected to two further finishing operations. The products that were chosen to be treated under the principles used in the previous rules of origin were those products of export concern to the European Communities, namely bed linen, silk scarves, and table linen. When the United States provided special treatment for such products, so that they would be conferred origin where such products were dyed and printed and subjected to two finishing operations, it was providing a *de facto* advantage to the European Communities products. The advantage to the European Communities is that these products are not conferred the origin of where the fabric is formed - usually a developing country under restraints - but are instead allowed unrestricted access to the United States market.

3.59 The products for which the exceptions are provided indicate that the United States is providing a *de facto* advantage to those products of export concern to the European Communities, even though the products in question are origin-neutral.

(g) The measures at issue are inconsistent with Article 2(e) of the *RO Agreement*

3.60 This provision obliges Members not only to administer their rules of origin in a consistent, uniform, impartial and reasonable manner, but also to adopt rules that lend themselves to being administered in this manner. The complexity and arbitrary criteria which are used in section 334 and section 405 make it nearly impossible to administer these legislative provisions in a consistent, uniform, impartial and reasonable manner. Their complexity is such that traders have to regularly seek rulings from the United States Customs as to the determination of origin for a particular product. Also, the requirement that exporters have to provide visas for specified products when the fabric that left their country was in greige form shows the difficulties of the administration of these rules of origin.

4. Conclusion

3.61 India respectfully requests the Panel to find that the United States rules of origin set out in section 334 of the Uruguay Round Agreements Act and modified in section 405 of the Trade and Development Act of 2000 and the customs regulations implementing these statutory provisions, and the application of these sections and regulations, are inconsistent with the United States obligations under Article 2 of the *RO Agreement*. India requests that the Panel recommend that the United States bring its measures into conformity with its obligations under the *RO Agreement*.

B. FIRST WRITTEN SUBMISSION OF THE UNITED STATES

1. Introduction

3.62 The *RO Agreement* prescribes a set of obligations that are informed by its guiding principles, as set out in the preamble. These principles list the fundamental objectives of the *RO Agreement*. Among these principles are: (a) that clear and predictable rules of origin and their application facilitate the flow of international trade; (b) that laws, regulations and practices regarding rules of origin be transparent; and (c) that rules of origin should be prepared and administered in an impartial, transparent, predictable, consistent and neutral manner. The United States has rules of origin for textile and apparel products that were formulated in a transparent process; are clear, concise, and complete; and are applied in an impartial, predictable, consistent, neutral and transparent manner. As such, the United States rules of origin regime is clearly consistent with the *RO Agreement*. What the *RO Agreement* does not prescribe, however, is what specific rules of origin Members must use. But that is precisely what India seeks in this dispute. Alternatively, India seeks to impose a system in which there are no rules.

3.63 Despite the fact that India has no published rules or guidance regarding its origin determinations, eight years after the United States enacted statutory rules of origin for textile and apparel products as part of the legislation implementing its Uruguay Round commitments, India is challenging the specific rules utilized by the United States because it disagrees with the content of those rules. India asserted in its first written submission ("India First Submission") that it would show that the United States rules of origin embodied in section 334 of the URAA were enacted to pursue protectionist trade objectives; that they restrict, distort, and disrupt trade; and are discriminatory and administered in an unfair manner, all in violation of Article 2 of the *RO Agreement*. India also asserted that it would show that section 405 of the Trade and Development Act of 2000 ("Trade Act"), which modified section 334 pursuant to a settlement of WTO dispute settlement proceedings, is similarly inconsistent with Article 2.

3.64 India has not shown that the United States rules of origin regime is inconsistent with Article 2. Instead, India devotes significant discussion to the different origin determinations it believes would result from use of its interpretation of the "substantial transformation" concept. India is correct about one thing, however, these rules represented a change from previous United States practice – a change to concise, predictable, published rules from the practice of interpreting substantial transformation on a case-by-case basis. India's problem is that it does not like the certain and specific origin determinations that result from the product-specific rules of origin which the United States promulgated in order to bring greater certainty to the textile and apparel trade. India, in effect, is asking the Panel to read into the *RO Agreement* certain specific criteria and, indeed, interpretations of what constitutes an operation that confers origin. However, the *RO Agreement* does not permit such a reading. The *RO Agreement* provides for changes to origin regimes and allows varying origin criteria to be used until harmonization is completed.

3.65 As the United States discusses below, the rules of origin regime established in section 334 and section 405 are not inconsistent with Article 2(b)-(e), as read in good faith in accordance with the ordinary meaning to be given to their terms in their context and in the light of the object and purpose of the *RO Agreement*. These rules were enacted to combat circumvention of established quotas, prevent transshipment, facilitate harmonization and best capture where a new product is formed. Furthermore, both section 334 and its modification section 405 were offered on an MFN basis, in accordance with WTO rules. As such, these rules are not inconsistent with the *RO Agreement*. Rather, they facilitate the flow of international trade.¹³

3.66 Where then do India's arguments lead? They lead to one of two impermissible results: (1) that the United States should have no rules of origin for textile and apparel products and instead simply make case-by-case determinations of origin, or (2) that the Panel should determine what the specific rules of origin should be. Neither of these results is allowed under the *RO Agreement*. Either would be contrary to the goals of the *RO Agreement* – to provide transparency, clarity and predictability in a rules of origin regime.

2. Factual background

(a) The Agreement on Rules of Origin

3.67 In the *RO Agreement*, WTO Members sought to bring about further liberalization of world trade by providing for transparent laws, regulations, and practices regarding rules of origin that are non-discriminatory, clear and predictable.¹¹ Article 2 of the *RO Agreement* prescribes a set of disciplines on Members to promote transparency and prevent trade distortion through rules of origin until the work programme for the harmonization of origin rules is completed. Specifically, Article 2 directs Members to ensure that, in relevant part:

¹³ See *RO Agreement* preamble.

- notwithstanding underlying commercial policy, rules of origin are not to be used as instruments to pursue trade objectives directly or indirectly (Article 2(b));
- rules of origin do not themselves create restrictive, distorting or disruptive effects on international trade (Article 2(c));
- rules of origin do not discriminate between other Members (Article 2(d)); and
- rules of origin are administered in a consistent, uniform, impartial and reasonable manner (Article 2(e)).

3.68 India's claims, that the United States rules of origin are protectionist, create restrictive, distorting and disruptive effects on trade, are discriminatory, and are not uniformly administered, are based on the flawed understanding that the *RO Agreement* would preclude product-specific rules of origin and that the *RO Agreement* precludes different rules of origin from applying to different products. However, Article 2(b)-(e) does not direct Members to adopt particular origin regimes before harmonization, nor does it require that the same rules be used for similar products. Contrary to India's desire, nothing in Article 2 or any other provision of the *RO Agreement* mandates that Members use a particular rule for a particular manufacturing process, or for particular products. Furthermore, nothing in these provisions can be read to imply that Members may not change their rules of origin. In fact, Article 2(i) of the *RO Agreement* envisions that Members will introduce changes to their rules during the transition period and imposes disciplines upon such changes.¹⁴ Moreover, and perhaps most importantly, nothing in the *RO Agreement* precludes a Member from settling disputes in a WTO-consistent manner through an agreement to amend its rules of origin, as encouraged by the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU").

(b) Section 334 of the Uruguay Round Agreements Act

3.69 Section 334 implemented United States obligations with respect to rules of origin, and established a body of rules that are based on the principle that the origin of fabric and certain textile products is derived where the fabric is woven, knitted or otherwise formed; and that the origin for any other textile or apparel product is where that product is wholly produced or assembled.¹⁵ If production or assembly, whichever is applicable, occurs in more than one country, then origin is conferred where the most important assembly or manufacturing process takes place. This reflects the United States' conclusion that assembly is generally the most important step in the manufacturing of assembled apparel. In enacting section 334, the United States Congress expressed a policy of seeking to harmonize United States rules with those of other major importing Members, and to reduce circumvention of quota limits through illegal transshipment by providing greater certainty and uniformity in the application of origin rules.¹⁶

3.70 India goes to great lengths to portray section 334 as a complicated, unmanageable, discriminatory set of rules. They are not. First, by their mere existence, and in contrast to the chaos of having no rules, these sector-wide rules are clear, predictable and neutral, as prescribed by the *RO Agreement*. Second, these rules are based on a simple principle that the process that results in the creation of a new textile product, and therefore merits a change of country of origin, is assembly.¹⁷

¹⁴ In fact, Article 4 of the *Agreement on Textiles and Clothing* also envisions that such changes would take place, and sets forth a mechanism for Members to reach a mutually acceptable solution regarding appropriate adjustments, a mechanism India chose not to use here.

¹⁵ See Exhibit US-1.

¹⁶ H.R. Rep. 103-826(i), Uruguay Round Agreements Act, P.L. 103-465, October 3, 1994. Exhibit US-2.

¹⁷ India contradicts itself when it asserts that the United States Customs Service ("Customs Service") does not define what it means by "important assembly in manufacturing process." India First Submission, para. 30. In the same paragraph, however, India acknowledges that the Customs Service recognizes three types of operations as major: fabric forming, cutting and assembly. Furthermore, between cutting and forming, forming is more important. This is consistent with the policies underlying section 334.

They are, therefore, "readily understandable, published in easily understood language, uncomplicated and predictable in application."¹⁸

3.71 India vigorously asserts that section 334 was such a dramatic change from previous United States practice that it significantly distorts trade. Setting aside the fact that an effect on trade should not be equated with distortion of trade, the prior application of substantial transformation was criticized for being "too subjective, too inconsistent in the results it produce[d], too vulnerable to political pressure in its administration."¹⁹

(c) Section 405 of the Trade and Development Act of 2000

3.72 Section 405 amended section 334 in order to settle a WTO dispute brought by the European Communities alleging that section 334's provisions had negatively affected trade in specific exporting sectors of the European Communities, most notably Italian silk products.²⁰ The United States held extensive consultations with the European Communities. In order to settle the dispute, the United States agreed to amend section 334, creating two exceptions to section 334's "fabric formation rule":

- for silk, cotton, man-made and vegetable fiber fabric, origin would once again be conferred by dyeing and printing and two or more finishing operations; and
- for certain textile products excepted from the assembly rule, origin would be conferred where dyeing and printing and two or more finishing operations took place, with exceptions.²¹

3.73 These amendments apply to all WTO Members, not just the European Communities. India's complaint that they are discriminatory has no merit. Section 334, as amended by section 405 is codified at 19 U.S.C. § 3592.²²

3. Procedural background

3.74 On 3 June 2002, India requested that a panel be established in this dispute pursuant to Article 6 of the DSU, Article XXIII of GATT 1994, and Article 8 of the *RO Agreement*.²³ India requested the Panel to consider the consistency of sections 334 and 405 with Article 2 (b)-(e) of the *RO Agreement*. The Panel was established on June 24, 2002, and composed on 10 October 2002.²⁴

4. Legal argument

3.75 The United States rules of origin regime is consistent with the ordinary meaning of Article 2 of the *RO Agreement*, in its context and in light of the object and purpose of the *RO Agreement*. India's burden is to show that the United States regime does not comport with the provisions of Article 2. India does not and cannot show that section 334 and section 405 are inconsistent with the

¹⁸ See N. David Palmeter, "The US Rules of Origin Proposal to GATT: Monotheism or Polytheism," *Journal of World Trade* (1990) 24:2, pp. 25-36, at 28-9. Exhibit INDIA-1.

¹⁹ Palmeter, at 27. Exhibit INDIA-1.

²⁰ H.R. Conf. Rep. 106-606, section 405, Clarification of section 334 of the Uruguay Round Agreements Act, p. 232 (2000). Exhibit US-3.

²¹ See Exhibit US-3.

²² Exhibit US-4.

²³ India had originally submitted its request on 7 May 2002 but omitted reference to Article 2. On 3 June India submitted a corrected panel request, and it is on the basis of this request that the Panel was established.

²⁴ The United States notes that India, in its first submission, makes a reference to the "customs regulations" implementing section 334 and section 405 as inconsistent with the *RO Agreement*. See India First Submission, para. 7 (*supra*, para. 3.4). As India did not make this claim in either its Consultation Request or its Panel Request, such a claim cannot form part of this dispute.

RO Agreement. It is well-established that the complaining party in a WTO dispute bears the burden of coming forward with argument and evidence sufficient to establish a prima facie case of breach of a Member's WTO obligations.²⁵ If the balance of evidence and argument is inconclusive with respect to a particular claim, India, as the complaining party, must be found to have failed to establish that claim.²⁶ Furthermore, a finding that the United States regime is inconsistent with Article 2 leads to an impermissible result under the *RO Agreement*: that the United States should have no rules of origin and instead simply make case-by-case determinations of origin, or that the WTO dispute settlement system can assign origin determinations for specific products.

3.76 Customary rules of interpretation of public international law, as reflected in Article 31(1) of the *Vienna Convention on the Law of Treaties* ("Vienna Convention"), provide that a treaty "shall be interpreted in accordance with the ordinary meaning to be given to the *terms* of the treaty in their *context* and in the light of its object and purpose."²⁷ The Appellate Body, in *US - Wool Shirts and Blouses*, has recognized that Article 31 of the Vienna Convention reflects a customary rule of interpretation.²⁸ In applying this rule, however, the Appellate Body in *India - Patents* cautioned that the panel's role is limited to the words and concepts used in the treaty.²⁹

(a) Section 334 is consistent with Article 2(b)

3.77 The text of Article 2, read in its context and in light of the *RO Agreement's* object and purpose, does not preclude Members from determining the origin of goods based on assembly, type of material, or type of product. India distinguishes between the product-specific tariff shift rules and rules based on case-by-case applications of "substantial transformation" criteria. However, India's criticism of this distinction is based on its own interpretation of what, in its view, the product specific result *should* be, ignoring the greater certainty and clarity brought about by section 334 as against the case-by-case subjective origin determinations which had preceded it. To require the United States to utilize a particular rule for a specific product, as India advocates, would be to add an obligation not contained in the *RO Agreement* during the transition phase.

3.78 Article 2 provides, in relevant part, that "Until the work programme for the harmonization of rules of origin set out in Part IV is completed, Members shall ensure that: . . . (b) notwithstanding the measure or instrument of commercial policy to which they are linked, their rules of origin are not used as instruments to pursue trade objectives directly or indirectly[.]"

3.79 The United States agrees with India that the operative clause in Article 2(b) is the obligation that rules of origin are not to be used "as instruments to pursue trade objectives."³⁰ The United States

²⁵ See, e.g., Appellate Body Report, *United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India* ("US - Wool Shirts and Blouses"), WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323, page 14; Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)* ("EC - Hormones"), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135, para. 104; Panel Report, *Korea - Definitive Safeguard Measure on Imports of Certain Dairy Products* ("Korea - Dairy"), WT/DS98/R and Corr.1, adopted 12 January 2000, as modified by the Appellate Body Report, WT/DS98/AB/R, DSR 2000:I, 49, para. 7.24.

²⁶ See, e.g., Panel Report, *India - Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products* ("India - Quantitative Restrictions"), WT/DS90/R, adopted 22 September 1999, as upheld by the Appellate Body Report, WT/DS90/AB/R, DSR 1999:V, 1799, para. 5.120. See also Appellate Body Report, *European Communities - Trade Description of Sardines* ("EC - Sardines"), WT/DS231/AB/R, adopted 23 October 2002, para. 270, quoting Appellate Body Report, *US - Wool Shirts and Blouses*, *supra*, at 335.

²⁷ Vienna Convention Article 31(1) (emphasis added).

²⁸ Appellate Body Report, *US - Wool Shirts and Blouses*, *supra*, at 16.

²⁹ Appellate Body Report, *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products* ("India - Patents (US)"), WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9, paras. 45-46 (emphasis added).

³⁰ India First Submission, para. 42 (see, *supra*, para. 3.19).

also agrees that "instrument" can be defined as "tool," "device," or "means" and that "objective" is a goal.³¹ Likewise, the United States agrees that the preamble to the *RO Agreement* provides the relevant "object and purpose" of the *RO Agreement*. However, the United States submits that India's interpretation of a "trade objective" is incorrect, as it is overly broad. If "trade objective" is understood to be any objective related to trade, rules of origin could not be used to pursue transparency or predictability, two trade-related goals. Such an interpretation would be at odds with both the object and purpose of the *RO Agreement* and the context of this provision. Nevertheless, the United States accepts India's contention that protection of a domestic industry is an "impermissible" trade objective for purposes of Article 2(b).

3.80 India seems to make three arguments with respect to its claim that section 334 is inconsistent with Article 2(b): (1) the objective of the United States in formulating its rules of origin was to protect its domestic industry; (2) the Panel should look to the measures or instruments of commercial policy listed in Article 1.2 and assess whether the United States rule of origin "achieves the same results;" and (3) "the design, architecture and structure" of section 334 "demonstrate that it was adopted to protect the domestic textile industry."³²

3.81 The section 334 rules of origin do not have as their objective the protection of domestic industry. The Statement of Administrative Action ("SAA") is clear on what its objectives were: to prevent quota circumvention and address illegal transshipment, to advance harmonization, and to more accurately reflect where the most significant production activity occurs.³³ Congress concluded that greater clarity needed to be brought into determinations of origin in this area, which was of great interest to the United States trading community - whether from the standpoint of seeking to import textiles and apparel or from the standpoint of deterring circumvention of commercial instruments.³⁴ The type of finishing operations presented to the Customs Service for determination of origin and application of quotas had grown, and under the increasing number of case-by-case applications by the Customs Service of the substantial transformation criteria, the list of processes that were deemed to confer origin also expanded, sometimes including processes that in retrospect were understood not to be significant.³⁵

3.82 India points to no evidence to support its assertion that section 334 has been used to achieve protection of the domestic industry. Furthermore, the commentaries referenced by India³⁶ acknowledge that the United States was trying to prevent circumvention: "Some new industrialized countries of Southeast Asia could otherwise try to circumvent the quantitative restrictions applied to their exports of textile products. They could do so by exporting semi-finished products (*in casu* dyed or printed cloths) to third countries, in the hope that the origin of those countries (for which no

³¹ See *Id.* para. 46 (*supra*, para. 3.23), notes 29 and 30, citing *The New Shorter Oxford English Dictionary* and *The New Oxford Thesaurus of English*.

³² *Id.* paras. 46-49 (see, *supra*, paras. 3.23-3.26).

³³ As India correctly notes, the SAA is an authoritative expression of the Administration's and Congress's views regarding implementation of the URAA. H.R. Doc. No. 316, 103d Cong. 2d sess., Vol. 1 (1994), at 656.

³⁴ See SAA pages 124-126. Exhibit US-5.

³⁵ For example, one of these processes was cutting. Some traders successfully argued that the location of cutting of a product that could receive further finishing conferred origin. Congress acted to harmonize United States rules in this respect with those of our major trading partners.

³⁶ We note, however, that one of the commentaries addresses a 1984 rules change, which presumably cannot be used to infer the intent of the United States Congress ten years later when section 334 was passed. See India First Submission, note 33.

quantitative restrictions for exports of textile products are applied) would be attributed to the finished cloths."³⁷

3.83 Rather, India's quarrel is with certain specific determinations of origin for particular products. That is, India disagrees with the judgment of the United States that certain processes constitute sufficient "transformation" to merit changing the origin of a product (except in certain circumstances). Not only is there nothing in the text of the *RO Agreement* that says that Members must confer certain origin determinations, there is nothing in Article 2(b) that indicates that if a Member does not include certain finishing operations in a determination of origin the Member is using its rules of origin to pursue trade objectives. It is the policy decision of the United States that origin conferring production is based on assembly, not a finishing operation. The United States rules take into account which finishing operations merit changing origin, and that may vary based on the type of product. Moreover, Article 2(a) sets forth a range of criteria that can be used by a Member in formulating its rules of origin, and the United States rules of origin for textile and apparel products are consistent with these criteria. Specifically, Article 2(a)(i) directs Members that apply a tariff classification criterion to specify headings or subheadings in the rule. Both section 334 and section 405 meet this directive. Article 2(a)(ii) directs that where a manufacturing or processing criterion is prescribed, the operation that confers origin must be precisely specified. This is exactly what the United States rules do. India's arguments, that the United States should not confer origin based on where the product is formed or assembled, essentially renders Article 2(a) a nullity by its sweeping view of the subsequent provisions.

(b) Section 405 is consistent with Article 2(b)

3.84 With respect to India's claims that section 405's amendment of section 334 constitutes an impermissible use of rules of origin, India's arguments fail on their face.³⁸ First, the modifications in section 405 apply to all Members on an MFN basis. India was a third party to the European Communities disputes; as such India was well aware of the very specific nature of the European Communities' complaints.³⁹ In particular, India knew the importance of its interest with respect to the products it exports in whether dyeing and printing and additional finishing operations conferred origin. If India did not believe that the scope of the European Communities' consultation request captured its concerns, it could have sought separate consultations.⁴⁰

3.85 As a result of extensive consultations with the European Communities, as well as representatives of its textile industry, the United States agreed that, at least with respect to goods of silk, certain cotton blends, and fabrics made of man-made and vegetable fibers (specifically silk scarves and flat products such as linens), dyeing and printing along with two or more finishing operations were significant enough to confer origin. Therefore, modification of section 334 to reflect this would serve as an appropriate mutually satisfactory solution to the issues in dispute.

3.86 It would be absurd to penalize a Member for reaching a mutually satisfactory settlement of a dispute with another Member, pursuant to the provisions of the DSU, where the benefits of the settlement accrue to all Members. Yet that is precisely what India asks of this Panel.⁴¹ The logic that India would have the Panel accept -- namely, that the United States' decision to resolve a trade dispute with the European Communities necessarily implies that the United States believed that the

³⁷ See Franklin Dehousse, Katelyne Ghemar and Philippe Vincent, "The EU-US Dispute Concerning the New American Rules of Origin for Textile Products," *Journal of World Trade* 36:1 67-84, 2002 at 73, India First Submission, note 46. Exhibit INDIA-12.

³⁸ See India First Submission, paras. 69-85. The United States does not intend to engage in a merits discussion of a settled dispute that is not part of the terms of reference of this dispute.

³⁹ See India First Submission, note 48.

⁴⁰ See *United States - Measures Affecting Textiles and Apparel Products* (I), WT/DS85/9, G/TBT/D/13/Add.1, Notification of Mutually-Agreed Solution, 25 February 1998. Exhibit INDIA-13.

⁴¹ See India First Submission, para. 84 (*supra*, para. 3.51).

European Communities' claims in that dispute were valid -- is untenable. Does India perhaps wish to discourage Members from achieving mutually satisfactory solutions? That would be the likely consequence of accepting the logical leap that India urges on the Panel; and it would be inconsistent with provisions such as DSU Article 3.7, which provides that such solutions are "clearly preferred" to "bringing a case". Notwithstanding India's unsupported assertions to the contrary, the United States decision to settle the European Communities dispute by amending section 334 was in no way a recognition of any violation of any WTO obligations.

(c) Section 334 and section 405 are consistent with Article 2(c)

3.87 Article 2(c) of the *RO Agreement* provides, in relevant part, that "(c) rules of origin shall not themselves create restrictive, distorting, or disruptive effects on international trade." The ordinary meaning of this phrase is clear from its terms. As discussed above, India bears the burden of showing that these measures, in and of themselves, restrict, distort and disrupt trade. India has failed to meet its burden. Contrary to its assertion, an effect on or "modification" to trade is not sufficient to rise to the level of "restriction," "distortion," or "disruption."⁴² Even if modification were sufficient, India has not presented any concrete data to support these allegations. Furthermore, assuming that it were true, India presents no textual support in the *RO Agreement* for its argument that rules favoring one product over another, or one fabric over another, restrict, distort or disrupt trade.⁴³ Nor does the letter from the Cotton Textiles Export Promotion Council help India establish a prima facie case in this dispute.⁴⁴ India does not address the possibility that Sri Lankan producers may have decided to weave their own fabric or to source it from elsewhere.

3.88 India also argues that the rules disrupt trade by "their sheer complexity." First, India has not demonstrated that "complexity" is a prohibited criterion. It would seem that India's view incorrectly equates "simplicity" either with the absence of non-preferential rules of origin (such as is the situation in India) or perhaps with an origin regime that operates through case-by-case origin determinations that will, by its very nature and operation, involve subjectivity and greater administrative discretion than what currently exists in the United States origin regime. Second, India presents no evidence that the rules have discouraged exporters from shipping their products to the United States because they simply could not understand them. Nor could they: the United States regime is perfectly comprehensible to businesses engaged in importing and exporting. Finally, the United States does not share India's apparent view that having no rules, at least no published rules, is less complex. Rather, the United States believes that in order for rules of origin to be "clear and predictable" so as to facilitate trade; transparent; and "applied in an impartial, transparent, predictable, consistent and neutral manner,"⁴⁵ they should be published, and be written as completely and concisely as possible. Section 334 and section 405 meet these standards.

3.89 India's argument is tantamount to saying that the *RO Agreement* established a "standstill" for origin regimes. There is no foundation for such an assertion. The *RO Agreement* clearly allows for changes in rules of origin, particularly since regimes such as the United States, which provide transparency through publication and certainty through product-specific rules, greatly contribute to a trade-facilitative environment. Moreover, since the *RO Agreement*, in Article 2(i), clearly allows changes in rules, some effect on international trade must have been envisioned, including the possibility that products would have different countries of origin.

⁴² See India First Submission, para. 91.

⁴³ *Id.*

⁴⁴ See India First Submission, para.93. Exhibit INDIA-15.

⁴⁵ See *RO Agreement* preamble.

(d) Consistent with Article 2(d), the rules are not discriminatory

3.90 Article 2(d) provides, in relevant part, that Members should ensure that " ... (d) the rules of origin that [Members] apply to imports and exports ... shall not discriminate between other Members, irrespective of the affiliation of the manufacturers of the good concerned... ." As a preliminary matter, it appears that India is making this claim only with respect to section 405, and therefore that the applicable provision of Article 2(d) that it claims is being violated is that rules "shall not discriminate between other Members irrespective of the affiliation of the goods concerned."⁴⁶ In respect of this claim regarding Article 2(d), however, India makes no attempt to show how the settlement with the European Communities, which is applicable to India and all other Members on an MFN basis, is discriminatory. Accordingly, India has failed to meet its burden to establish that sections 334 and 405 are inconsistent with Article 2(d).

(e) The administration of the rules is consistent with Article 2(e)

3.91 Article 2(e) provides, in relevant part, that "(e) [Members'] rules of origin are administered in a consistent, uniform, impartial and reasonable manner. . . ." Once again, India makes no effort to show how the *administration* of section 334 and section 405 is inconsistent with Article 2(e)'s instruction that Members ensure that "rules of origin are *administered* in a consistent, uniform, impartial and reasonable manner" (emphasis added). Rather than addressing the actual language of the provision, India attempts to *add* factors to this provision: "members should adopt rules that lend themselves to being administered in a consistent, uniform, impartial and reasonable manner;" and that the rules should not be "complex and arbitrary."⁴⁷ In other words, India attempts to recast this obligation in order to challenge attributes of the rule itself, rather than of its administration. However, India may not by fiat amend the terms of Article 2(e) so as to challenge the law itself, rather than its administration. Just as claims under Article X:3 of the GATT 1994 must fail if they are based on challenges to aspects of the laws themselves, rather than their administration⁴⁸ so too must claims under Article 2(e) fail if they are based on perceived infirmities of the rules themselves, rather than their administration.

5. Conclusion

3.92 For the foregoing reasons, the United States requests that the Panel find that India has failed to establish that section 334 of the URAA and section 405 of the Trade and Development Act of 2000 are inconsistent with Article 2(b)-(e) of the *Agreement on Rules of Origin*.

C. ORAL STATEMENT OF INDIA AT THE FIRST MEETING OF THE PANEL

3.93 It is my honour to represent India before you today. My name is K.M. Chandrasekhar, and I am the Ambassador of India. The members of the Indian delegation are our officials, Mr M. K. Rao, First Secretary (Legal), Mr Sudhakar Dalela, First Secretary (WTO), Mrs Alka Bhatia, First Secretary, Geneva, all with the Permanent Mission of India to the WTO, Mr S. Rajagopal from the Cotton Textile Export Promotion Council of India, and our advisers, Mr Frieder Roessler, Executive Director, Advisory Centre on WTO Law, and Ms. Cherise Valles, Counsel, Advisory Centre on WTO Law.

3.94 Exports of textile and apparel products are of critical importance to India and other developing countries. We have initiated these dispute settlement proceedings because the United States is using rules of origin to undermine India's market access rights for these products. India also

⁴⁶ See India First Submission, paras. 98-9 (*supra*, paras. 3.58-3.59).

⁴⁷ See India First Submission, para. 101 (*supra*, para. 3.60).

⁴⁸ Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas* ("EC – Bananas III"), WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591, para. 200. A similar provision is found in Article 1.3 of the *Agreement on Import Licensing Procedures*.

has a systemic interest to ensure that rules of origin are prepared and applied in accordance with the obligations assumed by all WTO Members. We are aware that the outcome of this dispute will be watched closely by all of those who support the trade-neutral application of rules of origin.

3.95 The *RO Agreement* exists because rules of origin need to be used correctly. The *RO Agreement* exists in order to prevent the abuse of rules of origin. Rules of origin can be used as a perfectly legitimate instrument to define the national origin of products in order to determine the treatment to be accorded to that product. Rules of origin can also be used to determine the products eligible for preferential treatment. Every WTO Member that applies non-preferential but country-specific trade policy instruments needs rules that determine in which country a product is deemed to originate. Article 2 of the *RO Agreement* reserves each Member's right to determine the criteria that confer origin pending the adoption of harmonized disciplines after the transition period. The *use* of rules of origin is therefore at present in no way curtailed. However, rules of origin can also be abused for the purpose of impairing the benefits of market access rights and the right to non-discriminatory treatment and arbitrary origin requirements can create unnecessary obstacles to trade. Article 2 therefore obliges Members not to use rules of origin to pursue trade objectives and not to impose origin requirements that create restrictive, distorting and disruptive effects on international trade or that discriminate between WTO Members. The *abuse* of rules of origin is therefore clearly prohibited.

3.96 Contrary to the assertion of the United States, India is not asking you to adopt interpretations of Article 2 that would curtail the right of Members to determine the criteria which confer origin, or to change such criteria over time or to apply different criteria to different products. A Member may do so. However, a Member may not have rules of origin that are adopted and applied in a manner inconsistent with its obligations under Article 2 of the *RO Agreement*. It is clear that the United States has exercised its right to determine criteria for rules of origin for purposes for which such rules may not be used and, in a manner, which cannot be reconciled with its obligations under the *RO Agreement*. India brought this case because the United States is clearly abusing its right to determine the criteria that confer origin for the purpose of protecting its domestic industry and of favouring products of export interest of one other Member of the WTO over others. In fact, the abuse is so serious that it is difficult to imagine what measures would be subject to the disciplines of Article 2 of the *RO Agreement* if measures of the type imposed by the United States were considered to be consistent with that provision. A finding that the United States measures at issue are consistent with Article 2 of the *RO Agreement* would render that provision a nullity.

3.97 It is now clear that the harmonisation of rules of origin is likely to take much longer than the drafters of the *RO Agreement* had anticipated. As a result, the disciplines to be observed pending the harmonisation have become more important than ever. All Members, not only India, have an interest in ensuring that these disciplines are interpreted in a manner that is consistent with the objectives of the *RO Agreement*. All Members, not only India, have an interest in ensuring that the market access commitments they have already negotiated and those that they will negotiate in the Doha Work Programme are not rendered meaningless through the manipulation of rules of origin. The United States was the main promoter of the *RO Agreement*. India would therefore like to encourage the United States to look beyond the application of its rules of origin during the remaining years of the Agreement on Textiles and Clothing and assist the Panel in developing constructive interpretations fully consistent with the objectives of the *RO Agreement*.

3.98 India's main legal claims are that the United States is using its rules of origin to pursue trade objectives and that its rules of origin themselves restrict, distort or disrupt international trade. The "fabric forward" rule of section 334 meant that more textile and apparel products were conferred the origin of countries that were under quota restraints. Section 405 provided exceptions to the "fabric forward" rule for certain products of export interest to the European Communities, but then also provided a further exception that if those products were made from certain fibres, such as cotton, they

would be subject to the "fabric forward" rule. These latter products were once again conferred the origin of the countries that were under quota restraints.

3.99 India demonstrated in our first submission that sections 334 and 405 were adopted to pursue trade objectives, that they create restrictive, distorting and disruptive effects on international trade and that they entail a *de facto* discrimination between exports of the European Communities and those of other Members of the WTO and that they consequently violate Article 2(b), (c) and (d) of the *RO Agreement*. However, the United States fails to rebut in any meaningful way the claims and argument that India made.

3.100 Contrary to what is stated in the United States' submission, India does not seek to have the Panel "prescribe...what specific rules of origin Members must use." Nor does India seek to "impose a system in which there are no rules." India has not, and would not, make such claims. Rather, India is making a claim as to what the United States rules of origin should not be.

3.101 The term "trade objectives" is not defined in the *RO Agreement*. As noted in India's submission, the ordinary meaning of "trade objectives" in the context of Article 2(b) is an aim, goal, or object related to trade. We similarly argued that one way of assessing whether a rule of origin is being used as an instrument to pursue a trade objective is to assess whether it achieves the same results as a measure or instrument of commercial policy would. Trade objectives include the objective of protecting the domestic industry against import competition, or of favouring imports from one WTO member over imports from another. Any rule of origin that does so is, by definition, used as an instrument to pursue trade objectives.

3.102 The United States' submission (see para. 3.79 above) provides the important acknowledgement that "the United States accepts India's contention that protection of a domestic industry is an 'impermissible' trade objective for the purposes of Article 2(b)." The European Communities submission adds that "the European Communities can join the consensus among the parties that in any event, the objective of protecting domestic industry would come under Article 2(b) of the *RO Agreement* (see European Communities' submission, para. 11). Furthermore, the European Communities is also ready to accept India's contention that favouring one Member over another would, in principle, be a trade objective covered by that provision."

3.103 For the purposes of this dispute, it is not necessary for the Panel to develop a general definition of the term "trade objectives." India's view is that it would be sufficient for the Panel to find that the United States measures at issue have as their objective the protection of the domestic industry against import competition or the favouring of imports from one WTO Member over imports from another.

3.104 The United States explains that section 334 was passed "to prevent quota circumvention and address illegal transshipment to advance harmonization and to more accurately reflect where the most significant production activity occurs." The definition of "circumvention" was provided by the United States in its first submission. It cites with approval a commentary that the United States was addressing circumvention through section 334 because "some new industrialized countries of Southeast Asia could otherwise try to circumvent the quantitative restrictions applied to their exports of textile products. They could do so by exporting semi-finished products (in casu dyed or printed cloths) to third countries, in the hope that the origin of those countries (for which no quantitative restrictions for exports of textile products are applied) would be attributed to the finished cloths." However, this is not circumvention. Circumvention is a term which implies a violation of the applicable origin rules through false declarations and other illegitimate means. The reaction of the market to the incentives and disincentives created by country-specific quotas cannot be described as circumvention. These newly industrialized countries of Southeast Asia were not "circumventing" origin rules but were adapting their production to their market access conditions. Since the origin determinations of the products in these new trade patterns were conducted in conformity with the then

applicable section 12.130 regulations, as a matter of definition, they could not constitute "circumvention."

3.105 In its submission, the European Communities rightly points out that if the expression "circumvention of quotas" was used to describe the changing of trade patterns in response to quotas, the intent to pursue a trade objective could be established through the legislative history itself. The United States' intention to combat "circumvention" corresponds, in the words of the European Communities, to an intention to "re-apply quantitative restrictions where these have lost their bite through changes in trade patterns and regulations." As noted by the European Communities and China, this is precisely the type of trade objective that Members are not to achieve through the use of rules of origin.

3.106 India has demonstrated in its submission that the trade objective of section 334 was the protection of the United States domestic industry. The effect of section 334, especially its fabric forward provision, was that a range of textiles and clothing products imported into the United States were subjected to the strict quotas of the developing countries whereas previously they had been under no quota or a more generous quota. India noted that the United States has not provided any explanations in its submission that would justify the conclusion that section 334 was meant to be trade neutral. We therefore believe that we have made a prima facie case of violation that the United States has failed to rebut.

3.107 The United States submits that the main purpose of section 405 was the same as that of section 334, namely to prevent circumvention or transshipment. However, the changes effected through section 405 did not address circumvention or transshipment concerns. As noted by China, the United States' arguments that these concerns were a legitimate basis for the changes to its textile origin rules are inapposite with respect to section 405. We note that also with respect to section 405 the United States has failed to give any explanations that would support its claim that section 405 does not reveal the intent to favour exports of the European Communities over those from other Members of the WTO. It merely asserted that the main objective of section 405 was to prevent circumvention and transshipment. However, as noted by the European Communities in its submission, the Appellate Body made clear in *Chile – Alcoholic Beverages* that the mere stating of objectives does not constitute effective rebuttal by a respondent.

3.108 The United States passed section 405 to amend certain provisions in section 334. India has argued that the sole objective of section 405 was to favour the exports of the European Communities, while maintaining the restraints for non-European Communities countries. The United States has not responded adequately to this argument. The only point the United States makes is that Members should not be discouraged from achieving mutually agreed solutions. India agrees that Members should not be discouraged from arriving at mutually agreed solutions. However, India is challenging the discriminatory terms of the legislation implementing the settlement.

3.109 Article 2(b) of the *RO Agreement* is violated if rules of origin are used as instruments "to pursue trade objectives. " The legal status of a rule of origin under this provision thus depends on the purpose it serves. If its only objective is to determine the origin of products, it is consistent with Article 2(b). If it is used, directly or indirectly, to pursue a trade objective, it is not. The principal remaining interpretative issue is how the objective of rules of origin at issue should be determined. One approach would be to look at the declared intent of the legislators and to ask: what objective did Congress declare to pursue when adopting the rules? Another approach would be to examine the objective that is expressed in the legislation and ask: what is the objective revealed by the terms of the legislation?

3.110 The Appellate Body has clearly indicated its preference for latter approach. Article III:2 of the GATT prohibits the application of internal taxes on products "so as to afford protection to domestic production". In *Japan – Alcoholic Beverages*, the Appellate Body ruled that the question of

whether internal taxes were being applied so as to afford protection had to be determined by examining the objectives revealed by the legislation's design, architecture and structure rather than the reasons given by the legislators.

3.111 The approach adopted by the Appellate Body in respect of Article III:2 can be transposed to the case before the Panel. WTO law leaves Members in principle free to determine the criteria on the basis of which they tax products and determine their origin. However, neither internal taxes nor rules of origin must serve trade policy purposes. The consistency of both internal taxes and rules of origin with WTO law thus depends on the objective pursued. The obligations governing internal taxes have, of course, a different rationale than the obligations governing rules of origin. However, since both sets of obligations distinguish between legal and illegal measures on the basis of the objective pursued, there is no reason why the Appellate Body's approach to Article III:2 of the GATT should not be applied to Article 2(b) of the *RO Agreement*.

3.112 In its submission, the European Communities states that a difference in the test to be applied might be justified because in its view "Article 2(b) of the *RO Agreement* is exclusively about intent whereas Article III of the GATT is rather about showing effects through intent". However, both the wording of Article III of the GATT ("so as to afford protection") interpreted by the Appellate Body and the wording at issue in this case ("to pursue trade objectives") refer to intent ("so as to" and "to") and effect ("protection" and "trade objectives"). There is consequently no textual justification for the distinction made by the European Communities. It would in our view be too far-reaching to conclude that "Article 2(b) of the *RO Agreement* is exclusively about intent", as asserted by the European Communities. There is no reason to declare a rule of origin illegal merely because it was *intended* to be used as an instrument to pursue trade objectives; it must also be capable of achieving those objectives. The Panel would for these reasons be on more solid ground if it were to apply the conceptual framework developed by the Appellate Body for Article III:2 of the GATT also to Article 2 (b) of the *RO Agreement*.

3.113 In India's first written submission, we adopted a two-pronged approach to this interpretative issue. We demonstrated that the objective features of the rules of origin at issue in this dispute all point in one direction: they were adopted to protect the United States textiles and apparel industry and to single out products of export interest to the European Communities for more favourable treatment. We fully recognise that the intentions expressed during the legislative history, by themselves, cannot constitute a violation of Article 2(b). However, we believe it can reasonably be assumed that the domestic industry and the Administration knew what the impact of their proposals would be and that the rules of origin finally adopted produce the desired result. We are therefore of the view that our presentation of the legislative history of the rules of origin at issue justifies, given the absence of alternative explanations by the United States, the conclusion that the measures are in effect used as instruments to pursue trade objectives.

3.114 Let me now turn to the meaning of the phrase "rules of origin shall not themselves create restrictive, distorting or disruptive effects on international trade" in Article 2(c) of the *RO Agreement*. Unlike Article 2(b), this provision does not refer to the "use" of rules of origin (that is, their link to a particular commercial policy instrument) but to the rules of origin "themselves". This indicates that Article 2(c) obliges Members to ensure that the rules of origin as such (whatever the commercial policy instrument to which they are linked) do not create restrictive and other adverse effects on international trade.

3.115 The basic interpretative issue is whether the words "create restrictive . . . effects" refer to the effects that the rules of origin are capable of creating or whether they refer to the effects they actually create in the market place. If the former were true, it would be sufficient for India to demonstrate that the incentives and disincentives faced by traders as a result of the rules of origin at issue are such so as to create restrictive effects. If the latter were true, India would have to demonstrate that the regulatory framework imposed by the United States has actually produced those effects.

3.116 The parties to this proceeding take different positions on this issue. In the view of India, a Member violates Article 2(c) if it adopts rules of origin creating restrictive effects. What is relevant, according to India, under Article 2(c) is the nature of the rules of origin that the Member adopted, not the reaction of the market to those rules. As a result, the other Members could therefore challenge the rules of origin under Article 2(c) as soon as they enter into force. The United States takes the position that a violation of Article 2(c) has to be proven through trade data showing adverse effects. The implication of the United States' position is that Members wishing to challenge rules of origin under Article 2(c) would have to wait until the rules of origin have actually produced an adverse impact and trade data are available to demonstrate this. A further implication is that the consistency of a rule of origin would depend on the market's reaction to it and consequently on factors that normally escape the control of Members.

3.117 The question of whether the rules of international trade regulate conduct or effects has been an issue on many previous occasions. In *EC – Oilseeds*, the CONTRACTING PARTIES to the GATT 1947 had to decide whether a quota restriction can be deemed to have been "made effective" within the meaning Article XI:1 even if the quota is not exhausted and therefore did not actually restrict imports. They decided that the mere imposition of a quota violated Article XI. The CONTRACTING PARTIES also had to decide whether a tax was "applied" to imported products within the meaning of Article III:2 of the GATT even if there had not yet been any imported product on which the tax had actually been imposed. The CONTRACTING PARTIES decided that the actual impact of a tax was irrelevant under Article III:2. The Appellate Body noted the CONTRACTING PARTIES' jurisprudence approvingly in *Japan – Alcoholic Beverages* and ruled that "Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products and that 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."

3.118 Articles III and XI of the GATT have thus never been interpreted to require the attainment or avoidance of particular effects on international trade. They have been interpreted to require the establishment of a regulatory framework that enables investors and traders to foresee under what condition they will have to compete with the products of the importing country. The purpose of Articles III and XI of the GATT is to prevent the impairment of market access concessions through non-tariff measures imposed internally or at the border. As noted in the Preamble, the purpose of Article 2 of the *RO Agreement* is to prevent the impairment "of the rights of Members under GATT 1994" through rules of origin. Given that the basic rationale of these provisions is the same, the approach to their interpretation should be the same. Just like the terms "made effective" in Article XI of the GATT and "applied" in Article III:2 of the GATT, the terms "create effects" in Article 2(c) must be given a meaning consistent with the basic function of the world trade order, which is to create predictability for traders and investors.

3.119 The only logical conclusion that one can draw from these considerations is that Article 2(c) of the *RO Agreement*, just as all the other provisions in WTO law designed to prevent the circumvention of market access commitments through non-tariff measures, must be interpreted as a provision prescribing conditions of competition, not the avoidance of certain trade results. What is thus relevant is whether the rules of origin create conditions of competition with restrictive, distorting and disruptive effects, and not whether the actual application of these rules to a specific commercial policy instrument has produced such effects.

3.120 If, as the United States advocates, a claim of violation of Article 2(c) could only be made if and when trade data are available and it had to be demonstrated that the change in trade flows was caused by the rules of origin and not other factors, this important provision in the *RO Agreement* would become for all practical purposes unenforceable because the effect of the rules of origin and the effect of the policy instrument to which they linked could, in practice, not be segregated. India believes that the approach to the interpretation of Article 2(c) advocated by the United States is

therefore not only inconsistent with the GATT and WTO jurisprudence and the basic function of the world trade order but also with the fundamental principle of interpretation that each provision of a treaty must be given effect.

3.121 In response to India's claim that the United States rules of origin have restrictive, distorting or disruptive effects on international trade, the United States argues that a modification of trade is not sufficient to rise to the level of "restriction, distortion or disruption". This is no doubt true. Rules of origin, by their very nature, change patterns of trade and this consequence, by itself, can therefore not be deemed to be "restrictive, distorting or disruptive" within the meaning of Article 2(c). The meaning of these terms has to be examined in the context in which they appear. Their immediate context is the second sentence of Article 2(c) according to which rules of origin shall not impose requirements that are unduly strict or unrelated to manufacturing or processing. This suggests that Article 2(c) is meant to ensure that Members do not include in their rules of origin requirements that need not be imposed to determine in which country a sufficient amount of economic activity has taken place to justify the conferral of origin. In other words, *Article 2(c) is meant to ensure that the conferral of origin does not depend on the fulfilment by producers and traders of conditions creating restrictive, distorting or disruptive effects that are not necessary to determine the origin of products and that consequently go beyond those inevitably created by any rule of origin.* This conclusion is supported by the fourth clause of the preamble of the *RO Agreement* according to which this Agreement is "to ensure that rules of origin themselves do not create *unnecessary* obstacles to trade".

3.122 The United States, supported by the European Communities, argues that section 405 is not discriminatory within the meaning of Article 2(d) because the rules of origin in that section apply to all Members equally. This argument implies that Article 2(d) covers only cases of formal discrimination, that is rules of origin that explicitly distinguish between different WTO Members. In the view of India, this is an untenable position.

3.123 The most-favoured-nation provisions of Article I of the GATT have been applied in past practice to measures involving *de facto* discrimination. For instance, tariff treatment less favourable for Arabica and Robusta coffee than for other groups of coffee was deemed to be inconsistent with Article I. In *EC – Bananas*, the Appellate Body noted this jurisprudence approvingly and concluded that also the most-favoured-nation provisions of Article II of the General Agreement on Trade in Services (GATS) applied to both *de facto* and *de jure* discrimination. The Appellate Body considered that, "if Article II of the GATS was not applicable to *de facto* discrimination, ... it would not be difficult to devise discriminatory measures aimed at circumventing the basic purpose of that Article." There is no reason why the approach to the principle of non-discrimination laid down in the *RO Agreement* should be different. The danger of circumventing the purpose of Article 2(d) through product distinctions is just as great as the danger of circumventing the most-favoured-nation provisions of the GATT and the GATS through product or service-specific distinctions. Indeed, the case before you is a clear demonstration that arbitrary distinctions between closely related products can be used to achieve the objective of favouring one WTO Member over others.

D. ORAL STATEMENT OF THE UNITED STATES AT THE FIRST MEETING OF THE PANEL

1. Introduction

3.124 Mr Chairman and members of the Panel. We are pleased to have this opportunity to appear before you to present the arguments of the United States in defence of the rules of origin found in section 334 of the Uruguay Round Agreements Act and section 405 of the Trade and Development Act of 2000. As we discussed in our first submission, the United States rules of origin are consistent with the *RO Agreement* and advance its objectives. India bears the burden of making a showing, based on more than mere allegations, that the United States rules of origin are inconsistent with the provisions of the *RO Agreement*. India has not done so, not in its first submission, and not at the first meeting of the Panel with the parties.

3.125 Let's begin by taking a step back. The *RO Agreement* was drafted because Uruguay Round negotiators wanted to ensure that rules of origin: (a) were clear and predictable and would through their application facilitate the flow of international trade; (b) were implemented through transparent laws, regulations and practices; and (c) were prepared and administered in an impartial, transparent, predictable, consistent and neutral manner. The *RO Agreement* prescribes a set of obligations that are guided by these principles. At the same time, while setting out the program for harmonization, the *RO Agreement* drafters did not impose a single set of rules of origin at the close of the Uruguay Round. Instead, the *RO Agreement* left policy flexibility in the hands of individual Members (both in Members' design of rules of origin, and in Members' right to alter those rules of origin from time to time), and specifically set out various mechanisms that could be used (*see* Article 2(a)). In addition, the *RO Agreement* provides for changes to origin regimes in Article 2(i) and allows varying origin criteria to be used until harmonization is completed.

3.126 When it looks at the United States measures, the Panel will see that the United States rules of origin for textiles and apparel products were drafted in such a way that they advance the *RO Agreement's* objectives. And, when the Panel looks at India's arguments, it will see that, at bottom, India is hoping to impose a single set of rules of origin on the United States (and, implicitly, on all other Members) - notwithstanding the fact that the *RO Agreement* was intended to leave flexibility in the hands of Members. Of course, we recognize that the *RO Agreement* imposed disciplines on Members. But not the ones that India would like you to believe exist. India appears to argue that the *RO Agreement* prescribes a specific determination of origin for, say, bedsheets, or that a particular outcome resulting from the application of rules of origin is somehow less than neutral because it is not a determination of origin that India agrees with.

3.127 The United States cannot help but note that India's approach to its own measures helps to demonstrate the benefits of the approach of the United States measures at issue. India has notified the WTO that it does not have non-preferential rules of origin for textiles, apparel or other products, even though India maintains non-preferential commercial policy regimes that would appear to be implemented through origin determinations.

3.128 With that background, let us take a look at the legal arguments that India has put before the Panel. India asserts that the United States rules of origin were enacted to pursue protectionist trade objectives; that they restrict, distort, and disrupt trade; and that they are discriminatory and administered in an unfair manner, all in violation of Article 2 of the *RO Agreement*. India also claims that section 405 is discriminatory and similarly inconsistent with Article 2. India's problem is that it does not like the certain and specific origin determinations that result from the product-specific rules of origin which the United States promulgated in order to bring greater certainty to the textile and apparel trade. India, in effect, is asking the Panel to read into the *RO Agreement* certain specific criteria and, indeed, interpretations of what constitutes an operation that confers origin.

3.129 The rules of origin regime established in section 334 and section 405 are not inconsistent with Article 2(b)-(e), as read in good faith in accordance with the ordinary meaning to be given to their terms in their context and in the light of the object and purpose of the *RO Agreement*. These rules were enacted to combat circumvention of established quotas, prevent transshipment, facilitate harmonization and best capture where a new product is formed. Furthermore, both section 334 and its modification section 405 are maintained on an MFN basis, in accordance with WTO rules. As such, these rules are not inconsistent with the *RO Agreement*. Rather, they facilitate the flow of international trade.⁴⁹

⁴⁹ See *RO Agreement* preamble.

(a) The Agreement on Rules of Origin

3.130 Article 2 of the *RO Agreement* prescribes a set of disciplines on Members to promote transparency and prevent trade distortion through rules of origin until the work programme for the harmonization of origin rules is completed.

(b) Section 334 of the Uruguay Round Agreement Act

3.131 Section 334 established a body of rules that are based on the principle that the origin of fabric and certain textile products is derived where the fabric is woven, knitted or otherwise formed; and that the origin for any other textile or apparel product is where that product is wholly produced or assembled. If production or assembly occurs in more than one country, origin is conferred where the most important assembly, or manufacturing process, takes place. The United States system is based on the conclusion that origin is conferred where the most important assembly or manufacturing process takes place. This reflects the United States' judgment that assembly is generally the most important step in the manufacturing of assembled apparel and that fabric formation is the most important step in manufacturing fabric or flat goods.

(c) Section 405 of the Trade and Development Act of 2000

3.132 Section 405 amended section 334 in order to settle a WTO dispute brought by the European Communities alleging that section 334's provisions had negatively affected trade in specific exporting sectors of the European Communities, most notably Italian silk products.⁵⁰ In order to settle the European Communities dispute, the United States agreed to amend section 334, creating two exceptions to section 334's "fabric formation rule": 1) for silk, cotton, man-made and vegetable fiber fabric, origin would once again be conferred by dyeing and printing and two or more finishing operations; and 2) for certain textile products excepted from the assembly rule, origin would be conferred where dyeing and printing and two or more finishing operations took place, with exceptions. These amendments apply to all WTO Members, not just the European Communities.

2. Legal analysis

3.133 The text of Article 2, read in its context and in light of the *RO Agreement's* object and purpose, does not preclude Members from determining the origin of goods based on assembly, type of material, or type of product. To require the United States to utilize a particular rule for a specific product, as India advocates, would be to add an obligation not contained in the *RO Agreement* during the current transition phase.

(a) Section 334 is consistent with Article 2(b)

3.134 The United States submits that India's interpretation of a "trade objective" is incorrect, as it is overly broad. If "trade objective" is understood to be any objective related to trade, rules of origin could not be used to pursue transparency or predictability, two trade-related goals. Such an interpretation would be at odds with both the object and purpose of the *RO Agreement* and the context of this provision.

3.135 As we discussed in our first submission, the section 334 rules of origin do not have as their objective the protection of domestic industry. Instead, the purpose of these rules of origin is found in the Statement of Administrative Action (the "SAA"). The SAA is clear on what its objectives were: to prevent quota circumvention and address illegal transshipment, to advance harmonization, and to more accurately reflect where the most significant production activity occurs. In the United States'

⁵⁰ H.R. Conf. Rep. 106-606, section 405, Clarification of section 334 of the Uruguay Round Agreements Act, p. 232 (2000). Exhibit US-3.

experience, the type of finishing operations presented to the Customs Service for determination of origin and application of quotas had grown, and under the increasing number of case-by-case applications by the Customs Service of the substantial transformation criteria, the list of processes that were deemed to confer origin also expanded, sometimes including processes that in retrospect were understood not to be significant. Section 334 was designed to remedy these errors. India points to no evidence to support its assertion that section 334 has been used to achieve protection of the domestic industry.

3.136 Not only is there nothing in the text of the *RO Agreement* that says that Members must confer certain origin determinations, there is nothing in Article 2(b) that indicates that if a Member does not include certain finishing operations in a determination of origin the Member is thereby using its rules of origin to pursue trade objectives. It is the policy decision of the United States that origin conferring production is based on manufacturing or formation of either fabric or apparel, not a finishing operation. The United States rules take into account which operations merit changing origin, and that may vary based on the type of product. Moreover, as we have noted, Article 2(a) sets forth a range of criteria that can be used by a Member in formulating its rules of origin, and the United States rules of origin for textile and apparel products are consistent with these criteria.

(b) Section 405 is consistent with Article 2(b)

3.137 India's arguments that section 405's amendment of section 334 constitutes an impermissible use of rules of origin fail.⁵¹ First, the modifications in section 405 apply to all Members on an MFN basis. And while we do not wish to belabor the point today, we have also explained in our first submission that it would be absurd to penalize a Member for reaching a mutually satisfactory settlement of a dispute with another Member, pursuant to the provisions of the DSU, where the benefits of the settlement accrue to all Members. Yet that is precisely what India asks of this Panel.⁵² Does India perhaps wish to discourage Members from achieving mutually satisfactory solutions? That would be the likely consequence of accepting the logical leap that India urges on the Panel.

(c) Section 334 and section 405 are consistent with Article 2(c)

3.138 India has also failed to meet its burden of showing that section 334 and section 405, in and of themselves, restrict, distort and disrupt trade. To begin with, India presents no textual support in the *RO Agreement* for its argument that rules favoring one product over another, or one fabric over another, for that reason alone, restrict, distort or disrupt trade.⁵³ The single exhibit presented by India to support its allegations is a letter from the Cotton Textiles Export Promotion Council, which does not help India establish a *prima facie* case in this dispute.⁵⁴ India does not address the possibility that Sri Lankan producers may have decided to weave their own fabric or to source it from elsewhere. There is simply no causal connection between section 334 and either the rise or fall of Indian fabric exports to Sri Lanka.

3.139 In fact, data on India's exports of cotton woven fabric, available from the United Nations, indicates that quite to the contrary, India's exports to the world (as well as to the United States) increased between 1995 and 1996 (from \$959.6 million to \$1 billion), and while exports declined slightly in 1997 (to \$974.5 million), the 1997 value of exports was higher than that in 1995. Similarly, again according to United Nations data, India's exports of bed linen to the world increased between 1995 and 1996 (from \$3.2 million to \$4.7 million), and increased again in 1997 (to \$5.3 million). These statistics do not bear out a claim of trade disruption.

⁵¹ See India First Submission, paras.69-85 (*supra*, paras. 3.41-3.51).

⁵² See India First Submission, para. 84 (*supra*, para. 3.51).

⁵³ *Id.*

⁵⁴ See India First Submission, para.93, exhibit INDIA-15.

3.140 India also argues that the rules disrupt trade by "their sheer complexity." Importantly, India has not demonstrated that 'complexity' is a prohibited criterion, nor has India demonstrated that the United States rules are inordinately complex. In addition, India presents no evidence that the rules have discouraged exporters from shipping their products to the United States because they simply could not understand them. Indeed, India supplies nearly \$3 billion in textiles and apparel products to the United States, which strongly suggests that Indian exporters have not had too much difficulty understanding the rules.

(d) Consistent with Article 2(d), the rules are not discriminatory

3.141 As a preliminary matter, it appears that India is making a claim regarding Article 2(d) only with respect to section 405, and that the applicable provision of Article 2(d) India claims is being violated is that rules "shall not discriminate between other Members irrespective of the affiliation of the manufacturers [*sic*] of the goods concerned."⁵⁵ In respect of this claim regarding Article 2(d), however, India makes no attempt to show how the settlement with the European Communities, which is applicable to India and all other Members on an MFN basis, is discriminatory. Accordingly, India has failed to meet its burden to establish that sections 334 and 405 are inconsistent with Article 2(d).

(e) The administration of the rules is consistent with Article 2(e)

3.142 Similarly, India makes no effort to show how the *administration* of section 334 and section 405 is inconsistent with Article 2(e)'s instruction that Members ensure that "rules of origin are *administered* in a consistent, uniform, impartial and reasonable manner" (emphasis added). Rather, India attempts to recast this obligation in order to challenge attributes of the rule itself, rather than of its administration. However, just as claims under Article X:3 of the GATT 1994 must fail if they are based on challenges to aspects of the laws themselves, rather than their administration,⁵⁶ so too must claims under Article 2(e) fail if they are based on perceived infirmities of the rules themselves, rather than their administration.

3. Conclusion

3.143 Where then do India's arguments lead? They lead to one of two impermissible results: 1) that the United States should have no rules of origin for textile and apparel products and instead simply make case-by-case determinations of origin, or 2) that the Panel should determine what the specific rules of origin should be. Neither of these results is allowed under the *RO Agreement*, nor do they advance the goals of the *RO Agreement* - to provide transparency, clarity and predictability in a rules of origin regime.

E. SECOND WRITTEN SUBMISSION OF INDIA

1. Introduction

3.144 The purpose of this submission is to further elaborate India's claims and arguments in this proceeding, taking into consideration the questions from the Panel as well as the points raised by the United States and the third parties in their submissions and in their replies to the questions from the Panel.

⁵⁵ See India First Submission, paras. 98-9 (*supra*, paras. 3.58-3.59).

⁵⁶ Appellate Body Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas*, *supra*, para. 200. A similar provision is found in Article 1.3 of the *Agreement on Import Licensing Procedures*, para. 203.

2. Legal argument

(a) The measures at issue

3.145 The measures at issue in this dispute are (i) section 334 of the Uruguay Round Agreements Act, (i) its clarification contained in section 405 of the Trade and Development Act⁵⁷, and the implementing customs regulations set out in 19 C.F.R. § 102.21.⁵⁸

(i) *The fabric forward rule*

3.146 Section 334 (b)(1)(C) (consolidated as section 3592(b)(1)(C)) sets out the criteria to determine the origin of a fabric. It establishes the "fabric forward rule" whereby the country of origin of a fabric is where its constituent fibres, filaments or yarns are woven, knitted, needled, tufted, felted, or transformed by any other fabric-making process. It disregards further manufacturing operations, such as dyeing, printing as well as two or more finishing operations (DP2), as relevant transformation processes that could determine the country of origin of a fabric.

3.147 The fabric forward rule is implemented through specific customs regulations contained in 19 C.F.R. § 102.21. Paragraph (C)(1) provides that origin will be conferred where the textile or apparel product has been wholly obtained or produced. Paragraph (C)(2) establishes that when origin cannot be established by the application of (C)(1) then the country of origin of the good is where each foreign material incorporated in the textile or apparel product underwent an applicable change in tariff classification and/or "met any other requirement, specified for the good in paragraph (e) of this section."

3.148 19 C.F.R §102.21(e) provides for specific rules by tariff classification. According to some of these rules, a transformation or change that is the result of a fabric-making process entails an automatic tariff shift for the good at issue.

(ii) *The DP2 rule for fabric of silk, cotton, man-made fibre or vegetable fibre*

3.149 Section 405 (a)(3)(B) (consolidated as section 3592 (b)(2)(B)) amends the fabric forward rule and establishes that a fabric classified under the HTS as of silk, cotton, man-made fibre, or vegetable shall be considered to originate in, and be the growth, product, or manufacture of, the country, territory, or possession in which the fabric is dyed and printed when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decatizing, permanent stiffening, weighting, permanent embossing, or moireing (hereafter the "DP2").

3.150 It is important to note that the amendment does not contemplate a comparable change in the criterion to determine origin for all types of fabrics.

3.151 Customs regulations implementing this statutory provision are contained in § 102.21 (e). By virtue of it, tariff shifts originally envisaged to implement the fabric forward rule were modified only for certain HTS headings.

(iii) *The DP2 rule for products of 7 HTS headings*

⁵⁷ Both United States provisions are codified in 19 U.S.C. section 3592.

⁵⁸ India wishes to clarify its claims under the Customs regulations. In its response to question 10 from the Panel, the United States notes that "India has not made any claim with respect to the regulations in either its first submission or its oral statement." India notes that its claims and arguments with respect to the WTO-inconsistency of the customs regulations were made in its request for the establishment of the Panel and in paragraphs 7 and 53, *inter alia*, of its first submission. India also notes that the challenge of the customs regulations is in no way dependent upon its bringing a challenge under Article 2(e) of the *RO Agreement*.

3.152 Section 405 (a)(3)(C) (consolidated as section 3592(b)(2)(C)) sets out a departure from the application of the "wholly-assembled rule" as contained in section 334 (b)(1)(D), and the special rule to the wholly-assembled rule, provided for by section 334(b)(2)(A) (consolidated as section 3592 (b)(2)(A)(i)). Pursuant to section 405 (a)(3)(C), only for 7 HTS 4-digit headings out of 16 that were originally subjected to the special rule of section 334(b)(2)(A), and except for goods classified under such headings made of cotton or of wool or consisting of fibre blends containing 16 percent or more by weight of cotton, origin is conferred where the fabric is both dyed and printed, and subjected to two or more further finishing operations. This provision is implemented through § 102.21(e)(2).

(iv) *The fabric forward rule for products of 7 HTS headings made of cotton, wool or fibre blend with more than 16% cotton*

3.153 Section 405 (a)(3)(C) (consolidated as section 3592(b)(2)(C)) exempts products of the 7 HTS headings which are made of cotton, wool or consisting of fibre blends containing 16 percent or more by weight cotton from the application of the DP2 rule. For these specific products, origin is conferred in accordance with the fabric forward rule as defined in section 334 (b)(1)(C).

3.154 This provision is implemented through § 102.21(e)(1) which includes specific rules to determine origin where the fabric comprising the good was formed by a fabric-making process.

(b) The measures at issue are inconsistent with Article 2(b) of the *RO Agreement*

(i) *Definition of the terms "trade objectives"*

3.155 The terms "trade objectives", contained in Article 2(b), are not defined in the *RO Agreement*. The ordinary meaning of "trade objectives" in the context of Article 2(b) is an aim, goal, or object related to trade. One way of assessing whether a rule of origin is being used as an instrument to pursue a trade objective is to assess whether it achieves the same results as a measure or instrument of commercial policy would.⁵⁹ Trade objectives include the objective of protecting the domestic industry against import competition, or of favouring imports from a WTO Member over imports from another. Any rule of origin that does so is, by definition, used as an instrument to pursue trade objectives.

3.156 Paragraph 27 of the United States' first submission (see para. 3.79 above) provides the important acknowledgement that "the United States accepts India's contention that protection of a domestic industry is an 'impermissible' trade objective for the purposes of Article 2(b)." Paragraph 11 of the European Communities submission adds that "the European Communities can join the consensus among the parties that in any event, the objective of protecting domestic industry would come under Article 2(b) of the *RO Agreement*. Furthermore, the European Communities is also ready to accept India's contention that favouring one Member over another would, in principle, be a trade objective covered by that provision."

3.157 For the purposes of this dispute, it is not necessary for the Panel to develop a general definition of "trade objectives." India's view is that it would be sufficient for the Panel to find that the objectives of protecting the domestic industry and favouring imports from one WTO Member over imports from another are trade objectives within the meaning of Article 2(b).

(ii) *The prevention of quota circumvention as defined by the United States is the pursuit of a trade objective*

3.158 The United States explained that section 334 was passed "to prevent quota circumvention and address illegal transshipment to advance harmonization and to more accurately reflect where the most

⁵⁹ India's first submission, 30 October 2002, para. 46 (*supra*, para. 3.23).

significant production activity occurs."⁶⁰ The definition of "circumvention" was provided by the United States in its first submission. However, this is *not* circumvention. Circumvention is a term that implies a violation of the applicable origin rules through false declarations and other illegitimate means. The reaction of the market to the incentives and disincentives created by country-specific quotas cannot be described as circumvention. These newly industrialized countries of Southeast Asia were not "circumventing" origin rules but were adapting their production to their market access conditions.

3.159 The European Communities rightly points out that if the expression "circumvention of quotas" was used to describe the changing of trade patterns in response to quotas, the intent to pursue a trade objective could be established through the legislative history itself. The United States' intention to combat "circumvention" corresponds, in the words of the European Communities, to an intention to "re-apply quantitative restrictions where these have lost their bite through changes in trade patterns and regulations." This is precisely the type of trade objective that Members are not to achieve through the use of rules of origin.⁶¹

(iii) *The Senate Report shows that section 333, not section 334, was passed to implement the anti-circumvention provisions of the ATC*

3.160 India notes that in the Senate Report (Exhibit IND-10), under the heading "Textile transshipments" (section 333), there is a reference to Article 5.1 of the ATC. Specifically, the Report states that the *section 333* of the URAA adds a new section to Title IV to address specifically the problem of textile transshipments.

3.161 Article 5.1 of the ATC provides that circumvention "frustrates the implementation of this Agreement to integrate the textiles and clothing sector into GATT 1994. Accordingly, Members should establish the necessary legal provisions and/or administrative procedures to address and take action against such circumvention...".

3.162 From a review of the term "circumvention" as defined in the Article 5.1 of the ATC, it would seem that *section 333*, rather than *section 334*, was enacted to implement Article 5.1 since it tracks the language of Article 5.1 more directly, and addresses more specifically the type of circumvention noted in Article 5 of the ATC. This would imply that *section 334* was passed for reasons other than to prevent circumvention within the meaning of Article 5.1 of the ATC. India's argument is that *section 334* was passed to pursue trade objectives.

(iv) *Section 334 is being used as an instrument to protect the United States domestic industry*

3.163 *Section 334* is inconsistent with Article 2 (b) because it is being used to pursue the trade objective of protecting the United States domestic industry. The United States did not adequately respond to this claim in its first submission. Instead, it argued that *section 334* was enacted in conformity with other provisions of the *RO Agreement*, namely Article 2(a) which sets forth a range of criteria that can be used by a Member in formulating its rules of origin and Article 2(i) which allows a Member to change its rules of origin. India's view is that a Member's compliance with Articles 2(a) or 2(i) does not provide a justification for inconsistencies with Articles 2(b), 2(c) or 2(d) of the *RO Agreement*.

⁶⁰ First submission of the United States, 27 November 2002, para. 29. India notes there is a bilateral textile and apparel agreement between the United States and India which has been notified under Article 2.17 of the Agreement on Textile and Clothing, G/TMB/N/274, 22 July 1997.

⁶¹ Third party submission by the European Communities, 5 December 2002, para. 24 (*infra*, para. 4.280).

3.164 In the context of country-specific quotas, such as those permitted under the ATC, the concept of origin is critical. The United States changed its rules of origin in section 334 by introducing, *inter alia*, the "fabric forward" rule, i.e., to determine origin for certain made-up article where the greige fabric was formed. The clearly protectionist objective of section 334 can be demonstrated by its effect on the determination of origin for such products. The effect of section 334, especially its fabric forward provision, was that a range of textiles and clothing products imported into the United States were subjected to the strict quotas of the developing countries whereas previously they had been under no quota or a more generous quota. India notes that the United States has not provided any explanations in its submission that would justify the conclusion that the objective of section 334 was not to protect the domestic industry. India therefore believes that it has made a *prima facie* case of violation that the United States has failed to rebut.

3.165 India notes that its view on this matter is shared by certain third parties, notably, China. It notes that the circumstances and purposes that underlie the United States changes to its textiles origin rules in section 334 amount to an impermissible pursuit of trade policy objectives: the United States changed the definition of a product's origin by applying *per se* rules that no longer took into account the nature and degree of subsequent processing in a third country, thereby increasing the quantities of textile imports that would be subject to a country's limited quota and thus protecting the United States domestic textiles and apparel industry.⁶²

(v) *Section 405 is being used as an instrument to favour the European Communities*

3.166 The United States submits that the main purpose of section 405 was the same as that of section 334, namely to prevent circumvention or transshipment. However, the changes effected through section 405 did not address circumvention or transshipment concerns.

3.167 In its submission, the European Communities has accepted that "favouring one Member over another would, in principle, be a trade objective covered by Article 2 (b)."⁶³ China has stated that section 405 was a unilateral action taken by the United States, to the detriment of China and other Members, in order to appease one particular Member -- the EU -- and to avoid the difficulty of defending the provisions of section 334 before the WTO.⁶⁴ India agrees with China's views: the purpose of section 405 was to settle the case with the European Communities in a manner that favours the products of export interest to the European Communities.

3.168 As the United States itself admitted at the first hearing and in its responses to the Panel's questions, "the purpose of the exceptions to the rules contained in section 405 were (sic) to settle the WTO dispute with the European Communities"⁶⁵, in a manner that favours the European Communities. The United States has indicated that it bases its rules of origin on criteria set out in Article 2(a). However, the exceptions as set out in section 405 are not based on any of these criteria. Therefore, section 405 is being used to pursue the objective of favouring the European Communities.

(c) The measures at issue are inconsistent with the second sentence of Article 2(c) of the *RO Agreement*

(i) *The measures at issue require the fulfilment of a condition not related to manufacturing or processing*

⁶² Responses of China to questions by the Panel, 3 January 2003, Answer 39.

⁶³ Third party submission by the European Communities, 5 December 2002, para. 11 (*infra*, para. 4.276).

⁶⁴ Responses of China to questions by the Panel, 3 January 2003, Answer 42.

⁶⁵ Responses of United States to questions by the Panel, 6 January 2002, Answer 45 to Question 37.

3.169 The second clause of the second sentence of Article 2(c) makes clear that a Member cannot require the fulfilment of a condition not related to manufacturing or processing, as a prerequisite to determine origin. Both Articles 2(a) and 2(c) reflect the significance that manufacturing or processing of a product has upon the determination of origin for that product.

3.170 The United States rules of origin require the fulfilment of conditions not related to manufacturing or processing in three situations. First, when there is a distinction made between fabric of silk, cotton, man-made fibre, or vegetable fibre and fabric made of other fibres, such as wool in determining when the fabric forward rule will be applied.⁶⁶ Second, when there is a distinction made between products classified under 7 HTS 4-digit headings listed in section 405 (a) (3) (C) and the products classified under the remaining 16 HTS headings in section 334 (b) (2) in determining when origin will be conferred by dyeing, printing and two or more finishing operations.⁶⁷ Third, when within those 7 HTS 4-digit headings, there is a distinction made between products made of cotton, wool, or a fibre blend with more than 16% cotton and products made of other fibres in determining when the fabric forward rule will be applied.

3.171 Based on these distinctions, different determinations of origin are made for each situation, which are not at all related to manufacturing or processing, and therefore are clearly inconsistent with the obligation in the second clause of the second sentence of Article 2(c).

3.172 A United States attorney, expert in the textiles and apparel sector, has noted the absurdity of these distinctions⁶⁸ and concluded that the United States rules of origin containing the distinctions between fabrics, products and fibre blends were "far more motivated by a desire to protect United States wool and cotton producers than by any desire to create genuinely logical changes to rules of origin."⁶⁹ India agrees with this interpretation, and considers that the United States rules of origin require the fulfilment of conditions not related to manufacturing or processing as a prerequisite to the determination of country of origin, which is inconsistent with the second clause of the second sentence of Article 2(c).

(ii) *The measures at issue pose unduly strict requirements*

3.173 If the Panel were to conclude that the distinctions between fabrics, products and fibre blends *are* related to manufacturing or processing, India is of the view, that the Panel should find that these distinctions impose "unduly strict" requirements within the meaning of the first clause of the second sentence of Article 2(c).

3.174 The first clause of the second sentence of Article 2(c) prohibits the imposition of "unduly strict" requirements. The text of this provision supports the view that *Article 2(c) is meant to ensure that the conferral of origin does not depend on the fulfilment by producers and traders of conditions creating restrictive, distorting or disruptive effects that are not necessary to determine the origin of products and that consequently go beyond those inevitably created by any rule of origin.* This conclusion is also supported by the fourth clause of the preamble of the *RO Agreement* according to which this Agreement is "to ensure that rules of origin themselves do not create *unnecessary* obstacles to trade".

3.175 It is clear from the wording of Article 2(a) and Article 2(c) that the conferral of origin upon a product must be based on the determination of the country with which that product has a significant

⁶⁶ Section 405 (a) (3) (B), consolidated as §19 U.S.C.3592 (b) (2) (B).

⁶⁷ Section 405 (a) (3) (C), which provided exceptions to section 334 (b) (2) and consolidated as §19 U.S.C.3592 (b) (2) (C).

⁶⁸ John Peterson, "Rules of Origin: The textile mess gets messier", *Journal of Commerce*, July 2000 (Exhibit INDIA-13).

⁶⁹ *Ibid.*

economic link. It follows that the first clause of the sentence of Article 2(c) is violated if a Member confers origin on the basis of requirements that are burdensome and need not be imposed to determine that economic link between the product and the country seeking to be conferred origin for that product.⁷⁰ In its replies to India's questions, the United States has declared that it does not use criteria for the determination of origin other than those listed in Article 2(a).⁷¹ However, none of these criteria would require the imposition of requirements as strict as those applied by the United States.

3.176 India considers that the United States measures at issue impose strict requirements that do not assist the United States in determining the country with which the product has the most significant economic link.

(d) The measures at issue are inconsistent with the first sentence of Article 2(c) of the *RO Agreement*

(i) *The basic interpretative issue*

3.177 Article 2(c) of the *RO Agreement* could be interpreted to require Members to prevent rules of origin from having a restrictive or distorting *impact on international trade flows*. According to this "result-oriented" interpretation, the restrictive and distorting effects referred to in this provision would be the effects that occur *after* producers and traders have adjusted their business plans to the new rules.

3.178 Article 2(c) of the *RO Agreement* could also be interpreted as requiring Members to refrain from adopting and maintaining rules of origin which create *conditions of competition with restrictive, distorting or disruptive effects on international trade*. According to this "conduct-oriented" interpretation, the incentives and disincentives created by the rules of origin themselves, not their actual impact in the market, would be decisive. For the reasons set out below, India is of the view that the "conduct-oriented" interpretation is the correct one.

(ii) *Article 2 (c) does not require the showing of an actual restrictive, distorting and disruptive impact on international trade reflected in trade statistics*

3.179 According to the "result-oriented" interpretation, it is not the nature of the rule of origin but its actual impact in the marketplace that counts. The only obligation of the Members under the first sentence of Article 2(c) would be to modify the rules of origin if they generate a restrictive or distorting impact on international trade as reflected in trade statistics. According to the result-oriented interpretation, the purpose of this provision would be to protect expectations on the volume, direction and product-composition of trade. A complaint could therefore not be brought against rules of origin themselves immediately upon their adoption, but only against the trade impact generated by them after some time. Moreover, the complainant would have to bear the burden of demonstrating that the change in the volume, direction and product-composition of trade was attributable to the rule of origin, and not to other factors. The interpretation presupposes that Members know and control what the actual impact of changes in their rules of origin in the market will be. A violation of Article 2(c) would thus not depend exclusively on what the Member does, but would be triggered by what producers and traders do.

3.180 If, as the United States advocates, a claim of violation of Article 2(c) could only be made if and when trade data are available and it had to be demonstrated that the change in trade flows was caused by the rules of origin and not other factors, this important provision in the *RO Agreement* would become, for all practical purposes, unenforceable. The effects of the rules of origin themselves on the one hand and the effects of other commercial policy instruments to which they are

⁷⁰ Responses of India to questions by the Panel, 6 January 2003, Answer 11 (c).

⁷¹ Responses of the United States to questions by India, 6 January 2003, Answer to Question 1.

linked (as well as those to which they were not linked) and market factors could, in practice, not be segregated. India believes that the approach to the interpretation of Article 2(c) advocated by the United States is, therefore, not only inconsistent with the GATT and WTO jurisprudence and the basic function of the world trade order, but, also with the fundamental principle of interpretation that each provision of a treaty must be given effect.⁷²

3.181 For these reasons, India does not believe that a violation of Article 2(c) requires a showing of actual restrictive or distorting effects demonstrated through trade statistics.

(iii) *Article 2 (c) requires Members to refrain from adopting and maintaining rules of origin which create conditions of competition with restrictive, distorting and disruptive effects on international trade*

3.182 The "conduct-oriented" approach to the interpretation of Article 2(c) would take into account that a new rule of origin changes immediately the incentives and disincentives for producers and traders and, as a result, also their investment and other business plans. According to this approach, the *immediate* impact of the rule of origin on the decisions of producers and traders involved in international trade would be taken into account in assessing whether a rule of origin creates restrictive or distorting effects on international trade. *It thus takes into account that the very adoption of a rule of origin can have serious restrictive or distorting effects on international trade.*

3.183 According to this interpretation, the purpose of the provision would be to ensure that Members do not adopt and maintain rules of origin creating conditions of competition that operate to restrict or distort trade. A complaint could, therefore, be brought against new rules of origin immediately upon their adoption, and not only when the producers and traders have actually reacted to the new conditions of competition. *Members would be held responsible for the rules of origin they adopted, not for the reactions of the market to their rules of origin.* Their obligation under Article 2(c) would thus not go beyond what they can control or foresee. Given that market conditions constantly change and that rules of origin are only one of many factors that determine trade flows, a Member cannot foresee how precisely producers and traders will react to a new rule of origin. Members control and foresee only the conditions of competition that they impose. If the Panel were to rule that the actual trade effects of a rule of origin were to determine its legal status under Article 2(c), it would therefore have to presume Article 2(c) does not regulate the rules of origin adopted by Members, but the reaction of producers and traders to those rules. However, so far, all rules of conduct governing non-tariff measures have consistently been interpreted to regulate what Members should do, not what producers or traders have done.

3.184 Therefore, it cannot reasonably be assumed that the drafters meant to exclude from the coverage of Article 2(c), the immediate restrictive or distorting effects that rules of origin can create by forcing enterprises to change their business plans. The purpose of the *RO Agreement* is, according to its Preamble, to "further the objectives of the GATT 1994" and to "ensure that rules of origin do not nullify or impair the rights of Members under the GATT 1944". The drafters of the *RO Agreement* therefore expected the rules of the *RO Agreement* to be interpreted in a manner consistent with the basic objectives of the GATT, in general, and the market access rights accorded under it, in particular.

3.185 The European Communities adopted this conduct-oriented approach to Article 2(c) in its dispute with United States on measures affecting textiles and apparel products.⁷³ The European Communities twice brought claims under Article 2(c) immediately upon the adoption of new rules of

⁷² See e.g. Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline* ("US – Gasoline"), WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3, p. 23.

⁷³ *United States – Measures Affecting Textiles and Apparel Products*, WT/DS85/1, G/RO/D/1, G/TBT/D/13, 3 June 1997 and *United States – Measures Affecting Textiles and Apparel Products (II)*, WT/DS151/1, G/TMB/N/341, G/RO/D/3, G/TBT/D/19, G/L/279, 25 November 1998.

origin by the United States, without awaiting the impact of the new rules to show up in trade statistics. Why? Because the Italian producers of silk scarves and other manufacturers in the European Communities felt the restrictive effects of the new rules of origin immediately and urged the European Communities to intervene before the new rules had caused actual trade damage.

3.186 GATT and WTO jurisprudence support the conduct-oriented interpretation of Article 2 (c). All GATT and WTO panels and the Appellate Body have interpreted the rules governing tariff concessions and non-tariff measures as rules requiring the establishment of conditions of competition.⁷⁴

3.187 The purpose of Articles III and XI of the GATT is to prevent the impairment of market access concessions through non-tariff measures imposed internally or at the border. The purpose of Article 2 of the *RO Agreement* is to prevent the impairment "of the rights of Members under GATT 1994" through rules of origin. Given that the basic rationale of these provisions is the same, the approach to their interpretation should be the same. Just like the terms "made effective" in Article XI of the GATT and "applied" in Article III:2 of the GATT, the terms "create effects" in Article 2(c) must be given a meaning consistent with the basic function of the world trade order, which is to create predictability for producers and traders.

3.188 The only logical conclusion that one can draw from these considerations is that Article 2(c) of the *RO Agreement*, just as all the other provisions in WTO law designed to prevent the circumvention of market access commitments through non-tariff measures, must be interpreted as a provision prescribing conditions of competition, not the avoidance of a certain trade impact. What is thus relevant is whether the rules of origin create conditions of competition with restrictive, distorting and disruptive effects, and not whether the application of these rules to a specific commercial policy instrument has actually produced such effects.

(iv) *The measures at issue establish conditions of competition with restrictive, distorting or disruptive effects on international trade*

3.189 The measures at issue provide for distinctions between types of fabrics or fibre blends. These distinctions restrict, distort and disrupt trade flows between countries supplying different fabrics and fibres. India notes that the United States has failed to give any reasons as to why the differentiation between products made of different fabrics or fibre blends is required to determine in which country a sufficient amount of manufacturing, processing or other economic activity took place to justify the conferral of origin. Both China and the Philippines have given concrete examples of the trade distorting, disruptive and restrictive effects that the United States rules of origin themselves have on international trade.⁷⁵

(e) The measures at issue are inconsistent with Article 2(d) of the *RO Agreement*

(i) *Provisions that prohibit discrimination (treatment no less favourable) have been interpreted as prohibiting both de jure and de facto discrimination*

3.190 Both GATT and WTO jurisprudence confirm that provisions that prohibit discrimination (treatment less favourable) have been interpreted as prohibiting de jure and de facto discrimination.⁷⁶

⁷⁴ See for instance, BISD, 37/S/130-131.

⁷⁵ Responses of the Philippines to the questions by the Panel, Answer to Question 41 (e).

⁷⁶ See for instance, Appellate Body Report, (*EC – Bananas III*), *supra*, paras. 233 to 234; Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry* ("Canada – Autos"), WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000, DSR 2000:VI, 2995, para 63.

3.191 The concept of *de facto* discrimination was described by the Panel in *Canada-Pharmaceutical Patents* in the following terms:

de facto discrimination is a general term describing the legal conclusion that an ostensibly neutral measure transgresses a non-discrimination norm because its actual effect is to impose differentially disadvantageous consequences on certain parties, and because those differential effects are found to be wrong or unjustifiable.⁷⁷

3.192 [Void]

(ii) *De facto discrimination is covered by Article 2 (d) of the RO Agreement*

3.193 With respect to the concept of discrimination in Article 2(d), the United States, supported by the European Communities, argues that section 405 is not discriminatory within the meaning of Article 2(d) because the rules of origin in that section apply to all Members equally. This argument implies that Article 2(d) covers only cases of formal discrimination; that is rules of origin that explicitly distinguish between different WTO Members. In the view of India, this is an untenable position. There is no reason why the approach to the principle of non-discrimination laid down by the Appellate Body in the context of the non-discrimination provisions of the GATT and the GATS should not also apply to the prohibition of discrimination in the *RO Agreement*. The danger of circumventing the purpose of Article 2(d) through product distinctions is just as great as the danger of circumventing the most-favoured-nation provisions of the GATT and the GATS through product or service-specific distinctions. Indeed, the case before the Panel is a clear demonstration that arbitrary distinctions between closely related products can be used to achieve the objective of favouring one WTO Member over others.⁷⁸

(iii) *Section 405 discriminates on a de facto basis in favour of the European Communities*

3.194 Applying the test in *Canada – Pharmaceutical Patents*, the Panel will need to examine section 405 in order to assess whether it imposes differentially disadvantageous consequences and if these different effects are unjustifiable. India submits that both these elements are present in section 405.

(a) The effect of section 405 is to impose differentially disadvantageous consequences

3.195 Section 405 provides exemptions to the general rules for determining origin for certain fabrics, certain products and certain fibre blends. These exemptions are, *de jure*, applied on an origin-neutral basis. However, the type of exceptions indicates that the United States is providing a *de facto* advantage to those products of export concern to the European Communities. In response to the request of the European Communities, the United States re-worked the section 334 origin rules specifically for the products that were of concern to the European Communities, but not for any other products. The United States committed to change back to its prior rules with regard to silk accessories, silk fabrics, dyed and printed cotton fabrics, dyed and printed man-made fibre fabrics, and dyed and printed vegetable fibre fabrics.⁷⁹ This solution, of course, addressed those products of most concern to the European Communities: silk scarves, silk accessories, dyed and printed cotton fabrics.

⁷⁷ Panel Report, *Canada – Patent Protection of Pharmaceutical Products* ("Canada – Pharmaceutical Patents"), WT/DS114/R, adopted 7 April 2000, DSR 2000:V, 2295, para 7.101.

⁷⁸ India notes that the United States has replied in its answer 9 to the questions from India, that "Article 2(c) does not prescribe that Members must use the same rules to determine the origin of different products" India considers that a Member cannot apply different rules of origin to the same products just because they comprised of types of fabrics or different type of fibre blends.

⁷⁹ *United States – Measures Affecting Textiles and Apparel Products*, (I), WT/DS85/9, Notification of Mutually-Agreed Solution, 25 February 1998.

3.196 Section 405 does not make a formal distinction between Members. However, it *de facto* favours products from the European Communities since the fabrics, products or fibre blends that benefit from the exemptions are mainly the type of textile and apparel products which undergo "value-added" or substantial transformation operations in the European Communities. Those products singled out for exemptions from the fabric-forward rule and the wholly-assembled rule can, therefore, enter the United States without being subject to any quota restraints. However, when these products are made of certain fibres such as cotton, those products will be conferred origin where the greige fabric is woven. It is mainly developing countries under quota restraints that export cotton fabric. The effect of section 405 is clearly to impose differentially disadvantageous consequences.

(b) The differential effects created by section 405 are unjustifiable

3.197 As noted in India's first submission, the United States Congress passed section 405 in May 2000, containing text that was virtually identical to the text agreed upon by the United States and the European Communities in their second *procès-verbal* settling the WTO dispute resolution proceeding. Indeed, the United States has acknowledged that as a result of its agreement with the European Communities, it passed section 405 which provides exceptions to the rules in section 334 for certain specific products and for certain fabrics and fibre blends.⁸⁰ It is, therefore, indisputable that the United States modified its rules of origin in 2000 for the sole purpose of providing favourable market access for particular textile products that were of special concern to the European Communities.

3.198 The United States has stated that it "does not use criteria for the determination of origin other than those listed in Article 2 (a)."⁸¹ However, the exemptions provided for in section 405 do not bear any relation to the criteria for determining origin as set out in Article 2 (a). The amendments in section 405 thus created arbitrary and inconsistent reversions to the pre-section 334 rules of origin for a group of selected textile products, without any particular regard for the degree of further processing, assembly or other operations and how the extent of those further operations would change the nature of the products. Rather, the exceptions created by section 405 – a reversion to the pre-section 334 rules – were defined solely by the types of *end products* imported into the United States from the European Communities and for which the European Communities expressed concern.

3.199 It follows from the above that the United States rules of origin are unjustifiable because they were only enacted to favour one Member over another, and because the exemptions in section 405 (which makes distinctions between certain products) bears no relation to the manufacturing or processing of those products.

3. Findings and recommendations requested

3.200 For the reasons indicated above, India respectfully requests the Panel to find that the United States rules of origin set out in section 334 of the Uruguay Round Agreements Act and modified in section 405 of the Trade and Development Act of 2000 and the customs regulations implementing these statutory provisions, and the application of these sections and regulations, are inconsistent with:

- Article 2(b) of the *RO Agreement* because they are being used as instruments to pursue trade objectives;
- The second sentence of Article 2(c) of the *RO Agreement* because (a) they require the fulfilment of a certain condition not related to manufacturing or processing and (b) they pose unduly strict requirements;

⁸⁰ Responses of the United States to questions from India, 6 January 2003, Answer 7 to Question 8.

⁸¹ *Ibid*, Answer 1 to Question 1.

- The first sentence of Article 2(c) of the *RO Agreement* because they create restrictive, distorting and disruptive effects on international trade; and
- Article 2(d) of the *RO Agreement* because they discriminate between other Members.⁸²

3.201 In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered, according to Article 3:8 of the DSU, to constitute *a prima facie* case of nullification or impairment of benefits under that agreement. Accordingly, India requests the Panel to find that the measure at issue has nullified or impaired the benefits accruing to India under the *RO Agreement*.

3.202 India requests that the Panel recommend that the United States bring its measures into conformity with its obligations under the *RO Agreement*.

F. SECOND WRITTEN SUBMISSION OF THE UNITED STATES

1. Introduction

3.203 The issues for resolution in this dispute are clear and call for a straightforward reading of the provisions of Article 2 of the *Agreement on Rules of Origin ("RO Agreement")*. Through its first submission, oral statement, and answers to questions from the Panel, India urges the Panel to ignore the words of Article 2 and instead adopt its novel interpretations that at their core are simply India's disagreement with the determinations of origin for certain products. Starting with India's first claim - that section 334 was enacted to pursue trade objectives in violation of Article 2(b), India has latched on to the idea that one of the goals of section 334, preventing circumvention of quotas, is impermissible because circumvention must involve fraud. However, there is no consensus among Members as to whether any type of circumvention is legitimate, and therefore no basis for India's claim under Article 2(b). It is ironic that India seeks to sanction the United States for identifying, as one of four goals, addressing circumvention, when Article 5.1 of the *Agreement on Textiles and Clothing ("ATC")* calls on Members to take action against circumvention. Moreover, it would be unfortunate for a Member to be penalized for doing just what the *RO Agreement* mandates - enacting clear, concise, and transparent rules.

3.204 India bases its claim under Article 2(c) on analyses imported from dissimilar GATT provisions. Unable or unwilling to meet the standard plainly set out in the text of the provision, India instead attempts to convince the Panel to substitute a GATT analysis for discrimination. However, once again, India fails to meet its burden under that GATT standard. The words of Article 2(b) cannot be read to require an analysis of assumed "changed competitive conditions" upon the adoption of a rule of origin. Rather, this argument reveals India's true intent - it would simply like section 334 to go away and either force the United States to reach the specific origin determinations it seeks for particular products, or revert to a system with no product-specific rules of origin (by utilizing a case-by-case administrative system that India appears to favor). This is somewhat curious since trade data reveals that Indian exporters, and indeed international trade in the products at issue, have not been restricted, distorted or disrupted, but, on the contrary, have grown significantly. It is also curious since India appears to be contesting specific instances (section 405) where origin rules reverted to pre-section 334 principles.

3.205 Finally, India's claims with respect to section 405 center on the idea that because it was a the result of a settlement, and as such its terms reflect changes that the European Communities requested,

⁸² India has decided to refrain from further pursuing its claim that the administration of the United States rules of origin is inconsistent with Article 2(e) of the *RO Agreement* because India considers that the DSU does not provide an effective remedy against WTO-inconsistent actions that have been taken in the past. Therefore, any finding of violation of this provision would not result in an effective remedy for India.

section 405 impermissibly "favours" the European Communities and discriminates against India. Here again, however, not only does India make little effort to support its allegations, the analysis it offers for the basis of its allegations is also faulty.

2. India has failed to establish that section 334 of the URAA is inconsistent with United States obligations under the *RO Agreement*

3.206 India's allegations regarding section 334 are essentially that the United States rules of origin were enacted to protect the domestic textile industry and that they have restricted, distorted and disrupted trade. India's arguments in support of its allegations, however, are confused and sometimes contradictory. The only clear thread running through them is India's desire to operate in an environment in which section 334 does not exist.

3.207 India is the complainant in this dispute, and as such India bears the burden of coming forward with argument and evidence sufficient to establish a *prima facie* case of a breach of a Member's WTO obligations.⁸³ If the balance of evidence and argument is inconclusive with respect to a particular claim, India, as the complaining party, must be found to have failed to establish that claim.⁸⁴ India has not established a *prima facie* case that section 334 breaches United States obligations under the *RO Agreement*.

(a) The goals of section 334 are not impermissible trade objectives in the context of Article 2(b)

3.208 The Statement of Administrative Action ("SAA") lists four objectives for section 334: i) to reflect the important role assembly plays in the manufacture of apparel products; ii) to combat transshipment; iii) to harmonize United States rules with those of major trading partners and major textile and apparel importing countries such as the European Communities and Canada; and iv) to advance the *RO Agreement* goal of harmonization.⁸⁵ India has focused its allegations on a charge that section 334 is an impermissible "trade objective" in breach of Article 2(b) by arguing that, because it disagrees with the United States as to what constitutes circumvention, the United States effort to prevent circumvention through having clear, concise and transparent rules is a hoax.

3.209 What India is asking the Panel to do is to disregard what the SAA says about section 334 and make a subjective judgment that one of section 334's goals, preventing circumvention, is somehow illegitimate and that this one "illegitimate goal" makes all of section 334 inconsistent with the *RO Agreement*. However, as India noted in its first submission, and as was affirmed in the United States first submission, WTO dispute settlement panels have acknowledged that the SAA expresses an authoritative expression of the purpose of United States legislation.⁸⁶ The SAA stated that section 334 would combat circumvention⁸⁷ by: lessening confusion resulting from differences between United States practices and the practices of other major trading partners; facilitating the use of more effective labeling requirements; and focusing on practices more easily subject to inspection by the United States Customs Service.⁸⁸ The United States has explained in its submissions and in answers to

⁸³ See, e.g., Appellate Body Report, *US – Wool Shirts and Blouses*, *supra*, page 14; Appellate Body Report, *EC – Hormones*, *supra*, para. 104; Panel Report, *Korea – Dairy*, *supra*, para. 7.24.

⁸⁴ See, e.g., Panel Report, *India – Quantitative Restrictions*, *supra*, para. 5.120.

⁸⁵ Statement of Administrative Action in "Message of the President of the United States Transmitting the Uruguay Round Agreement, Text of Agreements, Implementing Bill, Statement of Administrative Action and Required Supporting Documents," H.R. Doc. No. 316, 103d Cong. 2d Sess., Vol. 1(1994) at 656, *et. seq.*, Exhibit US-6 at 119.

⁸⁶ See India first submission, para. 58 (*supra*, para. 3.33), United States' first submission, para. 29, *United States - section 129(c)(1) of the Uruguay Round Agreements Act*, WT/DS221/R, 30 August 2002, paras. 6.36-6.38.

⁸⁷ As the United States noted in answer to panel question 14 (para. 22), the reference in the SAA to transshipment has the same meaning as "circumvention" as that term is used in the ATC.

⁸⁸ SAA, Exhibit US-6 at 119.

questions from the Panel what practices could be harmonized (cutting would no longer confer origin) and how these changes would prevent circumvention (clear guidance for importers and customs officers), and so will not repeat those explanations here.⁸⁹

3.210 India's complaint is not so much with whether or how the United States was going to deter circumvention but with whether trying to address circumvention was acceptable. In its answers to Panel questions 2 and 17 (answers 17(b) and 17(d)) India sets a standard for judging whether preventing circumvention is legitimate - such circumvention must only be clearly fraudulent. India also makes the bald claim that the United States was not seeking to prevent fraudulent circumvention, but rather "legal circumvention" and that this was therefore illegitimate. India's arguments, however, fail for several reasons. First, as India itself acknowledges, and as noted by the European Communities, there is no consensus as to what constitutes "circumvention." The ATC provides examples of circumvention practices that frustrate the effective integration of textiles into the GATT, but does not define circumvention and there is no consensus among Members on the concept of legitimate vs. illegitimate circumvention (*See* India answer 17(a), European Communities answer to question 43(a), and United States answer to question 18(a) (paras. 27-32) (and exhibit US-7)). India is therefore asking the Panel to make a subjective determination, that the United States goal of preventing circumvention is a trade objective, without proving that there is an understanding among Members as to what "circumvention" means.

3.211 Moreover, if preventing quota circumvention were determined to be a "trade objective" for purposes of Article 2(b), then Members would be severely hampered in their ability to ensure compliance with textile and apparel quotas and to comply with Article 5 of the ATC. What India so easily objects to as "protectionism" is a methodology for implementing measures sanctioned under the ATC. Rules of origin designed to simplify and provide certainty in origin determinations ensure transparency and predictability, and allow importers, exporters, and Members to work together to prevent circumvention, as directed by ATC Articles 5.1 and 5.5. Such a design is clearly consistent with the purpose of Article 2 of the *RO Agreement*.⁹⁰

3.212 Finally, even assuming *arguendo* that the Panel would elect to disregard the statements in the SAA as "untrue," India would still have the burden of proving that the true purpose of section 334 was a trade objective - protection of the domestic industry. India has presented no evidence to support this allegation, not in its first submission, oral statement or answers to panel questions. The United States already has a regime in place for the purpose of protecting its domestic industry during the ATC transition period, i.e., a quota regime, and it does not need to use additional measures or subterfuge for such purposes. The quota regime that is in place under the transitional ATC agreement provides effective protection for the domestic industry. Indeed this is why this dispute exists - - even though India's quotas are increased annually by a scheduled factor, India requested but did not receive additional increases in their quota, beyond those agreed to by India and the United States, and commenced these proceedings within days of United States textile officials rejecting their request. It would indeed be a leap of legal logic, WTO or otherwise, to then find by "implication," as India

⁸⁹ *See* United States' answers to panel questions 14 (para. 22) and 19.

⁹⁰ It should also be noted that India's contention regarding the true purpose of section 333 of the URAA being to prevent circumvention, rather than section 334, suggests that India has mis-read or is mis-representing section 333. (*See* India answer to question by the panel 17(a).) Section 333 establishes new and more rigorous customs measures to counteract circumvention, once circumvention is uncovered (such as the publication of names of violators, additional "reasonable care" measures for importers to take when doing business with published violators, etc.). Thus, the purpose of section 333 is to establish "after the fact" remedies, which is different from section 334, the purpose of which is to prevent circumvention from happening in the first instance. Both are valid measures to counteract and deter circumvention.

urges, that the true purpose of section 334 was to protect the United States domestic industry. *See* India answer to panel question 17(a).⁹¹

3.213 Moreover, India has not met its burden under its proposed standard of showing that the design, structure and architecture of section 334 "reveals," *prima facie*, that the United States' "true objective" in enacting section 334 was protection of its domestic industry. India cites to the conclusions of the Appellate Body in the *Japan - Taxes on Alcoholic Beverages* and *Chile - Taxes on Alcoholic Beverages* disputes,⁹² in which this interpretative standard was developed, but makes little effort to discuss the factors identified by the Appellate Body in those disputes to determine whether the design, structure and architecture of section 334 reveals a discriminatory intent. While the United States does not consider that this analysis is necessary or relevant, or that it is the United States burden to make and rebut India's case, the United States would like to point out one instance where India has failed to meet its burden of proof under this standard - the "applied so as to afford protection" standard identified in these disputes.

3.214 One factor reviewed in this determination is the connection between the stated objectives and the results of the measure.⁹³ In section 334, the United States has achieved what it set out to do - the rules reflect where the most important manufacturing process takes place, there is closer harmonization with our major trading partners, and the clear, concise rules have resulted in a greater ability to identify circumvention. In addition, section 334 has facilitated an enormous increase in trade in textile and apparel products to the United States market. Accordingly, a conclusion that section 334 was enacted to protect the United States textile industry, and is therefore a trade objective in the context of Article 2(b), would not be based on any legal or factual foundation.⁹⁴ The United States urges the Panel not to adopt India's "trade objective by implication" standard.⁹⁵

(b) India has not shown that section 334 restricts, distorts or disrupts international trade

(i) *India's analytical framework is inconsistent with Article 2(c)*

3.215 India, in its first submission and in answers to panel questions, seems to suggest that the Panel may assess whether section 334 "creates restrictive, distorting, or disruptive effects on international trade" by looking at the effect on one single Member's trade.⁹⁶ This reading simply cannot be found in the words of Article 2(c). If the Members wanted to proscribe rules of origin that affected only one Member (or a couple for that matter) it would have been easy: the provision could have read: "Members shall ensure that their rules of origin shall not themselves create restrictive, distorting or disruptive effects on another Member's trade." However, even this provision would require some presentation of trade effects data and India is not, apparently, prepared to discuss *actual* effects on *its* trade. Rather, India seems to argue that the Panel should instead adopt a GATT product discrimination analysis, which would assess, India claims, "whether the rules of origin create conditions of competition with restrictive, distorting and disruptive effects."⁹⁷ India calls this a

⁹¹ In addition, the United States would like to be clear that nothing it has ever said amounts to, or should be construed as, an "admission," as India claims, that the true goal of section 334 was protection of the United States domestic industry. *See* India answer to question from the panel, question 2.

⁹² Appellate Body Report, *Japan – Alcoholic Beverages II*, *supra*, pages 26-29, Appellate Body Report, *Chile – Taxes on Alcoholic Beverages* ("*Chile – Alcoholic Beverages*"), WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, DSR 2000:I, 281, paras. 62, 69-71.

⁹³ *See* Appellate Body Report, *Chile-Alcohol*, *supra*, paras. 56-57, 69-71.

⁹⁴ In addition, contrary to India's assertions, the United States has not advocated that a claim under Article 2(b) can only be made "if and when trade data are available . . ." India oral statement paras.43-44. That point is relevant only to Article 2(c).

⁹⁵ *See* India answer 17(a) to questions from the Panel.

⁹⁶ India answer to question 11(b) from the panel and India first submission, para. 93.

⁹⁷ India oral statement paras. 39-45 (*supra*, paras. 3.116-3.121) and answers to panel questions 11 and 28 (India answers 14 and 26).

"conduct-oriented" approach (preamble to India answer 26) and urges that it should be pre-supposed that mere *adoption* of a rule of origin will have an "immediate impact" that distorts or restricts trade. This argument is, at best, circular and contradicted by India's own behavior. As a preliminary matter, it seems strange that India would advocate a legal position not in accordance with its behavior in this dispute. India, advocate today of a finding that says, essentially, "upon adoption assume impact [read effect]," waited *eight years* to bring this dispute, and its case is founded upon the basis that its trade has suffered as a result of the change in the United States rules of origin. This necessarily involves a *backward* look at the effect of the change. Indeed, the only evidence that India has so far presented to this Panel regarding its Article 2(c) claim is the charge by one of its exporting associations that its members have lost business since section 334,⁹⁸ (a claim that stands in stark contrast to actual United States import statistics).

3.216 India's interpretation is inconsistent with the text of Article 2(c) and unnecessary. The drafters of the *RO Agreement* must certainly have been aware of GATT Articles I and III and if they had wanted to adopt a product discrimination standard for Article 2(c), perhaps they could have done so -- although that, again, would contradict the *RO Agreement*'s sanctioning of product-specific rules. The United States submits that they chose not to do that because product differentiation *is* allowed under the *RO Agreement* (India seems to confuse differentiation with discrimination). There is no need for the Panel to resort to adopting this analysis when, in addition to the terms of the provision, there is other WTO guidance, more similar to Article 2(c) on which to rely. Further, as India itself notes, this analysis presumes an element of intent, which is not found in Article 2(c).

3.217 India makes a laborious argument that the panel should look at the effects of a change in rules of origin on conditions of competition in its answer to Panel question 26. This argument is misguided. As a preliminary matter, the United States notes again that the text of Article 2(c) does not discipline changes in rules of origin *per se*; instead, it applies to rules of origin "themselves." Thus, the type of comparative argument suggested by India is precluded by the text of Article 2(c) itself. Moreover, the fact that Article 2(i) sets forth specific disciplines on changes in rules of origin and does so expressly further indicates that 2(c) was not meant to discipline changes *per se*. The panel must examine whether the United States rules, as enacted, "create restrictive, distorting, or disruptive effects on international trade," not whether the change in United States rules altered conditions of competition.

3.218 In its questions to India (question 26(e)), the panel correctly noted that under India's interpretation of 2(c), "Members cannot introduce changes to their rules of origin, given that different rules of origin are almost bound to produce different trade effects." India's response, that changes are permitted provided they comply with Article 2, does not answer the panel's implied objection. Furthermore, at no time does India present analysis, pursuant to the WTO jurisprudence that it cites, of how section 334 "changed the competitive conditions."

3.219 India suggests in its answer to question 11(b) that the Panel should follow the reasoning of the panel in *United States – Section 337 of the Tariff Act of 1930*⁹⁹ and consider conditions of competition. Doing so, however, would misinterpret that report. India's approach to *Section 337* would mean by definition that there could be no changes in rules of origin because somebody always benefits and somebody always loses. In *Section 337*, the panel rejected the proposition that Article III allows "balancing more favourable treatment of some imported products against less favourable treatment of other imported products . . ." because such an interpretation would "lead to great uncertainties about the conditions of competition between imported and domestic products."¹⁰⁰

⁹⁸ In addition, as noted above, India only commenced these proceedings when it did not get an increase in its United States quota, and after India apparently decided not to pursue its claim under ATC procedures.

⁹⁹ Panel Report on *United States – Section 337 of the Tariff Act of 1930* ("US-Section 337"), L/6439, BISD 36S/345, adopted 7 November 1989.

¹⁰⁰ *Ibid.*, para. 5.14.

Finally, and most significantly, in neither *Section 337* nor in the *Oilseeds*¹⁰¹ case (cited by India in its answer to the panel question 26) did the panel conclude that a measure was inconsistent with the GATT solely because it had an impact on conditions of competition. In *Section 337*, the panel did not find the United States measure inconsistent with Article III because the measure had an impact on conditions of competition; instead, it first found that the measure subjected imported products to legal provisions that are different from those applicable to products of domestic origin, and it relied on the conditions of competition test to determine whether this differential treatment accorded to imported products less favorable treatment.¹⁰² In the *Oilseeds* case, the panel was considering whether the benefits to the United States under the European Communities' tariff concession for oilseeds were being nullified or impaired by subsidies granted by the European Communities.¹⁰³ The panel did not look to conditions of competition to determine whether Article II had been violated; instead, it looked to conditions of competition to determine if benefits under Article II were being nullified or impaired, despite no violation of Article II. India's reading would in essence make this a non-violation claim.

(ii) *The interpretation of "restrictive, distorting, disruptive effects"*

3.220 Article 2(c) itself gives guidance on how rules of origin might themselves create restrictive, distorting, or disruptive effects on international trade, for example by imposing "unduly strict requirements" as a "prerequisite for the determination of the country of origin" or by requiring "the fulfilment of a certain condition not related to manufacturing or processing as a prerequisite for the determination of the country of origin." India had the correct interpretation earlier, when it noted that the meaning of Article 2(c) could be ascertained from the "immediate context [of] the second sentence of Article 2(c) according to which rules shall not impose requirements that are unduly strict or unrelated to manufacturing or processing."¹⁰⁴

3.221 The determination of whether section 334 creates restrictions or distortions or disruption on international trade can be made simply, by looking at trade flows. As India acknowledges, the drafters of the *RO Agreement* gave us a specific example of how rules of origin can create the prohibited effects - through unduly strict requirements or the imposition of conditions not related to origin determinations. In the second sentence, the drafters also were clear that some effects would occur from simply having requirements and would not be considered to rise to the level of "distortions" of international trade. This also makes common sense, as the *RO Agreement* does not operate to address constant disputes about specific origin determinations for particular products which may have an uneven effect on one Member *versus* another.¹⁰⁵

3.222 A reading of Article 2(c) that does not require some showing of *actual* effects on international trade would render the provision meaningless and would mean that a complainant would never have to prove, in a case where it was specifically alleging that a provision had been violated, that there actually was a violation. As was noted in the United States response to the Panel's questions, in a given case, a change to rules of origin could eliminate restrictive, distorting, or disruptive effects produced by the former rules; or, it could be that, while the change in rules had an impact on trade, the result was a more transparent and more easily administered system, with benefits to trade, and rules that more accurately reflect commercial realities (i.e., reflect the important role of assembly).

¹⁰¹ Panel Report on *EEC – Payments and Subsidies to Processors and Producers of Oilseeds and Related Animal Feed Proteins ("EEC-Oilseeds")*, L/6627, BISD 37S/86, adopted 25 January 1990.

¹⁰² See *Ibid*, paras. 5.19-5.20.

¹⁰³ See *Ibid*, paras. 142-144.

¹⁰⁴ See India oral statement para. 45 (*supra*, para.3.121).

¹⁰⁵ See United States' answer to question 11 from the panel, paras. 10-16. In response to question 11(b), India speaks of Article 2(c) as serving "to protect expectations regarding the level of imports: and "expectations regarding the trade between the third countries." Setting aside India's dismissal of the need to show the Panel hard data to satisfy its allegations, nothing in the *RO Agreement* suggests that it was designed to protect expectations of levels of imports.

3.223 The United States submits that, despite India's claims to the contrary, the Panel will not make history by looking for actual effects on international trade in its assessment of "restrictive effects," as India suggests, because an important principle of treaty interpretation is sufficient in this case. The *Vienna Convention on the Law of Treaties* directs that examiners of a treaty provision determine the ordinary meaning of the provision from its words and in its context, as well as the object and purpose of the agreement.¹⁰⁶

3.224 This interpretation is further supported by similar provisions in other WTO agreements. As the Panel correctly noted in question 26(b) to India, Article 6.3 of the SCM Agreement, which addresses effects of subsidies on imports and exports is at least equally relevant to an analysis of Article 2(c) (effects on international trade) as GATT cases that address discrimination among like products. This is especially so if India is correct that the term "trade effects" does not appear anywhere in the GATT, because it does appear in *RO Agreement* Article 2(c), as well as in Articles 2(a) and 3.2 of the Agreement on Import Licensing Procedures, as the Panel noted.

3.225 Far from being restrictive, our clear and transparent rules of origin have facilitated a significant expansion of international trade, from India and the rest of the world. As shown in the attached Exhibit US-8, trade in the HTS classifications that India has identified as being affected by section 334 and 405 (footnotes 23, 25 and 56 of India's first submission) cannot be said to show a pattern of effects of a "restrictive, distorting or disruptive" action; in fact, the contrary is the case. Therefore, India has not shown how section 334 breaches the United States WTO obligations in Article 2(b) and 2(c). Finally, the United States notes that India has not made any specific allegations regarding an Article 2(d) discrimination claim with respect to section 334.

(c) India has not shown that section 405 is discriminatory or that it restricts, distorts and disrupts international trade

3.226 India appears to have three claims with respect to section 405 - that section 405, enacted to settle a WTO dispute with the European Communities, "favours" the European Communities in violation of Article 2(b) and 2(d), and that section 405 has restricted, distorted or disrupted trade in violation of Article 2(c). India made a vague argument in its first submission that because the settlement was reached to end a US-EC dispute, that was a "trade objective." However, as we explained in the first submission and oral statement of the United States, it would be absurd to find that a settlement, which furthers the goals of the WTO, is an impermissible trade objective under Article 2(b).¹⁰⁷

3.227 Similarly, with respect to India's charge that section 405 restricts, distorts, and disrupts international trade, the United States first notes that India has made little effort to develop this claim, either legally or factually. In addition, changes in rules of origin for quota goods will usually have quota implications that will be different for different Members, depending on their quota levels and the nature of their exports. In accordance with the terms of bilateral textile agreements incorporated into the ATC, there are several examples where United States textile and apparel quotas appear to treat imports from India more favorably than those of other WTO Members, for example with respect to duck fabric, skirts, cotton terry towels, as well as the annual growth rates for certain categories.

3.228 Finally, trade statistics do not bear out India's claims of a disruption of its trade. Section 405 was effective in May, 2000 and in 2001, a year in which overall United States imports of textile and apparel products contracted, United States imports of products affected by section 405 demonstrated no particular pattern that would indicate trade restriction, disruption or distortion. In fact, in several categories of section 405 products, United States imports from the world and from India instead showed healthy increases, for example, HTS 6213 (imports from world up 44 percent; imports from

¹⁰⁶ See *Vienna Convention*, Article 31.

¹⁰⁷ See also Third Party Submission of the European Communities, paras. 26-27 (*infra*, para. 4.282).

India up 57 percent); 6302.59 (imports from world up 21 percent; imports from India up 5 percent); 6302.93 (imports from world up 16 percent; imports from India up 70 percent); and 6303.99 (imports from the world up 35 percent; imports from India up 142 percent).

3.229 India's primary claim with respect to section 405 is its charge that because the exceptions to section 334 took into account specific products of interest to the European Communities, this "favoured" the European Communities and is discriminatory. Of course, any settlement has to be satisfactory to the complaining party. But if the settlement is applicable to all Members on an MFN basis, it will in all likelihood benefit all exporting Members. Neither can India rely on *Canada - Certain Measures Affecting the Automotive Industry* to substantiate a claim of *de facto* advantage in favor of the European Communities. In that dispute the Appellate Body was addressing an advantage given to *some* products that was based on the country of affiliation of the producers. However, in that case, the *de facto* discrimination resulted because Canada was giving advantage to some of the *same (like)* products based on nationality. In this dispute, India's charges in respect of the United States rules of origin relate to *different* products.¹⁰⁸ Furthermore, while it is true that in that report the Appellate Body made a reference to "*de facto* advantage," GATT Article I:1 is not at issue in this case. If India had wished to make such a claim, it could have brought a dispute under that provision. India did not do so.

3. Conclusion

3.230 For the foregoing reasons, the United States requests that the Panel find that India has failed to establish that section 334 of the URAA and section 405 of the Trade and Development Act of 2000 are inconsistent with Articles 2(b)-(e) of the *RO Agreement*.

G. ORAL STATEMENT OF INDIA AT THE SECOND MEETING OF THE PANEL

3.231 In the light of the arguments and evidence presented by India in our first and second submissions, in our oral statement at the first meeting of the panel, and in our answers to the questions from the Panel, India considers it has met its burden of proof in this case. India has clearly established that the United States rules of origin at issue are *prima facie* inconsistent with the obligations of the United States under Articles 2(b), 2(c), and 2(d) of the *Agreement on Rules of Origin (RO Agreement)*.

3.232 India accepts that as the complaining party we bear the burden of establishing the *prima facie* case of violation. In *each and every* claim that India is making, we have established a *prima facie* violation of the specific *RO Agreement* provisions being challenged. Therefore, it was up to the United States to rebut India's case. However, the United States has failed to do so. It failed to rebut India's arguments in its first submission. It did not rebut India's arguments in its oral statement at the first hearing. It also did not avail itself of the opportunity to effectively rebut India's case in its responses to the questions from the Panel or to the questions from India. The United States has also not rebutted India's claims in its second submission.

3.233 The main arguments that India has put forward in this case are addressed below and within the context of each of these claims, the points that have been made in the second submission of the United States will be addressed specifically.

3.234 With respect to the Article 2(b) claim, India has demonstrated throughout the proceedings that the United States measures at issue are being used as instruments to pursue trade objectives. In its second submission on page 8, the United States notes, that even if the Panel were to disregard the objectives listed in the Statement of Administrative Action (SAA) as "untrue," India would still have

¹⁰⁸ Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry* ("Canada – Autos"), WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000, DSR 2000:VI, 2995, paras. 81 and 85.

to prove that true purpose of section 334 was a trade objective. India believes that it has already done so.

3.235 The United States claims it already has a regime in place for the "purpose of protecting its domestic industry" and that this "quota regime under the transitional ATC agreement provides effective protection for the domestic industry." The fabric forward rule, by definition, increases the quantities of textile imports that would be conferred the origin of the countries that are under quota. This measure strengthens the impact of its quota regime under the ATC which – as the United States admits - was put in place to protect the domestic industry. The fabric forward rule is thus clearly being used to pursue a trade objective.

3.236 In its submission, the European Communities rightly points out that if the expression "circumvention of quotas" was used to describe the changing of trade patterns in response to quotas, the intent to pursue a trade objective could be established through the legislative history itself. The United States intention to combat "circumvention" corresponds, in the words of the European Communities, to an intention to "re-apply quantitative restrictions where these have lost their bite through changes in trade patterns and regulations." As noted by the European Communities, this is precisely the type of trade objective that Members are not to achieve through the use of rules of origin.¹⁰⁹

3.237 The United States argues, moreover, that it would be unfortunate for a Member to be "penalized for doing just what the *RO Agreement* mandates – enacting clear, concise, and transparent rules." India is not convinced that the rules of origin of the United States are clear and concise. We would like to note that in any event clear, concise, and transparent rules of origin must also be consistent with Articles 2(b), 2(c) and 2(d) of the *RO Agreement*. The argument of the United States therefore does not respond to India's claims.

3.238 With respect to section 405, India has demonstrated that it is being used as an instrument to pursue the trade objective of favouring one WTO Member, namely the European Communities, over others. India has shown that the only reason why section 405 was enacted was to settle the rules of origin dispute with the European Communities, and that the only products that benefited from this settlement were those of export interest to the European Communities. India notes that the United States has not offered any justification that section 405 is consistent with its obligations under Article 2(b). Therefore, the United States has not discharged its burden of rebuttal on this argument.

3.239 India has presented a prima facie case of violation of the first sentence of Article 2(c) of the *RO Agreement* based on a conduct-oriented interpretation of this provision. India has demonstrated that this interpretation is supported by the text of Article 2(c) and its context and by the object and purpose of the *RO Agreement*. As India noted in its answer 26(e) to the Panel's questions, the second sentence of Article 2(c) is an elaboration of the first sentence. The United States has agreed with this approach in its answers to the panel's questions.¹¹⁰ It thus acknowledged that, according to the second sentence, the imposition of unduly strict requirement and conditions unrelated to manufacturing or processing *as such* is inconsistent with Article 2(c), irrespective of the actual trade impact. It cannot reasonably be presumed that the drafters of the *RO Agreement* chose to employ a conduct-oriented approach for the second sentence of Article 2(c) while seeking to adopt a result-oriented approach for the first sentence of Article 2(c). The interpretation of the first sentence of Article 2(c) that has been put forward by the United States can therefore not be reconciled with its own interpretation of the second sentence of that provision.

¹⁰⁹ Third party submission by the European Communities, 5 December 2002, para. 24 (*infra*, para. 4.280).

¹¹⁰ Responses of the United States to the **questions** from the Panel, 6 January 2003, paragraph 16.

3.240 India would like to add that support for the conduct-oriented approach to Article 2(c) is also found in the negotiating history of the *RO Agreement*. The text of the first sentence of Article 2(c) reflects negotiating proposals originally made by Japan and Hong Kong. Japan proposed that "the rules of origin should not be *prepared or used* as a means of restricting or distorting international trade."¹¹¹ Hong Kong suggested that "rules of origin should not be *prepared, adopted or applied* in such a manner as to create trade distorting, restrictive or disruptive effects on international trade."¹¹² In the view of the original proponents of the norm incorporated into the first sentence of Article 2(c), it was thus not only the *application* of rules of origin that could create distorting, restrictive and disruptive effects on international trade, but also their *preparation*. That idea is now reflected in the final version of the *RO Agreement* in the seventh recital of the Preamble of the *RO Agreement*, which states that Members desire "to ensure that rules of origin are *prepared and applied* in an impartial, transparent, predictable, consistent, and neutral manner." The reference to the "rules of origin themselves" in Article 2(c) must therefore be understood to be a reference to the rules both as applied *and as prepared*. The United States' claim that the first sentence of Article 2(c) refers exclusively to the adverse effects created by the *application* of the rules therefore is untenable.

3.241 The United States, in its second submission, notes that India has waited eight years to bring this case, and therefore, implies that looking "backwards" at the effects of the change, India should have trade data available to prove that our trade has suffered. However, the United States fails to address the interpretative issue before the Panel. The interpretation of Article 2(c) should not depend on the interval between the adoption of a rule of origin and its challenge by another WTO Member.

3.242 Indeed, the United States has implicitly accepted the conduct-oriented approach because it agreed to provide "compensation" for the adverse trade effects caused by its new rules of origin on various countries such as the Philippines, Pakistan and Indonesia,¹¹³ and reached a settlement agreement with the European Communities before any of these WTO Members were in a position to demonstrate adverse trade effects through trade statistics.

3.243 The United States has said, "[i]ndications of whether rules restrict, distort or disrupt trade would be if they are overly burdensome to comply with or cause confusion in the market place."¹¹⁴ India agrees with the United States that these are relevant criteria. Furthermore, India notes that the United States rules of origin requirements relating to type of fabrics and fibre blends are overly burdensome to comply with. The differences between the type of fabrics and fibre blends impose stricter requirements. The rules of origin definitively cause confusion because the conferral of origin will differ depending on the fibre composition of the fabrics used to produce the end-products. Therefore, using the very test set out by the United States in its second submission, the United States rules of origin restrict, distort, or disrupt trade.

3.244 The United States has devoted a large part of its second submission (and has referred today in paragraph 21 of its oral statement) to referring to statistics that textile trade from India to the United States increased in specific years, and therefore, argues that India has not suffered adverse effects. However, India would argue that this result is precisely what section 334 was designed to achieve, namely to bring more finished products under the quota of the country where the greige fabric was woven. As we have pointed out in paragraph 90 of our first submission, the effects of the challenged measure have to be *on international trade* and not only on imports in the United States. For example, India has asserted that its exports of greige fabric to Sri Lanka for further processing into products such as cotton bed linen before onward export to the United States have been adversely affected by the "chilling effect" of the United States rules of origin.

¹¹¹ MTN.GNG/NG2/W/52, 17 January 1990.

¹¹² MTN.GNG/NG2/W/41, 15 September 1989.

¹¹³ Third party submission by the Philippines, 5 December 2002, para. 5. See also, for example, the MOU between Pakistan and the United States, G/TMB/N/328, 27 July 1998.

¹¹⁴ Second submission of the United States, 6 January 2003, para. XXIII.

3.245 With respect to Article 2(d), the United States has argued in its second submission that India has abandoned its claims with respect to section 334. India notes that we never made a claim under this provision with respect to section 334.

3.246 India has made a claim that section 405 and its implementing customs regulations are inconsistent with Article 2(d). In response, the United States argues that section 405 was enacted on an MFN basis. India agrees that section 405 does not make a formal distinction between Members. However, it *de facto* favours products from the European Communities since the fabrics, products or fibre blends that benefit from the exemptions are mainly the type of textile and apparel products which undergo "value-added" or substantial transformation operations in the European Communities. Therefore, these products can enter the United States without being subject to any quota restraints. However, when these products are made of certain fibres such as cotton, those products will be conferred origin where the greige fabric is woven. It is mainly developing countries under quota restraints that export cotton fabric. The effect of section 405 is clearly to impose differentially disadvantageous consequences for developing countries such as India which export cotton fabric and products thereof. In addition, India would note that the United States refers to its Harmonized Tariff Schedule (general note 22) which defines "wholly of" as meaning "that the goods are ...completely of the named material." However, for section 405, the United States arbitrarily made more than 16% cotton as the criterion to determine the applicable rule of origin (i.e., that origin would be conferred where the greige fabric is woven.) Indeed, as the United States has noted in paragraph 8 of its response to the Panel's questions, "by establishing a rule of certain goods containing 16% or more of weight of cotton, we ensured that we would cover the products defined in our settlement agreement." By reducing the threshold of the definition of a cotton product from one that is composed *completely* of cotton to one that is merely *16% and above* of cotton, the United States effectively brought more items under the definition of cotton, which according to section 405, would be conferred origin where the greige fabric was woven.¹¹⁵

3.247 In addition, India notes that the manufacturing and assembly of a product such as bed linen is the same whether it is made of silk or cotton. If, however, it was made of silk, it would be conferred origin where it was subjected to DP2. If, however, it was made of cotton, it would be conferred origin where the fabric was formed. In its reply to question 4 from India, the United States answered that India's concerns with respect to the differential treatment provided by the "exceptions in section 405 are based on a disagreement with the United States as to where the most significant or important manufacturing or assembly takes place." India considers that there should be no disagreement as to where the most significant or important manufacturing or assembly takes place between those products singled out for exemption and those that are not. It is the same for both types of products, as the products are the same. We consider in this respect that there are no technical reasons to discriminate in terms of rules of origin between identical products (which by definition are competitive or substitutable in the market) and that undergo the same manufacturing and processing. However, the different rules of origin that the United States applies to such products are unjustifiable.

H. ORAL STATEMENT OF THE UNITED STATES AT THE SECOND MEETING OF THE PANEL

1. Introduction

3.248 Good afternoon, Mr Chairman and members of the Panel. We are pleased to have this opportunity to once again appear before you to present the arguments of the United States in defense of the rules of origin found in section 334 of the Uruguay Round Agreements Act and section 405 of the Trade and Development Act of 2000. We will concentrate our remarks on responding to India's second submission, but note that our second submission and our responses to the questions by the

¹¹⁵ This "16% and more" definition is also not consistent with the definitions as set out in Chapters 50 to 55 of the Harmonized System which provides for a definition of "85% or more", as pointed out by the United States in paragraph 8 of its replies to the Panel's questions.

Panel also address India's current iteration of its claims. We welcome any questions you may have, and we look forward to responding to them. The United States rules of origin are not only consistent with the Agreement on Rules of Origin (the "*RO Agreement*"), they advance its objectives. India bears the burden of demonstrating why the Panel should adopt its interpretive theories and determine, by implication, that the United States rules of origin are inconsistent with the provisions of the *RO Agreement*. India has not done so and instead attempts to shift its burden of proof to the United States.

3.249 As we have previously discussed, the *RO Agreement* was drafted because Uruguay Round negotiators wanted to ensure that rules of origin: a) were clear and predictable and would through their application facilitate the flow of international trade; b) were implemented through transparent laws, regulations and practices; and c) were prepared and administered in an impartial, transparent, predictable, consistent and neutral manner. The *RO Agreement* prescribes a set of obligations that are guided by these principles. At the same time, while setting out the program for harmonization, the *RO Agreement* drafters did not impose a single set of rules of origin at the close of the Uruguay Round. Instead, the *RO Agreement* left policy flexibility in the hands of individual Members until harmonization is completed, and specifically set out various mechanisms that could be used. Moreover, the *RO Agreement* gave Members the right to alter those rules of origin from time to time in Article 2(i). The Panel should bear these Member decisions in mind as it evaluates both the United States rules of origin and India's legal arguments in this dispute.

3.250 India's answers to questions from the Panel and its second submission confirm that what India is hoping for is to impose a single set of rules of origin on the United States (and, implicitly, on all other Members) -- notwithstanding the fact that the *RO Agreement* was intended to leave flexibility in the hands of Members. This is shown by India's attempts to convince the Panel to adopt a *per se* rule that mere adoption of rules of origin creates effects prohibited by the *RO Agreement*. India is seeking to unilaterally change the *RO Agreement* by introducing GATT provisions not relevant in this dispute.

3.251 Has the United States "used" its rules of origin in an impermissible manner? Have those rules created restrictions, distortions and disruptions of international trade? Have those rules discriminated against India? These concepts would appear to be relatively straightforward and the answer, in each instance, an equally straightforward "no." Yet India tries to introduce complicated theories to distract the Panel from its real purpose in bringing this case - to impose on the United States its preferred rules of origin. India would have the Panel believe that it is concerned about the "serious abuse" of the *RO Agreement* on the part of the United States, yet if that were so, India would have brought this case eight years ago, when the rules were adopted. No, India's apparent motivation in bringing this case was the rejection by the United States of an unrelated request for greater access to the United States market. However, there is no "serious abuse" of the *RO Agreement* here, whether from a literal or practical standpoint. As the United States has noted before, the codification of the rules in section 334 largely clarified what was already existing practice under pre-334 customs regulations. Thus, it is unclear how the withdrawal of section 334 or section 405 (the "first objective" of the dispute settlement mechanism) would meet India's wishes.

2. Section 334

3.252 India ignores its burden to show that section 334 was enacted to pursue trade objectives and instead raises several ineffectual and somewhat puzzling arguments. First, India attempts to shift the burden of proof to the United States by arguing that the United States has not addressed its claim of protectionism. Of course, the United States has indeed argued throughout these proceedings that the purpose of section 334 was not to protect the United States textile industry, and, more importantly, that India has not shown that one of section 334's four stated objectives, preventing circumvention, was a smokescreen for protectionism.

3.253 Now, in its second submission, India "refines" its claim to be one of inferring protectionism from "quota effect." Not surprisingly, India's contention is a gross oversimplification of a complex worldwide production and trade network. Section 334 did not always shift origin to developing countries under tight quotas. In fact, at the time the rules of origin were implemented, and thereafter, six out of the top ten world exporters of cotton fabrics, accounting for 50 percent of world trade in cotton fabric, were countries that were not subject to quantitative restraints on fabric or bed linen in the United States. Thus, depending on particular and company-specific sourcing patterns, the application of section 334 rules was as likely to result in goods falling outside of quotas as it was to goods migrating into quotas. Neither is India helped by China's position that changes in rules of origin *per se* are inconsistent with Article 2(b) because the changes create effects that render them protective of the domestic industry, because clearly such an effect has not been demonstrated by China. Furthermore, even before section 334, most cotton bed linen imported into the United States originated in the country where the greige fabric was formed because bed linen is normally either dyed *or* printed, but rarely dyed *and* printed. Moreover, no amount of arguments focused on creating a debate about what circumvention may or may not mean to different Members, or attempts at redrafting the ATC, can change the fact that the United States has been quite clear regarding the "use" of section 334 - it was to further goals set forth in the SAA, which are entirely consistent with and supportive of the objectives of the *RO Agreement* itself.

3.254 India therefore asks the Panel to make a determination that the objectives stated in the SAA are not true and instead *imply* that the real reason was protectionism. Such a conclusion would be unsupported by WTO jurisprudence and any reading of Article 2(b) of the *RO Agreement*. India claims, the "design, structure and architecture" of section 334 reveals the protectionist intent. But India apparently does not feel that it should bear the burden of showing how the design, structure and architecture of section 334 reveals such an intent, but rather claims that it is the United States' burden to rebut an assertion that it has not established. Moreover, it is simply not credible to interpret this provision as meaning that whenever new rules come into force they should be presumed to have a restrictive, distorting or disruptive trade effect when there is no agreement on what the specific rules should be, such that a variation could be assumed to have these effects. India wants a standard that *presumes* an adverse effect on trade anytime a rule of origin is changed, in direct contravention of the words of the *RO Agreement*. Such a standard is not acceptable.

3.255 India has not made a case as to why a GATT Article I, III, or XI analysis should be relevant here, rather than looking to the ordinary meaning of the text (that is, within the "four corners" of the *RO Agreement*). Accordingly, the United States will only briefly review the arguments we made in our second submission. First, as the United States explained in its second submission, India's "conduct oriented approach" pre-supposes that mere *adoption* of a rule of origin will have an "immediate impact" that distorts or restricts trade. This argument is, at best, circular. As is the case with each of its claims, India's argument appears to envision either that Members adopt product-specific rules which result in outcomes it agrees with, or that Members may never change their rules or institute a product-specific origin regime. India's argument reads out of Article 2(c) its primary element "restrictive, distorting or disruptive effects on international trade." India's case is founded upon an unsupported claim that its trade *has* suffered as a result of the change in the United States rules of origin. The only evidence that India has so far presented to this Panel regarding its Article 2(c) claim is a facsimile message from one of its exporting associations claiming that its members have been "adversely impacted by section 334."¹¹⁶ Not only does this claim stand in stark contrast to actual United States import statistics, but the second example in the fax seems to indicate that Indian fabric exporters actually benefitted from section 334, as they were able to develop new business opportunities in China.

¹¹⁶ In addition, as noted above, India only commenced these proceedings when it did not get an increase in its United States quota, and after India apparently decided not to pursue its claim under ATC procedures.

3.256 India's interpretation is inconsistent with the text of Article 2(c) and is unnecessary. If the drafters of the *RO Agreement* had wanted a *per se* rule, they would have adopted one, but they did not. In addition, with respect to India's attempt to import into the *RO Agreement* the product discrimination standard of GATT Articles I and III, the drafters must certainly have been aware of GATT Articles I and III and if they had wanted to adopt a product discrimination standard for Article 2(c), they could have done so -- but they did not. The United States submits that Members chose not to adopt such a standard because product differentiation *is* allowed under the *RO Agreement* (India seems to confuse differentiation with discrimination).

3.257 India argues that the Panel should look at the effects of a change in rules of origin on conditions of competition in its answer to Panel question 26. This argument is misguided. As a preliminary matter, the United States notes again that the text of Article 2(c) does not discipline changes in rules of origin *per se*; instead, it applies to rules of origin "themselves." Thus, the type of comparative argument suggested by India is precluded by the text of Article 2(c) itself. Moreover, the fact that Article 2(i) sets forth specific disciplines on changes in rules of origin and does so expressly further indicates that 2(c) was not meant to discipline changes *per se*. The panel must examine whether the United States rules, as enacted, "create restrictive, distorting, or disruptive effects on international trade," not whether the change in United States rules altered conditions of competition. In its questions to India (question 28(e)), the Panel correctly noted that under India's interpretation of 2(c), "Members cannot introduce changes to their rules of origin, given that different rules of origin are almost bound to produce different trade effects. " Furthermore, at no time does India present analysis, pursuant to the WTO jurisprudence that it claims supports its interpretation of Article 2(c), of how section 334 "changed the competitive conditions."

3.258 Even if the Panel, in our view mistakenly, were to decide to adopt India's argument equating "effects on international trade" with "effects on conditions of competition created by a Member's conduct," the United States must emphasize that the question is whether the United States rules, themselves, had such effects, not whether the *changes* in the United States rules had such effect. As the United States rules reflect common international practice, are based on criteria related to production, and reflect where the most recent substantial transformation took place, the rules themselves cannot be found to create restrictive, distorting, or disruptive effects on international trade. Finally, the United States wonders, under India's analysis, what do the words "create effects" mean in Article 2(c)? If the drafters used that term instead of the terms found in GATT Articles III and XI, is not the logical conclusion that the drafters did not intend to draw from those articles? And how is the Panel to assess how a rule creates an "immediate impact"?

3.259 In addition to our arguments in our second submission, the United States calls the attention of the Panel to Exhibit US-9, which we are submitting today, and which shows year after year of steady increases in United States imports from India and from the world (mostly double-digit increases) in the categories that seem to be of core interest to India in this dispute, i.e., those under the "fabric formation" rule (identified in footnote 23 of India's first submission). These include bed linens, table linens and bath (toilet) linens classified in HTS heading 6302. For these categories, the trade data do not bear out any claim of disruption, distortion or restriction. Indeed, the data show increases in imports in the period 1995 - 1997 that are especially steep.

3.260 Again, it appears to be India's opinion, which it is not free under the *RO Agreement* to impose on the United States, that no distinction should be made in determining the origin of silk versus wool fabrics, and that the distinction that is made by the United States is unrelated to the "economic link" between the country claiming origin and the country where the product underwent the most significant processing. Neither does India even make an attempt to support its allegations that the rules impose "unduly strict requirements," other than for the Panel to assume that the rules set out in section 334 are burdensome. India has similarly not met its burden under Article 2(d) with respect to either section 334 or section 405. Indeed, the United States notes that this claim appears to relate only to section 405.

3. Section 405

3.261 Turning then to India's claims under section 405, we will first address India's claim at paragraph 34 of its second submission that the United States has cited circumvention as the reason for section 405. This claim is at best disingenuous. The United States has always been clear that the purpose of section 405 was to implement an agreement between the United States and the European Communities. And how else, since we were *changing* rules, would we implement a settlement agreement on its terms other than with the specific terms of the agreement reached with the European Communities? As we have also made clear, we do not accept that settling a dispute with another Member, on the terms agreed to, is an illegitimate "trade objective" for purposes of Article 2(b).

3.262 India also appears to argue one theory for both its Article 2(c) and 2(d) claims in respect of section 405 - "differential treatment." India begins with a discussion of WTO "like product" discrimination jurisprudence. With respect to India's arguments that its Article 2(c) claim is supported by the Appellate Body's findings in *EC – Bananas II* and *Canada – Autos*, as the United States explained in our second submission at paragraph 19, we are not proposing that the Panel balance more favorable treatment for some products with less favorable treatment for others. In addition, as the United States has previously noted, Article 2(d) addresses discrimination among Members – that is, applying different rules to different Members with respect to the *same* product – not discrimination between domestic *versus* imported products, or among imported products. Moreover, the issue for India here is not a showing of *de jure* as opposed to *de facto* discrimination. India makes no effort to meet either test. Neither does the panel report in *Canada- Pharmaceuticals Patents* save India's case. As the United States has previously noted, this dispute is not a product-discrimination case and Article 2(d) is not about product discrimination. Even if the United States were to accept that the panel report in that dispute were relevant here, India has not shown that the "actual effect" of section 405 is to impose "differentially disadvantageous consequences" on India, or China or the Philippines *and* that those differential effects are wrong or unjustifiable, as is the basis for the panel's reasoning in *Canada - Pharmaceuticals Patents*.

4. Conclusion

3.263 India spins a confusing web of theories in its effort to find some legal basis for its claims that section 334 and section 405 were adopted for impermissible reasons; restrict, distort and disrupt trade; and that section 405 is discriminatory. However, supposition or the ascribing by implication of nefarious purposes cannot give India the proof it lacks that the United States rules of origin are inconsistent with Article 2(b) of the *RO Agreement*. Neither can complicated linkages to WTO like product discrimination jurisprudence save India from its failure to show, based on even its theories, a factual foundation for its claim that the rules adversely affect trade. Finally, India makes an attempt to transfer a variation of its "competitive conditions" analysis to its claims that the rules discriminate in favor of the European Communities in violation of Article 2(d). Sweeping interpretive statements, without applying the facts of this case, barely rise to the level of assertion, much less a rebuttable *prima facie* showing. None of this analysis demonstrates inconsistency with Article 2(d). India's case was and always has been totally without merit.

IV. ARGUMENTS OF THE THIRD PARTIES

4.1 The arguments presented by China, the European Communities, and the Philippines in their written submissions and oral statements are reflected in the integrated summaries below.¹¹⁷ The third parties' answers to questions and comments on each other's responses are reproduced in Annex [...].

¹¹⁷ The summaries of the third parties' arguments are based on the executive summaries submitted by the third parties to the Panel.

A. THIRD-PARTY SUBMISSION OF CHINA

4.2 China believes that United States rules of origin set forth in section 334 of the United States Uruguay Round Agreements Act and certain modifications thereto contained in section 405 of the United States Trade and Development Act of 2000 are inconsistent with the obligations of the United States under Article 2 of the Agreement on Rules of Origin (*RO Agreement*). These United States enactments undermine one of the primary achievements of the Uruguay Round – the commitment by Members to trade-neutral rules of origin that are not used as instruments to pursue trade objectives and that do not create restrictive, distorting and disruptive effects on international trade.

4.3 *First*, the United States, by changing its rules to confer origin on the basis of criteria that are unrelated to value added and to changes in the nature of the product, but instead were explicitly intended to assuage the concerns of the United States textile industry, violated its obligations under Article 2(b) of the *RO Agreement*. This Article prohibits Members from pursuing, directly or indirectly, their trade objectives by using rules of origin as an instrument in that pursuit. A textual analysis of Article 2(b), as well as its objective and purpose, shows that while Members may use measures or commercial policy instruments to pursue trade objectives, they are prohibited from using their rules of origin to achieve such trade objectives.

4.4 The structure, legislative history and text of section 334 establish that the United States is pursuing its trade objectives – namely, the protection of its domestic textile industry – by changing pre-existing origin rules that were based on an examination of whether the product was "substantially transformed," to a new regime that confers origin on the basis of *per se* criteria that take no account of the value added or significance of the change in characteristics of the product as a result of subsequent processing, assembly or manufacturing that occurs in a third country. The new rules of origin provided for in section 334 move the United States position away from those of its major trading partners, such as the European Communities and Canada. In contrast to the United States origin rules as they existed prior to the enactment of section 334, the new United States determination of origin of a given textile product no longer considers the nature and extent of the processing operations in a third country – it rests instead on a *per se* rule regarding the nature of the underlying fabric. The United States change in the definition of a product's origin by applying *per se* rules that fail to account for the nature and degree of subsequent processing in a third country serves no other purpose than that of protecting the United States domestic textiles and apparel industry. Indeed, the United States position that changes to its rules of origin were necessary "to reduce circumvention of quota limits through illegal transshipment" amounts to an admission that the modifications to its rules of origin were used as an instrument to pursue trade objectives. Rather than enacting means to ensure true and correct information on the source of materials and processes under its previous origin rules, the United States simply changed the substantive origin rules so that such information was no longer relevant.

4.5 *Second*, by further modifying its origin rules to create exceptions for certain articles of special interest to the European Communities, and for the sole purpose of providing favorable market access in order to settle an existing WTO dispute settlement proceeding with the European Communities, the United States violated its obligations under Article 2(b) of the *RO Agreement*. The structure, legislative history and text of section 405 shows that it was carefully drafted to favor imports from the European Communities over those from other countries, thus operating as an instrument to pursue United States trade objectives.

4.6 As a result of the European Communities's challenge to the new rules of section 334, and the consultations that followed, it is apparent that the United States was prepared to re-work its section 334 origin rules specifically for the products that were of concern to the European Communities, but not for any other products. The United States committed to change back to its prior rules solely with regard to those products of most concern to the European Communities: silk scarves, silk accessories, dyed and printed cotton fabrics. Accordingly, the United States modified section 334 by enacting

section 405 in 2000, creating arbitrary and inconsistent reversion to the pre-section 334 rules of origin for a group of selected textile products, without any particular regard for the degree of further processing, assembly or other operations and how the extent of those further operations would change the nature of the products. The exceptions created by section 405 were defined solely by the types of *end products* imported into the United States from the European Communities and for which the European Communities expressed concern. The arbitrary result demonstrates that the rules of origin changes enacted in section 405 were used as an instrument to pursue the trade policy objectives of the United States, *i.e.* resolving its dispute with the European Communities.

4.7 *Third*, by enacting complex new rules of origin in section 334, and selective modifications thereto in section 405, that in and of themselves create restrictive, distorting and disruptive effects on international trade, the United States violated its obligations under Article 2(c),(d) and (e) of the *RO Agreement*. Article 2(c) of the *RO Agreement* prohibits Members from imposing rules of origin that "themselves create restrictive, distorting or disruptive effects on international trade." In addition, Article 2(d) provides that rules of origin "shall not discriminate between other Members irrespective of the affiliation of the goods concerned." Finally, Article 2(e) provides that rules of origin should be administered "in a consistent, uniform, impartial and reasonable manner."

4.8 The rules of origin enacted by the United States in section 334, as modified by section 405, are inconsistent with the obligations of the United States under Article 2(c),(d) and (e). Trade is distorted, disrupted and restricted as a result of arbitrary and differential treatment under rules of origin that reflect specific exemptions based on the type of fibre, rather than any criteria regarding the nature and extent of further processing and assembly in a third country. Furthermore, the section 405 modifications to section 334 discriminate among textiles imported from different Members, providing a *de facto* advantage to textile products of specific interest to the European Communities, to the disadvantage of textile products of interest to other Members. Finally, the complex and arbitrary nature of the section 334 rules of origin on textile and apparel products, particularly as modified by section 405, renders it virtually impossible that these rules can be applied in a consistent, uniform, impartial and reasonable manner.

B. THIRD-PARTY SUBMISSION OF THE EUROPEAN COMMUNITIES

1. Disciplines under Article 2 of the *RO Agreement* and their effect on Members' freedom to choose their rules of origin

4.9 Contrary to what the United States claims, if the Panel were to reach the conclusion that the United States rules are inconsistent with Article 2, its recommendation would neither be that the United States should not have any rules at all nor that it should adopt a specific set of rules. Its recommendation would simply be that the United States bring its rules of origin into conformity with its obligations under the *RO Agreement*.

4.10 The argument, however raises a general question, namely to what extent the disciplines under Article 2 of the *RO Agreement* restrict the freedom of Members to make determinations of origin and rules of origin. That question can best be approached through stating what Article 2 does not do. First, Article 2, in principle, does not oblige Members to have legislation on rules of origin. However, a Member that does not have any written rules and proceeds on a case-by-case basis, is much more vulnerable to claims under Article 2(e).

4.11 Second, Article 2 of the *RO Agreement* does not, as the United States rightly states, prevent Member from changing their rules of origin.¹¹⁸ Third, again as rightly stated by the United States,¹¹⁹ Article 2 of the *RO Agreement* does not prescribe any specific rules of origin. One might raise the

¹¹⁸ Para. 4 First Submission United States (see, *supra*, para. 3.64).

¹¹⁹ In particular in para. 8 First Submission United States (see, *supra*, para. 3.64).

question, in this context, whether the concept of substantial transformation is not an overall principle governing the *RO Agreement* and thus also inherent in Article 2. If this were the case, there would be, at least within certain limits, a substantive review of rules of origin of WTO Members during the transitional period. However, while the concept of substantial transformation was made the cornerstone of harmonisation (see Article 9 of the *RO Agreement*), it was intentionally left out of the disciplines to be applied during the transitional period.

4.12 While Members, thus, are not obliged to have a specific set of rules of origin under Article 2 of the *RO Agreement*, they are not entirely free to adopt/apply any kind of rules they like. The disciplines contained in Article 2 set limits to their sovereign right to freely choose their own rules. The rationale underlying the findings of the Appellate Body regarding Article III of the General Agreement on Tariffs and Trade 1994 (hereinafter "GATT 1994") is fully relevant here.¹²⁰

2. Article 2(b) of the *RO Agreement*

(a) "Trade objective"

4.13 The concept of "trade objectives" in this provision is unclear. The European Communities agrees with the United States that it cannot just mean any objective related to trade, including all those that are in the interest and to the benefit of all.

4.14 It is worth briefly commenting on the issue of multiple objectives in this context. Where it is established that a measure pursues several distinct objectives, the fact that one part of that measure pursues a legitimate objective (i.e. not covered by Article 2(b)) does not cure the inconsistency of other parts of the measure with Article 2(b) if the objectives pursued through those fall under that provision.

(b) "Used as instrument to pursue trade objectives directly or indirectly"

4.15 Article 2(b) clearly is about intent, not effect. Indeed, the subjective element of intent is triply present in the wording of Article 2(b). First, there is the expression "used", which can be found in the dictionary to mean "make use of (a thing), esp. for a particular end or purposes."¹²¹ The use of that word is then reinforced through the words "as instrument" which the parties have rightly identified to signify "as a means, tool or device". Second, the provision uses the expression "to pursue" which the dictionary identifies to mean, "try to obtain or accomplish, aim at."¹²² And finally, what is sought to be achieved is an "objective" which India rightly translates to signify a "goal". That conclusion is confirmed by a contextual interpretation of Article 2(b). If that provision were about effect, Article 2(c) would be devoid of substance. This would be contrary to the principle of effective treaty interpretation.¹²³

4.16 India takes a two-pronged approach based on the one hand, on the design, architecture and structure of the contested rules and, on the other hand, on the legislative history of these rules, relying on the Appellate Body's findings in the above-mentioned cases on taxation of alcoholic beverages.¹²⁴ The European Communities believes that the test applied in these cases to the interpretation of Article

¹²⁰ Appellate Body Report, *Japan – Alcoholic Beverages II*, *supra*, page 16; that finding was confirmed and further elaborated in Appellate Body Report, *Chile – Alcoholic Beverages*, *supra*, paras. 59 and 60; see also Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"* ("US – FSC"), WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619, para. 100.

¹²¹ *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. II, p. 3531.

¹²² *The New Shorter Oxford Dictionary*, *supra* footnote 9, p. 2422.

¹²³ On the principle of effective treaty interpretation see in particular Appellate Body Report, *United States – Gasoline*, *supra*, page 23.

¹²⁴ See, *supra*, footnote 121.

III of the GATT 1994, is also pertinent for the purposes of interpreting Article 2(b) of the *RO Agreement*.

(i) *Section 334 – Protection of domestic industry*

4.17 India's main contention is that section 334 confers origin on the basis of criteria that are unrelated to the value-added operations or the change in the nature of the product.¹²⁵ The European Communities questions the pertinence of this argument given that, in its view, Members are under no obligation during the transitional period to base their origin rules on the concept of substantial transformation, of which the "value added" idea is one facet. Arguing that a rule does not correspond to that idea amounts to imposing specific substantive criteria on origin rules during the transitional period, which, in the European Communities' view, cannot be read into Article 2(b) of the *RO Agreement*.

4.18 What is pertinent, on the other hand, is to show what the application of the "fabric forward" rule is designed to achieve in this specific case. Protectionist intent or an intent to increase the severity of a quota regime would be indicated if it could be demonstrated that through the switch in origin, achieved by the "fabric forward" rule, products imported into the United States now come under a strict quota, where previously they had been under no quota at all or under a more generous quota.¹²⁶ Such a "quota-effect" would show that origin rules are used to "re-apply" quantitative restrictions where these have lost their "bite" through changes in trade patterns or trade regulation. Indeed trade patterns may – and may legitimately so – change in order to "avoid" quotas by outsourcing origin-conferring processes to countries that have better market access conditions in a given country. To use origin rules to counter such changes is precisely what Article 2(b) prohibits.

4.19 As regards the legislative history, the United States legislator refers to the need to reduce circumvention of quotas. That reference would seem ambiguous. If it were used here to describe the above discussed phenomenon of changing trade patterns in order to avoid quotas, the intent to pursue a trade objective under Article 2(b) could already be established through the legislative history itself. For, as seen above, such re-organisation of trade is legitimate and Article 2(b) is precisely about preventing that origin rules be used to counter its effects. If, on the other hand, the expression were used in the sense of illegitimate circumvention, i.e. fraud on origin requirements, that objective, *per se*, would not come under Article 2(b). It would then be a matter of establishing whether, through changing origin rules in the way it was done here, the objective of preventing such fraud could indeed be achieved.

(ii) *Section 405 – Favouring the European Communities over other countries*

4.20 India seems to want to prove that the sole objective of section 405 was to settle the US/EC trade dispute.¹²⁷ Neither the United States nor the European Communities would deny that section 405 reflects the terms of the settlement reached between them. To equal settling a dispute with favouring one country over another, however, is absurd, quite apart from the fact it is contrary to the declared preference of the DSU for amicable settlements of disputes (Article 3.7). The fact that a settlement quite naturally focuses on the specific interests of the parties involved does not mean that those parties are favoured over other WTO Members. The "favouring" needs to be in the terms of the settlement themselves.

¹²⁵ See para. 51 First Submission India (*supra*, para. 3.28).

¹²⁶ This is a matter of showing which countries were traditionally the "countries of origin" for a given product in United States imports before the introduction of the "fabric forward" rule and what conditions applied to them regarding quota; and then compare to the quota conditions of those "fabric" producing countries that are now considered to be the origin of these same products.

¹²⁷ Para. 84 First Submission India (*supra*, para. 3.51).

3. Article 2(c)

(a) Points related to the meaning of certain elements

4.21 For the European Communities, Article 2 (c) is about showing *actual*, not *potential* effects. Several arguments support this view. First, if Article 2(c) were about potential effects, the drafting could have been different to reflect this idea more clearly. The provision could for example have spoken of rules being "susceptible of creating effects...". Second, if Article 2(c) were about potential effects, then there would be a considerable overlap with Article 2(b). And finally, nothing in the negotiating history indicates that Article 2(c) was intended to cover potential effects. India points to the difference between the wording used in Article 2 (c) ("effects on international trade") and that used in Article 3.2 of the Import Licensing Agreement ("effects on imports"). To the European Communities it would seem logical that Article 2(c) does not refer to effects on imports. Were Article 2 (c) restricted to effects on imports only, only the direct exporter would be protected.

(b) Existence of a de minimis threshold regarding restrictive, distorting or disruptive effects

4.22 The United States, when contending that the effect demonstrated by India does not "rise to the level of 'restriction', 'distortion' or 'disruption'" (para. 40), seems to hint to the existence of a *de minimis* threshold in Article 2(c). *De minimis* requirements where they are intended are usually spelled out by an Agreement¹²⁸ with the exception of the *de minimis* requirement read into Article III:2 second sentence of the GATT 1994 by the Appellate Body. However, proving differential treatment cannot be compared to proving an effect on trade. Therefore, the Appellate Body's findings on Article III, in this respect, cannot be applied to Article 2 (c) of the *RO Agreement*.

(c) How to demonstrate effect

4.23 It is obvious that where effects are not only different in nature (restrictive, distortive or disruptive), but are also felt on different levels of trade (up- or downstream in the chain of production/manufacture), there must be different ways of demonstrating them. There exists no single and unique standard of proof. The question of what kind of proof is required and sufficient has to be answered on a case-by-case basis. India has not presented any trade statistics. There would seem to be a number of possibilities for India to show "effects", be it on the level of exports of greige fabric, or on the level of direct exports of third countries to the United States.

4.24 Regarding the letter of the Cotton Textiles Export Promotion Council (First Submission India, Exhibit 15), the fact that the export activity ceased within the two years after section 334 has become effective is a coincidence in trends that has an indicative value. The more there are such coincidences, the stronger the indication that there is a causal link with the adoption of section 334. India, however, has only shown one such coincidence and there does not seem to be any indication that this is representative of the situation in Sri Lanka. Thus, this may not be enough to establish a *prima facie* case of violation of Article 2(c).

4.25 Finally, it is not enough to claim that the sheer complexity of rules has disruptive effects. While it is true that unnecessary complexity could lead to such effects, it still remains that those effects would have to be proven under Article 2(c) of the *RO Agreement*.

¹²⁸ For example Article 5.8 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994; Articles 27.10, 27.11 and 27.12 of the Agreement on Subsidies and Countervailing Measures; Article 6.4 of the Agreement on Agriculture; Article 9.1. of the Agreement on Safeguards.

4. Article 2(d)

4.26 India argues that section 405 is providing a *de facto* advantage to European Communities products without, however, offering any evidence for this claim. Section 405 does not distinguish between products on the basis of their origin. The "advantage" it offers is that it gives up on the fabric forward rule for a number of products. That "advantage" is accruing to all countries involved in the production of the products covered: those that produce the finished product as well as those that provide the greige fabric. Contrary to what India seems to say, there is a great number of countries that currently operate under section 405, including India itself.¹²⁹ In addition, any "new" country can engage in trade in these kinds of products and thus also benefit from the "advantage" provided in section 405.

4.27 Thus, the European Communities fails to see how the findings of the Appellate Body in *Canada - Automotive Industry* could apply to the present case.¹³⁰ Neither is there a "closed list" situation as in that case;¹³¹ nor could it be said that the advantage accruing from section 405 in practice ends up being granted only or mostly to a small number of countries.¹³²

4.28 In fact, India's problem does not lie in what has been enacted through section 405, it lies in what still remains of the fabric forward rule under section 334. Indeed, if section 405 were found to be inconsistent with Article 2 of the *RO Agreement* and were to be abolished, the "fabric forward" rule would fully apply again.

C. THIRD-PARTY SUBMISSION OF THE PHILIPPINES

4.29 In the succinct Third Party submission of the Philippines, the following claims are made:

4.30 Section 334 of the United States' Uruguay Round Agreements Act (URAA) and, subsequently, section 405 of the Trade and Development Act of 2000 (TADA), and the customs regulations implementing these legislations (the "disputed measures") create *inter alia* restrictive, distorting or disruptive effects on international trade, including on the Philippines' ability to effectively participate in the trade of these products.

4.31 The disputed measures constitute a violation of Article 2(b) of the WTO Agreement on Rules of Origin (the "Agreement") because they provide for extraordinarily complex rules of origin for textiles and apparel products under which the criteria that confer origin vary between similar products and processing operations. The Philippines agrees with India that the structure of the disputed measures, their implementation and administration, including especially the circumstances under which they were adopted, and their effect on the conditions of competition for textiles and apparel products demonstrate that they are used as instruments to pursue trade objectives, in this particular case, directly. Even if, for the sake of argument, the purposes outlined in the United States' Statement of Administrative Action could be taken as conclusive for this case, the same would still not qualify to absolve the United States of the need to amend the disputed measures and bring them into conformity with the Agreement.

4.32 It must emphasized that the United States, in recognition of the unjustifiable adverse effects of the disputed measures on Philippine trade in textiles and apparel products, entered into a series of Memorandums of Understandings (MOUs) beginning in 1997 in order to compensate the Philippines

¹²⁹ The United States imports statistics for the HS codes covered by section 405 are available on the internet at the following address: http://dataweb.usitc.gov/scripts/user_set.asp

¹³⁰ Appellate Body Report, *Canada – Autos*.

¹³¹ Ibidem, para. 73.

¹³² Ibidem, para. 81.

for the difficulties and adverse effects caused by the disputed measures. These MOUs, on their face, were clearly not intended to serve as a transition mechanism.

4.33 The disputed measures also constitute a violation of Article 2(c) of the Agreement because they create restrictive, distorting, and disruptive effects on international trade, posing unduly strict requirements, requiring the fulfilment of certain conditions not related to manufacturing or processing as a pre-requisite for the determination of the country of origin. While the United States argues on the basis of its understanding of what "restrictive, distorting, or disruptive effects on international trade" mean, these concepts need to be understood not in terms of the United States' understanding, but rather with regard to the known and proven effects of the disputed measures on international trade, that is, on the trade of other countries.

4.34 Furthermore, Article 2(c) likewise requires that the rules of origin do not pose unduly strict requirements or require the fulfilment of certain conditions not related to manufacturing or processing as a prerequisite for the determination of the country of origin. Also, Article 2(d) states that the rules of origin they apply to imports (and exports) be not more stringent than the rules of origin they apply to determine whether or not a good is domestic and shall not discriminate between other Members. On its face, the disputed measures fail on these counts because they, strangely, bifurcate the current "special rule" of origin for certain non-apparel textiles articles, with the result that some goods will have their origin determined according to where their constituent fabrics were formed (knitted or woven), while others will continue to have their origin determined according to the country where the constituent fabric was converted (by dyeing, printing, and two or more additional operations). In contrast, paragraph (4) of the URAA reveal less stringent rules in determining whether a good is domestic.

4.35 Finally, the disputed measures are a violation of Article 2(e) of the Agreement as they are not being administered in a consistent, uniform, impartial, and reasonable manner and thus discriminate between Members. Contrary to the United States' assertions, one cannot segregate the language of law from that of its administration. If the language of the law is violative then its administration cannot be any different; otherwise, such administration would have the absurd consequence of being violative of the very law supposed to be administered. In any event, under Article XVI:4 of the Marrakesh Agreement Establishing the WTO, the United States has the obligation to ensure the conformity of its laws, regulations and administrative procedures with its obligations. If the disputed measures do not and cannot on their face lend themselves to proper administration in a consistent, uniform, impartial and reasonable manner, any attempt at discussing the fine differences between the rule itself and its administration is futile and could not have been the intention of Article 2(e).

4.36 Accordingly, the Philippines requests the Panel to find that the disputed measures as set out in section 334 of the URAA and modified in section 405 of the TADA, and the customs regulations implementing these statutory provisions, and the application of these measures, are inconsistent with the obligations of the United States under Article 2, paragraphs (b), (c), (d) and (e) of the Agreement on Rules of Origin. In this light, the Philippines respectfully requests that the Panel recommend that the United States bring the disputed measures and their implementing measures into conformity with the Agreement on Rules of Origin.

V. INTERIM REVIEW

5.1 In letters dated 23 April 2003, India and the United States informed the Panel that they had no comments on the interim report issued to the parties on 11 April 2003. India and the United States also informed the Panel that they did not wish to request a meeting with the Panel on the interim report. Accordingly, consistent with Article 15.2 of the DSU, the Panel's interim report became the Panel's final report. The Panel corrected several typographical errors.

VI. FINDINGS

A. MEASURES AT ISSUE

6.1 The measures at issue in this dispute are:

- (a) Section 334 of the US Uruguay Round Agreements Act¹³³ (hereafter "section 334"), which entered into force on 1 July 1996,
- (b) the clarification of section 334 contained in section 405 of the United States Trade and Development Act¹³⁴ (hereafter "section 405"), which entered into force on 18 May 2000, and
- (c) the customs regulations contained in 19 C.F.R. § 102.21¹³⁵, which implement the aforementioned statutory provisions.

6.2 Section 334, as amended, is codified at 19 U.S.C. § 3592. In this Report, we will use the term "section 334" to refer to those parts of section 334, as amended, which were not affected by the amendments made by section 405. Similarly, we will use the term "section 405" to refer to those parts of section 334, as amended, which incorporate the amendments made by section 405.

6.3 Section 334 and section 405 lay down rules of origin, *inter alia*, for fabrics and certain made-up non-apparel articles assembled in a single country from single country fabric. The latter category of goods, also referred to in this Report as "flat goods", include goods of export interest to India, notably bedding articles (bed linen, quilts, comforters, blankets, etc.) and home furnishing articles (wall hangings, table linens, etc.).

6.4 Section 334 provides, in relevant part, that fabrics and made-up non-apparel articles falling under 16 specified HTS 4-digit headings¹³⁶ – essentially flat goods – are considered to originate in the country where the fabric is woven, knitted or otherwise formed, regardless of any further finishing operations which may have been performed in respect of the fabrics or articles concerned.¹³⁷ The parties have in some instances referred to this rule of origin as the "fabric forward" rule. We prefer to use the term "fabric formation" rule.

6.5 Section 405 provides, in relevant part, for two exceptions from the fabric formation rule established by section 334. The *first* exception created by section 405 is that fabric classified under the relevant HTS headings as of silk, cotton, man-made or vegetable fibre are considered to originate in the country in which the fabric is both dyed and printed when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing. We will refer to this rule as the "DP2" rule, and to the relevant operations as "DP2 operations". The DP2 rule does not apply to wool fabric, which, therefore, remains subject to the fabric formation rule established by section 334.

¹³³ Pub. Law 103-465, 108 Stat 4809, enacted on 8 December 1994, and codified at 19 U.S.C. § 3592. For the text of section 334, see, *supra*, para. 2.2.

¹³⁴ Pub. Law 106-200, entitled "Clarification of Section 334 of the Uruguay Round Agreements Act", enacted on 18 May 2000, and codified at 19 U.S.C. § 3592. For the text of section 405, see, *supra*, para. 2.5.

¹³⁵ Reproduced, in relevant part, in Annex C.

¹³⁶ For a list of the goods concerned, see *supra*, para. 2.3. India notes that one of the 16 HTS headings refers to goods which are deemed to originate where the yarn was produced. India's first written submission, para. 36.

¹³⁷ United States' reply to Panel question No. 7.

6.6 The *second* exception created by section 405 is that made-up non-apparel articles classified under seven of the 16 HTS 4-digit headings specified in section 334¹³⁸ are subject to the DP2 rule, except where such articles are classified under the relevant headings as of cotton or of wool or consisting of fibre blends containing 16 percent or more by weight of cotton. The articles classified under the relevant headings as of cotton or of wool or consisting of fibre blends containing 16% or more by weight of cotton remain subject to the fabric formation rule established by section 334.¹³⁹

6.7 The two tables reproduced below reflect in simplified form our understanding of the relevant provisions of section 334 and section 405.

Table 1 – Origin of Fabrics

| <u>ORIGIN OF FABRICS</u> | | |
|---|---|---|
| ORIGIN-CONFERRING PROCESS | FABRIC-FORMATION (KNITTING, WEAVING, ETC.) | DYEING & PRINTING OF FABRIC & TWO OR MORE SPECIFIED FINISHING OPERATIONS ("DP2") |
| Wool fabrics | YES (section 334(b)(1)(C)) | NO |
| Other fabrics (silk, cotton, man-made fibres and vegetable fibres) | YES (section 334(b)(1)(C), unless subsequently subjected to DP2) | YES (section 405(a)(3)(B)) |

¹³⁸ For a list of the goods concerned, see *supra*, para. 2.7.

¹³⁹ It is our understanding from the parties' submissions that, under the United States' regulations applicable before section 334 entered into force, DP2 operations were normally considered significant enough, for fabrics and certain flat goods, to confer origin. United States' replies to Panel questions Nos. 33 and 47(a); India's first written submission, paras. 14-15.

Table 2 – Origin of Made-Up Articles Assembled in a Single Country from Single Country Fabric(s)

| <u>ORIGIN OF MADE-UP ARTICLES ASSEMBLED IN SINGLE COUNTRY FROM SINGLE COUNTRY FABRIC(S)</u> | | | |
|--|---|---|-------------------------------|
| ORIGIN-CONFERRING PROCESS | FABRIC-FORMATION (KNITTING, WEAVING, ETC.) | DYEING & PRINTING OF FABRIC & 2 OR MORE SPECIFIED FINISHING OPERATIONS ("DP2") | "WHOLLY ASSEMBLED" |
| Articles (scarves, bed linen, etc.) specified in section 334(b)(2)(A) and section 405(a)(3)(C) and made of: | | | |
| - Wool | YES (section 334(b)(2)(A)) | NO | NO |
| - Cotton | YES (section 334(b)(2)(A)) | NO | NO |
| - Cotton blends (more than 16% cotton by weight) | YES (section 334(b)(2)(A)) | NO | NO |
| - Other (silk, man-made fibres, vegetable fibres) | YES (section 334(b)(2)(A), unless subsequently subjected to DP2) | YES (section 405(a)(3)(C)) | NO |
| Articles which are "knit to shape" (e.g., stockings) | YES (section 334(b)(2)(B), although "knitting-to- shape" is not considered fabric making, but component or article formation) | NO | NO |
| Other articles (including apparels) | NO | NO | YES (section 334(b)(1)(D)) |

6.8 It should be noted that the rules of origin contained in section 334, as amended, are used by the United States "for purposes of the customs laws and the administration of quantitative restrictions".¹⁴⁰ They are, accordingly, used not only for the administration of quantitative restrictions, but also for such purposes as the gathering of trade statistics, origin marking and administering MFN customs duties.¹⁴¹ However, the present dispute primarily arises from the application of section 334, as amended, for the purpose of administering the textile quota regime maintained by the United States pursuant to the provisions of the *Agreement on Textiles and Clothing*.¹⁴² Thus, this dispute concerns the use of rules of origin in support of a trade policy instrument – quotas – which, by definition, is trade-restrictive. The United States even acknowledges that the textile quota regime has been put in place "for the purpose of protecting its domestic industry during the [...] transition period [provided for in the *Agreement on Textiles and Clothing*]"¹⁴³.

6.9 Regarding the customs regulations contained in 19 C.F.R. § 102.21, it is sufficient to note that they were promulgated pursuant to section 334(a) and amended, on an interim basis, to take account

¹⁴⁰ Section 334(b)(1).

¹⁴¹ United States' reply to Panel question No. 34.

¹⁴² India's first oral statement, paras. 8 and 11.

¹⁴³ United States' second written submission, para. 10.

of the amendments made to section 334 by section 405. The regulations contained in 19 C.F.R. § 102.21, including the interim amendments, are legally binding.¹⁴⁴

B. OVERVIEW OF THE PARTIES' CLAIMS AND ARGUMENTS

6.10 **India** claims that the United States rules of origin set out in section 334 and modified in section 405 and the customs regulations implementing these statutory provisions, and the application of these statutory provisions and implementing regulations:¹⁴⁵

- (a) are being used by the United States as instruments to pursue trade objectives, thereby violating Article 2(b) of the *RO Agreement*. Section 334 is being used as an instrument to protect the United States' textile and apparel industry. Section 405 is being used as an instrument to favour imports of the products of concern to the European Communities;
- (b) create restrictive, distorting and disruptive effects on international trade and are, therefore, inconsistent with the United States' obligations under Article 2(c), first sentence, of the *RO Agreement*;
- (c) require the fulfilment of a certain condition not related to manufacturing or processing and pose unduly strict requirements and are, therefore, inconsistent with Article 2(c), second sentence, of the *RO Agreement*; and
- (d) with respect to section 405, discriminate between Members, and in particular, discriminate in favour of the European Communities and are, therefore, inconsistent with the United States' obligations under Article 2(d) of the *RO Agreement*.¹⁴⁶

6.11 Based on these claims, India requests that the Panel find that the measures at issue, and their application, are inconsistent with the United States' obligations under Article 2(b), (c) and (d) of the *RO Agreement*, and that the Panel recommend that the United States bring its measures into conformity with its obligations under the *RO Agreement*.¹⁴⁷

6.12 The **United States** argues that the rules of origin at issue are not inconsistent with Article 2(b), (c) or (d). According to the United States, these rules were enacted to combat circumvention of established quotas, prevent transshipment, facilitate harmonization and best capture where a new product is formed. The United States further argues that these rules of origin were offered on an MFN basis, in accordance with WTO rules. In the view of the United States, the measures at issue are therefore not inconsistent with the *RO Agreement*. Rather, they facilitate the flow of international trade, consistent with the terms of the preamble to the *RO Agreement*.

6.13 Based on these arguments, the United States requests that the Panel find that India has failed to establish that the measures at issue are inconsistent with Article 2(b), (c) and (d) of the *RO Agreement*.

¹⁴⁴ United States' reply to Panel question No. 54(a); India's reply to Panel question No. 54(a); *supra*, para. 2.8.

¹⁴⁵ India's first written submission, para. 8; India's second written submission, para. 75.

¹⁴⁶ India's second oral statement, para. 18.

¹⁴⁷ India initially also claimed that the criteria used in section 334 and section 405 are so complex and arbitrary that it is nearly impossible to administer these statutory provisions in a consistent, uniform, impartial and reasonable manner and that these provisions are, therefore, inconsistent with Article 2(e) of the *RO Agreement*. India's first written submission, para. 101. India later abandoned this claim. India's second written submission, footnote 37.

6.14 The **Panel** notes that, in response to its questions, India has clarified that its claims concern the imposition and maintenance by the United States of the rules of origin set out in section 334 and section 405, and implemented through customs regulations, not the fact that the United States changed its rules of origin in 1996 and 2000.¹⁴⁸ As a result, we understand India's complaint to be in respect of the results of the United States' legislative changes made in 1996 and 2000, not the fact that changes were made.¹⁴⁹

C. PRELIMINARY REMARKS

6.15 This is the first time a panel has been called upon to interpret and apply the provisions of the *RO Agreement*. It is therefore appropriate, briefly to address, as a preliminary matter, the general issues of the allocation of the burden of proof, the applicable rules of interpretation and the nature of the disciplines prescribed by the provision at issue in this dispute, Article 2 of the *RO Agreement*.

1. Burden of proof

6.16 The rules concerning burden of proof are well established in WTO jurisprudence. In *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses*, the Appellate Body stated that:

"[...] the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption."¹⁵⁰

6.17 Once the Panel determines that the party asserting the affirmative of a particular claim or defence has succeeded in raising a presumption that its claim is true, it is incumbent on the Panel to assess the merits of all the arguments made and the admissibility, relevance and weight of all the factual evidence submitted with a view to establishing whether the party contesting a particular claim has successfully rebutted the presumption raised. If the arguments and evidence adduced by the parties remain in equipoise, the Panel must, as a matter of law, find against the party who bears the burden of proof.

6.18 In this case, it is for India as the complaining party to establish the violations of the *RO Agreement* it alleges. Specifically, it is for India to submit arguments and evidence sufficient to raise a presumption that the measures at issue are inconsistent with the United States' obligations under the *RO Agreement*. Once it has done so, it is for the United States to rebut that presumption.

2. Applicable rules of interpretation

6.19 Article 3.2 of the DSU provides that panels are to clarify the provisions of "covered agreements" in accordance with customary rules of interpretation of public international law. The *RO Agreement* is one of the "covered agreements" subject to the DSU.¹⁵¹ It is clear from Appellate Body jurisprudence that Articles 31 and 32 of the Vienna Convention on the Law of Treaties (the "Vienna Convention")¹⁵² are part of the customary rules of interpretation of public international

¹⁴⁸ India's reply to Panel questions Nos. 15 and 18.

¹⁴⁹ *Ibid.*

¹⁵⁰ Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India* ("United States – Wool Shirts and Blouses"), WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323; at 335.

¹⁵¹ Appendix 1 of the DSU.

¹⁵² Vienna Convention on the Law of Treaties, done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; (1969) 8 International Legal Materials 679.

law.¹⁵³ Pursuant to Article 31(1) of the Vienna Convention, the duty of a treaty interpreter is to interpret a treaty in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. If, after applying the rules of interpretation set out in Article 31(1), the meaning of the treaty remains ambiguous or obscure or leads to a result that is manifestly absurd or unreasonable, Article 32 allows the treaty interpreter to have recourse to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion.

6.20 These rules of interpretation are equally applicable to the provisions of the *RO Agreement*.

3. Disciplines prescribed by Article 2 of the *RO Agreement*

6.21 All of India's claims are based on the provisions of Article 2 of the *RO Agreement*. Article 2 lays down disciplines governing Members' application of non-preferential rules of origin "[u]ntil the work programme for the harmonization of rules of origin set out in Part IV [of the *RO Agreement*] is completed".¹⁵⁴ After this "transition period"¹⁵⁵, i.e., "upon implementation of the results of the harmonization work programme"¹⁵⁶, Members will apply harmonized rules of origin and the application of those rules will be subject to the provisions of Article 3 of the *RO Agreement*.

6.22 As of the date of establishment of this Panel, the work programme for the harmonization of rules of origin set out in Part IV of the *RO Agreement* had not been completed. As a result, India is entitled to invoke the provisions of Article 2 of the *RO Agreement*.

6.23 With regard to the provisions of Article 2 at issue in this case – subparagraphs (b) through (d) – we note that they set out what rules of origin should not do: rules of origin should not pursue trade objectives directly or indirectly¹⁵⁷; they should not themselves create restrictive, distorting or disruptive effects on international trade¹⁵⁸; they should not pose unduly strict requirements or require the fulfilment of a condition unrelated to manufacturing or processing¹⁵⁹; and they should not discriminate between other Members¹⁶⁰. These provisions do not prescribe what a Member must do.

6.24 By setting out what Members cannot do, these provisions leave for Members themselves discretion to decide what, within those bounds, they can do. In this regard, it is common ground between the parties that Article 2 does not prevent Members from determining the criteria which confer origin¹⁶¹, changing those criteria over time¹⁶², or applying different criteria to different goods¹⁶³.

¹⁵³ See, e.g., Appellate Body Reports, *United States — Standards for Reformulated and Conventional Gasoline* ("*United States — Gasoline*"), adopted 20 May 1996, DSR 1996:I, p. 16; *Japan — Taxes on Alcoholic Beverages* ("*Japan — Alcoholic Beverages II*") WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, p. 104; *India — Patent Protection for Pharmaceutical and Agricultural Chemical Products* ("*India — Patents (United States)*"), WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, para. 46; *European Communities — Customs Classification of Certain Computer Equipment* ("*EC — Computer Equipment*"), WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, adopted 22 June 1998, DSR 1998:V, para. 84; and *United States — Shrimp*, para. 114.

¹⁵⁴ Chapeau of Article 2 of the *RO Agreement*.

¹⁵⁵ Title of Article 2 of the *RO Agreement*.

¹⁵⁶ Article 3 of the *RO Agreement*.

¹⁵⁷ Article 2(b) of the *RO Agreement*.

¹⁵⁸ Article 2(c), first sentence, of the *RO Agreement*.

¹⁵⁹ Article 2(c), second sentence, of the *RO Agreement*.

¹⁶⁰ Article 2(d) of the *RO Agreement*.

¹⁶¹ India's first oral statement, para. 5; India's reply to Panel question No. 4; United States' first oral statement, para. 3.

¹⁶² India's first oral statement, para. 6; United States' first oral statement, para. 3.

¹⁶³ India's first oral statement, para. 6; United States' first written submission, para. 8.

6.25 Accordingly, in assessing whether the relevant United States rules of origin are inconsistent with the provisions of Article 2, we will bear in mind that, while during the post-harmonization period Members will be constrained by the result of the harmonization work programme, during the transition period, Members retain considerable discretion in designing and applying their rules of origin.

D. INDIA'S CLAIMS IN RESPECT OF SECTION 334 AND SECTION 405

6.26 In this Section, the Panel will assess India's claims in respect of the statutory provisions at issue in this dispute, *i.e.*, section 334 and section 405. In the next Section, the Panel will assess India's claims in respect of the customs regulations implementing these statutory provisions.

1. India's claims under Article 2(b) of the *RO Agreement*

6.27 India claims that both section 334 and section 405 are inconsistent with Article 2(b) of the *RO Agreement*. The Panel will examine these claims in turn. Before doing so, however, it is necessary to address the parties' interpretation of Article 2(b).

(a) Article 2(b) of the *RO Agreement*

6.28 Article 2(b) provides as follows:

"Until the work programme for the harmonization of rules of origin set out in Part IV is completed, Members shall ensure that:

[...]

(b) notwithstanding the measure or instrument of commercial policy to which they are linked, their rules of origin are not used as instruments to pursue trade objectives directly or indirectly[.]"

6.29 **India** considers that the operative clause of Article 2(b) is the obligation that rules of origin must not be used "as instruments to pursue trade objectives". India points out that the *New Shorter Oxford English Dictionary* defines "instrument" as "a thing used in or for performing an action; a means" and "objective" as the "thing aimed at or sought; a target, a goal, an aim". India considers, therefore, that the ordinary meaning of the term "trade objective" in the context of Article 2(b) is an aim, goal, or object related to trade. According to India, for the purposes of this dispute, it is not necessary to develop a general definition of the term "trade objectives". In India's view, it is sufficient for the Panel to find that trade objectives include the objective of protecting the domestic industry against import competition or of favouring imports from one country over imports from another. India maintains that any rule of origin that is used as an instrument to protect a domestic industry or to favour imports from one country over imports from another country is an instrument to pursue "trade objectives" as that term is used in Article 2(b).

6.30 India considers that its interpretation of Article 2(b) is supported by the context. The use of the term "notwithstanding" in the preceding clause – "notwithstanding the measure or instrument of commercial policy to which they are linked" – implies a contrast between this clause and the prohibition that rules of origin must not be used to pursue trade objectives. Thus, in India's view, measures or commercial policy instruments may pursue aims, goals or objects related to trade, or trade objectives, but rules of origin may not do so either directly or indirectly. In other words, WTO Members may use rules of origin to implement commercial policy instruments of the kind listed in Article 1.2 of the *RO Agreement*, but they may not use rules of origin to pursue policy objectives of the kind commonly pursued with these policy instruments.

6.31 India contends that the object and purpose of the *RO Agreement* also supports its interpretive approach. Specifically, India notes that the seventh recital of the preamble states that Members desire, through the *RO Agreement*, "[...] to ensure that rules of origin are prepared and applied in an impartial, transparent, predictable, consistent and neutral manner". India also notes that, according to its preamble, the *RO Agreement* is "to further the objectives of the GATT 1994". According to the preamble of the GATT 1994, the GATT 1994 is to expand the production and exchange of goods through the reduction of tariffs and other barriers to trade. In India's view, one of the fundamental purposes of the *RO Agreement* thus is to ensure that the barriers to trade Members agreed to reduce in the framework of the GATT 1994 are not indirectly re-established through the use of rules of origin protecting domestic industries.

6.32 Finally, with respect to how to assess whether a rule of origin is being used as an instrument to pursue a trade objective, India submits that one way is to assess whether the rule of origin in question achieves the same results as a measure or instrument of commercial policy. India also considers it useful to examine the design, architecture, and structure of the relevant rule of origin. India recalls that the Appellate Body has noted that "[a]lthough it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the *design*, the *architecture*, and the revealing *structure* of a measure".¹⁶⁴

6.33 The **United States** agrees with India that the operative clause in Article 2(b) is the obligation that rules of origin are not to be used "as instruments to pursue trade objectives". The United States also agrees that "instrument" can be defined as "tool", "device", or "means" and that "objective" is a goal. Likewise, the United States agrees that the preamble to the *RO Agreement* provides the relevant "object and purpose" of the *RO Agreement*. However, the United States submits that India's interpretation of a "trade objective" is overly broad. The United States argues that if "trade objective" is understood to be any objective related to trade, rules of origin could not be used to pursue transparency or predictability, two trade-related goals. According to the United States, such an interpretation would be at odds with both the object and purpose of the *RO Agreement* and the context of Article 2(b).

6.34 As for India's contention that the protection of a domestic industry and the favouring of imports from one Member over imports from another would constitute "trade objectives" within the meaning of Article 2(b), the United States accepts India's contention that protection of a domestic industry is an "impermissible" trade objective for the purposes of Article 2(b). Concerning the other objective identified by India as a "trade objective" – the favouring of imports from one Member over imports from another – the United States cautions that rules of origin might have the practical effect of favouring one Member over another and that such rules could not, on that basis alone, be considered to pursue a "trade objective".¹⁶⁵ Apart from this, the United States does not raise concerns with respect to the second trade objective referred to by India. In fact, the United States suggests that "discrimination" in favour of one Member could be considered to be a "trade objective".¹⁶⁶

6.35 Regarding the issue of how it can be assessed whether a rule of origin is being used as an instrument to pursue a trade objective, unlike India, the United States does not consider that it is necessary or relevant to analyse whether the design, structure and architecture of a contested rule of origin measure reveals an "impermissible" trade objective.

6.36 The **Panel** agrees with the parties that the operative part of Article 2(b) is the phrase "rules of origin are not [to be] used as instruments to pursue trade objectives directly or indirectly". It is clear

¹⁶⁴Appellate Body Report, *Japan – Taxes on Alcoholic Beverages* ("Japan – Alcoholic Beverages II"), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97, at 120 (emphasis added by India).

¹⁶⁵United States' reply to Panel question No. 6; United States' second written submission, para. 31.

¹⁶⁶United States' second written submission, para. 29.

from this phrase that in order to establish a violation of Article 2(b), a Member needs to demonstrate that another Member is using rules of origin for a specified purpose, *viz.*, to pursue trade objectives. As noted by India, this interpretation of Article 2(b), which is not in dispute, confronts the Panel with the following two issues. *First*, how is the Panel to determine whether a Member's rules of origin are used for the purpose specified in Article 2(b)? And *second*, what are "trade objectives"?

6.37 Beginning with the *first* issue, we agree with India that the Appellate Body has already taken a position on how panels should conduct an inquiry into the objectives of a measure. The Appellate Body did so in the context of an analysis under Article III:2, second sentence, of the GATT 1994. In examining whether a tax measure was applied "so as to afford protection to domestic production", the Appellate Body stated that:

"[...] it is not necessary for a panel to sort through the many reasons legislators and regulators often have for what they do and weigh the relative significance of those reasons to establish legislative or regulatory intent." The *subjective* intentions inhabiting the minds of individual legislators or regulators do not bear upon the inquiry, if only because they are not accessible to treaty interpreters. It does not follow, however, that the statutory purposes or objectives – that is, the purpose or objectives of a Member's legislature and government as a whole – to the extent that they are given *objective* expression in the statute itself, are not pertinent. To the contrary, as we also stated in *Japan – Alcoholic Beverages*:

Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the *design*, the *architecture*, and the revealing *structure* of a measure. (emphasis added)¹⁶⁷

6.38 The reasons cited by the Appellate Body in support of its view do not appear to be specific to the provisions of Article III:2, second sentence, of the GATT 1994. Hence, these reasons apply with equal force in the context of Article 2(b) of the *RO Agreement*. Accordingly, in applying Article 2(b), we will follow the above-quoted statement by the Appellate Body.

6.39 In respect of the *second* issue, the meaning of the term "trade objectives" as it appears in Article 2(b), we recall the statement by India that, for the purposes of the present dispute, it is not necessary for the Panel to develop a general definition of the term "trade objectives". India considers that it would be sufficient for the Panel to find that the objectives of protecting the domestic industry against import competition and favouring imports from one Member over imports from another are "trade objectives" within the meaning of Article 2(b).¹⁶⁸ The United States has not objected to the Panel proceeding in this way.

6.40 In seeking to determine whether the objectives of "protecting the domestic industry against import competition" and "favouring imports from one Member over imports from another" are "trade objectives" within the meaning of Article 2(b), the Panel begins by noting that, as a textual matter, these objectives are clearly related to trade. In that sense, they could certainly be covered by the ordinary meaning of the term "trade objectives", which, as India has identified, is "goals" or "aims" related to trade.¹⁶⁹

6.41 The relevant context supports this reading of the term "trade objectives". Article 2(c), first sentence, of the *RO Agreement* provides that "rules of origin shall not themselves create restrictive, distorting, or disruptive effects on international trade". This provision reveals a concern about rules of origin inhibiting trade. Reading Article 2(b) in this context supports the interpretation that Article

¹⁶⁷ Appellate Body Report, *Chile – Taxes on Alcoholic Beverages* ("*Chile – Alcoholic Beverages*"), WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, DSR 2000:I, 281, para. 62 (footnotes omitted).

¹⁶⁸ India's second written submission, para. 24; India's first oral statement, para. 18.

¹⁶⁹ *Supra*, para. 6.29.

2(b) prohibits the use of rules of origin for the purpose of protecting the domestic industry against import competition and of favouring imports of one Member over imports from another.

6.42 More importantly, we note that the operative clause of Article 2(b) – to the effect that rules of origin should not be used as instruments to pursue trade objectives – is preceded by the phrase "notwithstanding the measure or commercial policy instrument to which they are linked". This phrase implies that, whereas rules of origin may not pursue "trade objectives", commercial policy measures or instruments may do so. It follows that the "trade objectives" mentioned in the operative clause of Article 2(b) would include the kind of policy objectives which trade policy measures or instruments typically pursue. Plainly, the objectives of "protecting the domestic industry against import competition" and "favouring imports from one Member over imports from another" fit within this category.

6.43 Finally, we believe that interpreting the term "trade objectives" as suggested by India is consistent with the objective of Article 2(b). In our view, Article 2(b) is intended to ensure that rules of origin are used to implement and support trade policy instruments, rather than to substitute for, or to supplement, the intended effect of trade policy instruments. Allowing Members to use rules of origin to pursue the objectives of "protecting the domestic industry against import competition" or "favouring imports from one Member over imports from another" would be to substitute for, or supplement, the intended effect of a trade policy instrument and, hence, be contrary to the objective of Article 2(b).

6.44 Taken together, the foregoing considerations lead us to the conclusion that the objectives identified by India – *i.e.*, the objectives of "protecting the domestic industry against import competition" and of "favouring imports from one Member over imports from another" – may, in principle, be considered to constitute "trade objectives" in pursuit of which rules of origin may not be used.

6.45 Bearing in mind the above conclusions, we now turn to examine whether section 334 is inconsistent with Article 2(b), as claimed by India.

(b) Consistency of section 334 with Article 2(b) of the *RO Agreement*

6.46 **India** argues that an examination of the design, architecture, and structure of section 334 shows that it is used as an instrument to pursue the objective of protecting the domestic textiles and apparel industry. India submits that section 334 confers origin on the basis of criteria that are unrelated to the value added operations or the change in the nature of the product. Instead, the criteria are those that are commonly used in the application of commercial policy instruments.

6.47 India considers that the new rules of origin moved the United States away from those used by its major trading partners such as the European Communities and Canada. To India's knowledge, no other country determines origin on the basis of the place where the greige fabric was formed, if that fabric was further processed and made into a flat good, thereby reflecting the importance of cutting and sewing to produce a finished product. India notes that greige fabric, and even dyed and printed greige fabric, can be put to a variety of uses. India points out that, in contrast, once the fabric is cut and sewn into a pillowcase, no one can use that fabric for anything other than a pillow case.

6.48 India argues that the fact that the "fabric forward" rule set out in section 334 is used for a wide variety of non-apparel flat textile articles, such as bedding articles (quilts, comforters, mattresses, blankets), home furnishings (wall hangings, table linens) and fashion accessories such as scarves, shows that the section 334 rules are being used as instruments to pursue trade objectives. India notes in this respect that, for home textiles, bedding articles, furnishings, and miscellaneous made up articles, the section 334 rules work a significant change in the determination of the country of origin. India notes that under the "fabric forward" rule, these products are deemed to originate in

the country where their constituent fabric is formed (woven or knitted) in the greige state and no account is taken of any subsequent value-added operations such as the dyeing, printing or finishing of the fabric, the cutting of the fabric into components, the assembly of those components into finished articles or any other operations. India offers the example of down-filled comforters, which are classified under HTS subheading 9404.90 and subject to the fabric forward rule. According to India, this means that if the down-filled comforter was cut, sewn and assembled in country A and had a value of US \$200, it would be nevertheless determined as a product of country B if the greige fabric used in its manufacture, which cost only a few dollars, was woven in country B.

6.49 India submits that the clearly protectionist objective of section 334 can be demonstrated by its effect on the determination of origin for the products subject to section 334. India points out that the effect of section 334, especially its fabric forward provision, was that a range of textiles and clothing products imported into the United States were subjected to the strict quotas of the developing countries whereas previously they had been under no quota or a more generous quota. In India's view, the fabric forward rule increases the quantities of textile imports that are conferred the origin of the countries that are under quota.¹⁷⁰ India argues that this strengthens the impact of the United States' quota regime under the *Agreement on Textiles and Clothing* which – as the United States admits – was put in place to protect the domestic industry. According to India, the fabric forward rule is thus clearly being used to pursue a trade objective.

6.50 India further notes that, according to the Statement of Administrative Action (the "SAA") that accompanied the Uruguay Round Agreements Act¹⁷¹, the purpose of section 334 was to:

- help combat transshipment and other circumvention of textile and apparel quotas;
- bring the United States' rules of origin in line with the rules employed by other major textile and apparel importing countries;
- advance the goal of harmonizing international rules of origin set out in the *WTO RO Agreement*;
- more accurately reflect where the most significant production activity occurs.¹⁷²

6.51 With respect to the *first* objective listed in the SAA, India notes that there is a specific provision in Article 5 of the *Agreement on Textiles and Clothing* which enables countries to address the problem of "circumvention by transshipment, re-routing, false declaration concerning country or place of origin, and falsification of official documents". India points out that Article 5.2 specifically provides that "should any Member believe that [the *Agreement on Textiles and Clothing*] is being circumvented by transshipment, re-routing, false declaration concerning country or place of origin, and falsification of official documents, and that no, or inadequate, measures are being applied to address and/or take action against such circumvention, that Member should consult with the Member or Members concerned with a view to seeking a mutually satisfactory solution". In the view of India, the section 334 changes in determining the rules of origin do not assist the United States in combating transshipment and other circumvention of textile and apparel quotas.¹⁷³

¹⁷⁰ In its second oral statement, India went further and said that the fabric forward rule "by definition" increases the quantities of textile imports that are conferred the origin of the countries that are under quota. India's second oral statement, para. 8.

¹⁷¹ The SAA may be found in "Message of the President of the United States Transmitting the Uruguay Round Agreement, Text of Agreements, Implementing Bill, Statement of Administrative Action and Required Supporting Documents", H.R. Doc. No. 316, 103d Cong. 2d Sess., Vol. 1 (1994) at 656 *et. seq.*; exhibit US-6.

¹⁷² SAA, *supra*, pp. 118-119.

¹⁷³ According to India, the question arises here that if the United States believed the application of the principle of substantial transformation did not discourage transshipment or other circumvention of textile and apparel quotas and sought therefore to move away from this principle in section 334, why did it revert to the

6.52 India further notes that Article 5.1 of the *Agreement on Textiles and Clothing* provides that circumvention "frustrates the implementation of this Agreement to integrate the textiles and clothing sector into GATT 1994. Accordingly, Members should establish the necessary legal provisions and/or administrative procedures to address and take action against such circumvention [...]". India submits that *section 333* of the URAA¹⁷⁴, rather than *section 334*, was enacted to implement Article 5.1 since it tracks the language of Article 5.1 more directly, and addresses more specifically the type of circumvention noted in Article 5 of the *Agreement on Textiles and Clothing*.¹⁷⁵ According to India, this implies that *section 334* was passed for reasons other than to prevent circumvention within the meaning of Article 5.1 of the *Agreement on Textiles and Clothing*.

6.53 India points out that, notwithstanding this, the United States insists that *section 334* was passed, *inter alia*, "to prevent quota circumvention and address illegal transshipment [...]".¹⁷⁶ India points out that the definition of "circumvention" was provided by the United States when it cited with approval a commentary that the United States *was* addressing circumvention through *section 334* because "some new industrialized countries of Southeast Asia could otherwise try to circumvent the quantitative restrictions applied to their exports of textile products. They could do so by exporting semi-finished products (*in casu* dyed or printed cloths) to third countries, in the hope that the origin of those countries (for which no quantitative restrictions for exports of textile products are applied) would be attributed to the finished cloths". India submits that this is not circumvention. India recalls its view that circumvention is a term which implies a violation of the applicable origin rules through false declarations and other illegitimate means. India considers that the reaction of the market to the incentives and disincentives created by country-specific quotas cannot be described as circumvention. The newly industrialized countries of Southeast Asia were not, in the view of India, "circumventing" origin rules, but were adapting their production to their market access conditions. India considers that since the origin determinations of the products in these new trade patterns were conducted in conformity with the pre-*section 334* rules of origin, as a matter of definition, they could not constitute "circumvention".

6.54 India further notes that the European Communities rightly points out that if the expression "circumvention of quotas" was used by the United States to describe the changing of trade patterns in response to quotas, the intent to pursue a trade objective could be established through the legislative history itself. India considers that the United States' intention to combat "circumvention" corresponds, in the words of the European Communities, to an intention to "re-apply quantitative restrictions where these have lost their bite through changes in trade patterns and regulations".¹⁷⁷ In India's view, this is precisely the type of trade objective that Members are not to achieve through the use of rules of origin.¹⁷⁸ India submits that the prevention of quota circumvention as defined by the United States is the pursuit of a trade objective.

6.55 Regarding the *second* objective of *section 334* as described in the SAA, India asserts that the *section 334* rules on fabric did not bring the United States' rules of origin in line with the rules employed by other major textile and apparel importing countries or United States trading partners. India considers that, to the contrary, *section 334* was the subject of criticism in the WTO Committee on Rules of Origin. India notes, for example, that at the 1 February 1996 meeting, the representatives of Canada, the European Communities and Switzerland expressed concern with respect to the

substantial transformation principle to determine origin for some of the products listed in the specified HTS heading in *section 405*, but not all products, when it settled the dispute with the European Communities?

¹⁷⁴ Exhibit INDIA-5.

¹⁷⁵ Referring to the negotiating history, India notes that in the Senate Report, under the heading "Textile transshipments" (*section 333*), there is a reference to Article 5.1 of the *Agreement on Textiles and Clothing*. Specifically, India notes that the Report states that *section 333* of the URAA adds a new section to Title IV to address specifically the problem of textile transshipments.

¹⁷⁶ India refers to United States' first written submission, para. 29.

¹⁷⁷ India refers to European Communities' written third-party submission, para. 24.

¹⁷⁸ India refers to *ibid.*

unilateral changes of origin rules for certain textiles and apparel by the United States.¹⁷⁹ India submits that if United States had in effect changed its rules of origin in order to harmonize them with those of its major trading partners such as the European Communities and Canada, those very trading partners would not have expressed concern over those changes. India argues that the fact that the European Communities challenged the United States rules of origin in the WTO indicated that it considered the United States' rules to be fundamentally different from those of the European Communities.

6.56 With regard to the *third* objective listed in the SAA, India contends that section 334 did not advance the goal of harmonizing the international rules of origin set out in the *RO Agreement*. India points out that Article 3 of the *RO Agreement* recognises the aim of Members to achieve the establishment of harmonized rules of origin, and, in this regard, sets forth in subparagraph (b) that "Members shall ensure, upon the implementation of the results of the harmonization work programme, that: [...] (b) under their rules of origin, the country to be determined as the origin of a particular good is either the country where the good has been wholly obtained or, when more than one country is concerned in the production of the good, the country where the last substantial transformation has been carried out". In India's view, section 334 represents a step away from the basis of substantial transformation.

6.57 With regard to the *fourth* objective listed in the SAA, India considers that it is unclear how the principle of determining origin as set out in section 334(b)(2)(A), *i.e.*, that the origin for certain made-up articles is determined where the greige fabric is woven, would help the United States "more accurately reflect where the production activity takes place". In India's view, the production activity would more accurately be determined where the value is added or the last substantial transformation takes place, rather than where the greige fabric is woven.

6.58 The **United States** notes that India makes three arguments with respect to its claim that section 334 is inconsistent with Article 2(b): (1) the objective of the United States in formulating its rules of origin was to protect its domestic industry; (2) the Panel should look to the measures or instruments of commercial policy listed in Article 1.2 of the *RO Agreement* and assess whether the United States' rule of origin "achieves the same results"; and (3) "the design, architecture and structure" of section 334 "demonstrate that it was adopted to protect the domestic textile industry".¹⁸⁰

6.59 With respect to the *objectives* of the United States in formulating section 334, the United States argues that section 334 rules of origin do not have as their objective the protection of domestic industry. The United States notes that the SAA is clear on what the objectives of section 334 were: (i) to prevent quota circumvention and address illegal transshipment, to advance harmonization, and (ii) to more accurately reflect where the most significant production activity occurs.¹⁸¹ According to the United States, the United States Congress concluded that greater clarity needed to be brought into determinations of origin in this area, which the United States says was of great interest to the United States' trading community – whether from the standpoint of seeking to import textiles and apparel or from the standpoint of deterring circumvention of commercial instruments. The United States points out that the type of finishing operations presented to the Customs Service for determination of origin and application of quotas had grown, and under the increasing number of case-by-case applications by the Customs Service of the substantial transformation criteria, the list of processes that were deemed to confer origin also expanded, sometimes including processes that in retrospect were understood not to be significant.¹⁸²

¹⁷⁹ India refers to document G/RO/M/5, para. 1.6.

¹⁸⁰ The United States refers to paras. 46-49 of India's first written submission.

¹⁸¹ The United States considers that these objectives are entirely consistent with and supportive of the objectives of the *RO Agreement* itself.

¹⁸² As one example of these processes the United States cites cutting. According to the United States, some traders successfully argued that the location of cutting of a product that could receive further finishing

6.60 The United States asserts that India has not shown that preventing circumvention, one of the four stated objectives of section 334, was a smokescreen for protectionism. The United States notes in this regard that the commentaries referenced by India acknowledge that the United States was trying to prevent circumvention: "Some new industrialized countries of Southeast Asia could otherwise try to circumvent the quantitative restrictions applied to their exports of textile products. They could do so by exporting semi-finished products (*in casu* dyed or printed cloths) to third countries, in the hope that the origin of those countries (for which no quantitative restrictions for exports of textile products are applied) would be attributed to the finished cloths."¹⁸³ The United States further argues that what India is asking the Panel to do is to disregard what the SAA says about section 334 and make a subjective judgment that preventing circumvention is somehow illegitimate and that this one "illegitimate goal" makes all of section 334 inconsistent with the *RO Agreement*. The United States recalls in this regard that WTO dispute settlement panels have acknowledged that the SAA contains an authoritative expression of the purpose of United States legislation.¹⁸⁴ The United States notes that the SAA stated that section 334 would combat circumvention¹⁸⁵ by: lessening confusion resulting from differences between United States' practices and the practices of other major trading partners (cutting would no longer confer origin); facilitating the use of more effective labelling requirements; and focusing on practices more easily subject to inspection by the United States Customs Service.

6.61 The United States further argues that India's complaint is not so much whether or how the United States was going to deter circumvention but whether trying to address circumvention was acceptable. The United States notes that, in its answers to Panel questions Nos. 2 and 17, India sets a standard for judging whether preventing circumvention is legitimate – such circumvention must only be clearly fraudulent. The United States further notes that India also makes the claim that the United States was not seeking to prevent fraudulent circumvention, but rather "legal circumvention" and that this was therefore illegitimate. In the view of the United States, India's arguments fail for several reasons.

6.62 The United States points out, *first*, that, as India itself acknowledges and as also noted by the European Communities, there is no consensus as to what constitutes "circumvention". The United States believes that the *Agreement on Textiles and Clothing* provides examples of circumvention practices that frustrate the effective integration of textiles into the GATT 1994, but does not define circumvention and there is no consensus among Members on the concept of legitimate *versus* illegitimate circumvention. The United States considers, therefore, that India has not proven that there is an understanding among Members as to what "circumvention" means.

6.63 The United States argues, *secondly*, that if preventing quota circumvention were determined to be a "trade objective" for purposes of Article 2(b), then Members would be severely hampered in their ability to ensure compliance with textile and apparel quotas and to comply with Article 5 of the *Agreement on Textiles and Clothing*. The United States contends that what India so easily objects to as "protectionism" is a methodology for implementing measures sanctioned under the *Agreement on Textiles and Clothing*. In the view of the United States, rules of origin designed to simplify and provide certainty in origin determinations help prevent circumvention.

conferred origin. The United States notes that Congress acted to harmonize United States rules in this respect with those of the United States' major trading partners

¹⁸³ The United States refers to exhibit INDIA-12.

¹⁸⁴ The United States refers, *inter alia*, to Panel Report, *United States – Section 129(c)(1) of the Uruguay Round Agreements Act* ("United States – Section 129(c)(1) URAA"), WT/DS221/R, adopted 30 August 2002, paras. 6.36-6.38.

¹⁸⁵ The United States notes that the reference in the SAA to "transshipment" has the same meaning as "circumvention" as that term is used in the *Agreement on Textiles and Clothing*.

6.64 The United States notes, *thirdly*, that India's contention regarding section 333 of the Uruguay Round Agreements Act suggests that India has misread or is misrepresenting section 333. According to the United States, section 333 establishes new and more rigorous customs measures to counteract circumvention, once circumvention is uncovered (such as the publication of names of violators, additional "reasonable care" measures for importers to take when doing business with published violators, etc.). The United States argues that the purpose of section 333 is thus to establish "after the fact" remedies, which is different from section 334, the purpose of which is to prevent circumvention from happening in the first instance. The United States submits that both are valid measures to counteract and deter circumvention.

6.65 The United States argues, *finally*, that even assuming *arguendo* that the Panel would elect to disregard the statements in the SAA as "untrue", India would still have the burden of proving that the true purpose of section 334 was a trade objective, namely, the protection of the domestic industry. The United States submits that India has presented no evidence to support this allegation. The United States recalls that it already has a regime in place for the purpose of protecting its domestic industry during the *Agreement on Textiles and Clothing* transition period, *i.e.*, a quota regime, and it does not need to use additional measures or subterfuge for such purposes. According to the United States, it would, therefore, be a leap of legal logic to then find by "implication", as India urges, that the true purpose of section 334 was to protect the United States' domestic industry.¹⁸⁶

6.66 With respect to the *results* which section 334 achieves, the United States notes that India points to no evidence to support its assertion that section 334 has been used to achieve protection of the domestic industry. The United States argues that, in section 334, it has achieved what it set out to do, *i.e.*, the rules reflect where the most important manufacturing process takes place, there is closer harmonization with major trading partners, and the clear, concise rules have resulted in a greater ability to identify circumvention. The United States claims, in addition, that section 334 has "facilitated an enormous increase" in trade in textile and apparel products to the United States' market.¹⁸⁷ Accordingly, in the view of the United States, a conclusion that section 334 was enacted to protect the United States' textile industry and is therefore pursuing a trade objective in the context of Article 2(b) would not be based on any legal or factual foundation.

6.67 The United States also rejects India's claim that a protectionist objective can be inferred from "quota effect". In the view of the United States, India's contention is a gross oversimplification of a complex worldwide production and trade network. The United States contends that section 334 did not always shift origin to developing countries under tight quotas. In fact, according to the United States, at the time the rules of origin were implemented, and thereafter, six out of the top ten world exporters of cotton fabrics, accounting for 50 percent of world trade in cotton fabric, were countries that were not subject to quantitative restraints on fabric or bed linen in the United States. The United States maintains that, as a result, depending on particular and company-specific sourcing patterns, the application of section 334 rules was as likely to result in goods falling outside of quotas as it was to goods migrating into quotas. The United States further points out that, even before section 334, most cotton bed linen imported into the United States originated in the country where the greige fabric was formed because bed linen is normally either dyed *or* printed, but rarely dyed *and* printed.

6.68 With respect to the issue of the *design, structure and architecture* of section 334, the United States submits that India has not met its burden of showing that the design, structure and architecture of section 334 "reveals" that the United States' "true objective" in enacting section 334 was protection of its domestic industry.

6.69 The United States notes that section 334 established a body of rules that are based on the principle that the origin of fabric and certain textile products is derived where the fabric is woven,

¹⁸⁶ The United States refers to India's reply to Panel question No. 17(a).

¹⁸⁷ United States' second written submission, para. 12.

knitted or otherwise formed; and that the origin for any other textile or apparel product is where that product is wholly produced or assembled. The United States notes that if production or assembly occurs in more than one country, origin is conferred where the most important assembly, or manufacturing process, takes place. The United States contends that its system is based on the conclusion that origin is conferred where the most important assembly or manufacturing process takes place. According to the United States, this reflects the United States' judgment that assembly is generally the most important step in the manufacturing of assembled apparel and that fabric formation is the most important step in manufacturing fabric or flat goods.

6.70 The United States notes that India disagrees with the judgment of the United States that certain processes constitute sufficient "transformation" to merit changing the origin of a product (except in certain circumstances). The United States argues that there is nothing in the text of the *RO Agreement* that says that Members must confer certain origin determinations¹⁸⁸, and that there is nothing in Article 2(b) that indicates that if a Member does not include certain finishing operations in a determination of origin the Member is using its rules of origin to pursue trade objectives. The United States submits that it is the policy decision of the United States that origin-conferring production is based on assembly, not a finishing operation. The United States notes that its rules take into account which finishing operations merit changing origin, and that that may vary based on the type of product. In the view of the United States, Article 2 does not preclude Members from determining the origin of goods based on assembly, type of material, or type of product.

6.71 Moreover, the United States argues that Article 2(a) sets forth a range of criteria that can be used by a Member in formulating its rules of origin, and that United States' rules of origin for textile and apparel products are consistent with these criteria. According to the United States, India's arguments that the United States should not confer origin based on where the product is formed or assembled essentially renders Article 2(a) a nullity in view of India's sweeping view of the subsequent provisions of Article 2. The United States believes, furthermore, that rules of origin designed to simplify and provide certainty in origin determinations ensure transparency and predictability and allow importers, exporters and Members to work together to prevent circumvention, as directed by Articles 5.1 and 5.5 of the *Agreement on Textiles and Clothing*. Such a design, the United States argues, is clearly consistent with the purpose of Article 2 of the *RO Agreement*.

6.72 The **Panel** begins by recalling India's claim that the United States is using the fabric formation rule set forth in section 334 as an instrument to pursue the objective of protecting its domestic textile industry. This is clear, in India's view, from the features, or design, of the fabric formation rule as well as from its effect.

6.73 We first address the features, or design, of the fabric formation rule. India seeks to cast doubt on the validity of this rule. Specifically, India asserts that no other country uses a fabric formation rule for flat textile goods. Since we have not been provided with information on the rules of origin employed by Members other than the United States, we are not in a position to determine whether India's assertion is correct. However, we note *en passant* that, within the framework of the harmonization work programme, a significant number of those Members expressing a view on the issue have indicated support for a fabric formation rule for flat textile goods.¹⁸⁹ In any event, even if the United States was using an unusual rule of origin, that would be irrelevant. There is no requirement in Article 2 of the *RO Agreement* to use a particular type of rule. Instead, as pointed out earlier¹⁹⁰, Article 2 simply provides broad parameters for the use of rules of origin.

¹⁸⁸ The United States argues that, to require it to utilize a particular rule for a specific product, as it claims India advocates, would be to add an obligation not contained in the *RO Agreement* during the transition phase.

¹⁸⁹ Document G/RO/52, p. 69.

¹⁹⁰ *Supra*, para. 6.25.

6.74 India also appears to question the rationality of a fabric formation rule. India argues, first of all, that a fabric formation rule does not reflect the importance of cutting and sewing to the making of a final article. India notes in this regard that, whereas greige fabric has a variety of uses, once the fabric is cut and sewn into a pillow case, the fabric can only be used as a pillow case. The United States, on the other hand, states that its rules of origin are based on where the most important assembly or manufacturing process takes place and that, in its judgment, fabric formation is the most important step in manufacturing flat goods. We are not aware of any basis in Article 2 of the *RO Agreement* on which to resolve the parties' disagreement regarding what is the most important manufacturing process. The silence of Article 2 on this issue suggests that Members are, subject to the disciplines contained in Article 2(b) and (c), free to make this determination as they deem fit.¹⁹¹ At any rate, we do not find the United States' view that the flat goods in question (*e.g.*, bedsheets) are basically fabric to be on its face unreasonable.¹⁹² Indeed, as we have noted, the fabric formation rule commands substantial support within the framework of the harmonization work programme. In these circumstances, we are not persuaded that the fabric formation rule is inherently unsound.

6.75 The other feature of the fabric formation rule which India finds revealing is that the fabric formation rule takes no account of any subsequent value-added operations, such as a DP2 operation, cutting, etc. India notes that, under a fabric formation rule, an article which has undergone value-added operations worth almost US\$200 may be determined to originate in a country where the fabric was formed at a cost of only a few US dollars. However, India points to no legal provision which would require that, during the transition period, origin determinations must reflect the importance of the various value-added operations performed in the manufacture of a good. We see no requirement in Article 2 that Members need to confer origin on the country where a significant, or even the most significant, economic contribution to a final good has been made.¹⁹³ Nor do we consider that the fact that an origin-conferring operation may not be the one which adds the most value to the final good necessarily indicates an objective on the part of the United States to use its rules of origin to protect its domestic textile industry.

6.76 In sum, India has not persuaded us that the mere fact that the United States is using a fabric formation rule requires us to conclude that it is doing so in order to protect its domestic textile industry.

6.77 We now turn to examine whether the effect of the fabric formation rule demonstrates that the United States is using section 334 to protect its textile industry. India contends that the application of the fabric formation rule as of mid-1996 meant that a range of flat goods "were subjected to the strict quotas of the developing countries whereas previously they had been under no quota or a more generous quota".¹⁹⁴ Similarly, India asserts that the fabric formation rule, "by definition", increases the quantities of textile imports that would be conferred the origin of the countries that are under quota.¹⁹⁵ India argues that this "strengthens the impact"¹⁹⁶ of the United States' quota regime and renders it "more restrictive"¹⁹⁷.

6.78 It is clear that applying a fabric formation rule will result in flat articles subject to that rule being conferred the origin of the fabric-forming country. Also, *if* the relevant fabric-forming country

¹⁹¹ Of course, the disciplines in Articles 2(b) and (c) may bar a Member from using particular rules of origin in a given case. Indeed, this is precisely what we need to examine in this case.

¹⁹² United States' reply to Panel question No. 14.

¹⁹³ Indeed, it is our understanding that, under the widely recognized substantial transformation criterion, a substantial transformation may, in some instances, be said to occur in situations where the transforming process adds little value, or even where it decreases the value of the transformed good.

¹⁹⁴ India's first oral statement, para. 22.

¹⁹⁵ India's second oral statement, para. 8.

¹⁹⁶ *Ibid.*

¹⁹⁷ India's reply to Panel question No. 72.

is under quota in the United States for the article concerned, the article will be subjected to that country's quota. However, the Panel was not provided with any evidence and/or data regarding:

- which countries are under quota in the United States with respect to the articles in question;
- the quota levels of those countries;
- the quota utilization by those countries;
- which countries are important suppliers of relevant fabric (*e.g.*, cotton); and
- the price and quality of the fabric made by those countries and their production capacity.

6.79 In these circumstances, *i.e.*, without specific information on the design of the United States' quota system, the market in the relevant final and intermediate goods and the relationship between the two, it is very difficult to assess the correctness, weight and implications of India's factual assertions.¹⁹⁸

6.80 It may well be that articles subject to the fabric formation rule became subjected to quotas as of mid-1996, when previously they were not under quota because origin was conferred on a country which was not under quota or on a country which was under a more generous quota. However, in the absence of relevant factual information, it is equally possible that, as a result of the application of the fabric formation rule, certain articles:

- could be exported to the United States quota-free because their fabric was formed in a country that was not under quota, when previously such articles were under quota; and/or
- could be exported to the United States under a more generous quota because the quota levels of the fabric-forming country might be higher than those of the previous origin-conferring country.

6.81 Likewise, it is not apparent that, as a general matter, the fabric formation rule set out in section 334 "by definition" increases the quantities of textile imports that would be conferred the origin of the countries that are under quota. It would certainly not do so if:

- countries producing made-up articles (including fabric-forming countries which export such articles under quota) could source fabric from countries not subject to quota in the United States¹⁹⁹; and/or if
- countries not under quota in the United States start a fabric-forming industry and export the fabric to countries producing made-up articles.

6.82 Moreover, if more articles would be conferred the origin of quota-countries, this would arguably matter only if the quota utilization of the fabric-forming countries is such that they have no, or insufficient, quota available for countries using fabric made by the quota-countries.²⁰⁰ In the

¹⁹⁸ The Panel does not believe that it would have been difficult for the parties to have provided this information. For instance, some of it is available from notifications to the WTO Textiles Monitoring Body ("TMB"). Without that information and arguments of the parties on its legal significance, the Panel is unable to draw any conclusion.

¹⁹⁹ India itself acknowledges this possibility. India's reply to Panel question No. 61. We also note the United States' assertion that, at the time the rules of origin were implemented, and thereafter, six out of the top ten world exporters of cotton fabrics, accounting for 50 percent of world trade in cotton fabric, were countries that were not subject to quota on fabric or bed linen in the United States. United States' second oral statement, para. 6. The United States has not, however, provided any evidence in support of its statement.

²⁰⁰ India appears to acknowledge this. India's reply to Panel question No. 64.

absence of relevant factual information, we are reluctant simply to conclude that all of these alternative "effects" of the fabric formation rule are hypothetical or irrelevant.

6.83 In conclusion, we consider that the evidence and argument adduced by India do not support the conclusion that the fabric formation rule necessarily, or in fact, brings more imports of made-up articles under quota in the United States.

6.84 In any event, if India had established to our satisfaction that, under the fabric formation rule, more imports would be under quota in the United States, this would only prove that there would be more restrained imports than under the pre-section 334 rules of origin. This circumstance would not prove, however, that the fabric formation rule is being used as an instrument to protect the United States' textile industry rather than as an instrument to implement United States' textile quotas and other commercial policy instruments. Article 2(b) is intended to preclude Members from using rules of origin to substitute for, or supplement, the intended effect of a trade policy instrument. Accordingly, where a rule of origin is linked, *inter alia*, to a quota, the rule of origin should not add to the protection already afforded by the quota.²⁰¹ India's argument is that if a rule of origin makes a quota regime more restrictive, the quota regime automatically becomes too restrictive in the sense that it would add to the protective effect of the quota regime, thus indicating the use of rules of origin in pursuit of the trade objective of protecting the domestic textile industry. But, India's argument focuses on the direction of a change in rules of origin, not the end point of the change. That is to say, India ignores the distinction between the use of rules of origin to implement and support a quota regime and the use of rules of origin to supplement the protective effect of the quota regime. Using rules of origin which render a quota regime more restrictive may be consistent with using rules of origin to implement and support such a regime.

6.85 Moreover, we note that the mere fact of making the quota system more restrictive could not, *ipso facto*, condemn the fabric formation rule. A restrictive fabric formation rule may have been adopted in pursuit of legitimate objectives.

6.86 One of the objectives claimed by the United States in using the fabric formation rule is "to more accurately reflect where the most significant production activity occurs".²⁰² Since we have already found that the fabric formation rule is not an unsound rule for the United States to apply to the made-up articles in question, we see no justification for determining that the stated United States objective of reflecting where the most important manufacturing process takes place is a pretext for protecting the United States' textile industry.²⁰³

6.87 Another objective claimed by the United States to underlie the fabric formation rule is to prevent quota circumvention. The United States has stated that the fabric formation rule helps prevent quota circumvention in two respects. *First*, the United States argues that a clear, simple and precise

²⁰¹ We think a rule of origin which has the effect of discouraging the full utilization of a quota could be one example of a rule of origin which affords extra protection to the Member maintaining the quota in question.

²⁰² United States' first written submission, para. 29; United States' replies to Panel questions Nos. 14 and 19.

²⁰³ Merely that the United States changed its substantive rules of origin in 1996 for some of the made-up articles in question does not, in our view, suggest that the fabric formation rule is not intended to "more accurately reflect where the most significant production activity occurs". It seems pertinent to note, in this regard, that the pre-section 334 rules, found at 12 C.F.R. 130, originated with the Administration, specifically the United States Customs Service, whereas section 334 was prescribed by Congress. India's first written submission, paras. 14 and 16. Nor do we think that the "clarification of section 334", enshrined in section 405, undermines the United States' assertion that the fabric formation rule is not intended to "more accurately reflect where the most significant production activity occurs". We note that, with respect to this clarification, the United States has stated that it was persuaded by the European Communities that, for the goods at issue, the most important manufacturing process would be better reflected by a DP2 rule. United States' reply to Panel question No. 76.

rule such as the fabric formation rule ensures transparency and predictability for traders and enhances the ability of customs officials to determine the origin of goods and, in that sense, identify circumvention.²⁰⁴ *Second*, the United States maintains that the clearly stated fabric formation rule removed ambiguity and uncertainty which the United States says existed under the pre-section 334 rules of origin, inasmuch as for most fabrics and flat goods (specifically towels and linens) manufacturing processes were analysed on a case-by-case basis to determine whether they were significant enough to confer origin.²⁰⁵ India has identified no provision in the *RO Agreement*, or the *Agreement on Textiles and Clothing*, which would preclude Members from taking appropriate preventative action against quota circumvention.²⁰⁶

6.88 In India's view, circumvention, properly understood, necessarily implies illegal behaviour. India contends, however, that the United States' notion of preventing quota circumvention is unduly broad, in that it encompasses not only action taken to prevent the illegal evasion of quotas by traders, but also action taken to prevent the legitimate avoidance of quotas.²⁰⁷ India submits that, in contrast, evasive and adaptive action taken by producers in response to country-specific quotas (*e.g.*, through reallocation of production) is not circumvention. India argues that rules of origin used to counteract such action must be considered to pursue a trade objective. The United States counters India's contention by noting that there is no consensus among Members regarding the constituent elements of the concept of "circumvention". The United States also points out that India's view would undermine Members' ability to ensure compliance with textile quotas.

6.89 Even if we were to accept India's contention that the concept of "circumvention" does not include legal quota avoidance strategies, this would not detract from the fact that the United States has offered a plausible explanation of how the fabric formation rule promotes the objective of preventing illegal quota circumvention. In these circumstances, we see no reason to dismiss the United States' contention that one of the objectives of the fabric formation rule is the prevention of quota circumvention.

6.90 This does not dispose, however, of the issue, raised by India, whether the fabric formation rule is, in addition or even primarily, being used by the United States to prevent "legal" circumvention. India argues that, if the fabric formation rule is being used for that purpose, this would demonstrate that it is being used to afford protection to the United States' textile industry by making the quota regime "more restrictive".²⁰⁸ We do not consider that there is an inherent link between the possible objective of preventing circumvention – defined here as the prevention of quota avoidance through legal means – and the objective of protecting the United States' textile industry, such that the two objectives could invariably be viewed as one and the same. The rationale for seeking to prevent quota avoidance may be to maintain the integrity and effectiveness of trade policy instruments, in this case textile quotas sanctioned by the *Agreement on Textiles and Clothing*.²⁰⁹ Maintaining integrity and effectiveness is a valid concern for Members implementing *country-specific* quotas. For that reason, we cannot accept that using rules of origin in pursuit, *inter alia*, of the

²⁰⁴ United States' replies to Panel questions Nos. 2, 14 and 19.

²⁰⁵ United States' replies to Panel questions Nos. 2, 19, 33 and 47(a).

²⁰⁶ India asserts that the fabric formation rule cannot be said to serve the purpose of preventing circumvention, given that another section of the URAA, section 333, was enacted for that purpose. The United States rebuts that assertion by pointing out that section 333 is designed to counteract circumvention by establishing certain measures to be taken once circumvention is found to have occurred, while section 334 is designed to prevent circumvention from occurring in the first place.

²⁰⁷ United States' first written submission, para. 32.

²⁰⁸ India's reply to Panel question No. 2.

²⁰⁹ See also United States' reply to India's question No. 10.

objective of maintaining the integrity and effectiveness of country-specific textile quotas would, *a priori* and without exception, constitute an illegitimate objective.²¹⁰

6.91 The issue, then, is more appropriately framed as follows: Has India established that the fabric formation rule cannot be said to pursue the objective of maintaining the integrity and effectiveness of country-specific United States' textile quotas? In other words, has India established that this is an instance where the United States is using rules of origin to supplement the protective effect of its quota regime?

6.92 India argues that if the United States considered that its previous rules of origin did not protect the integrity and effectiveness of various trade policy instruments, it would have introduced changes for all products, and not just for textile and apparel products.²¹¹ We are not persuaded by this argument. As we have noted above, trade in textile and apparel products is governed by a special WTO agreement, the *Agreement on Textiles and Clothing*, which, unlike most other WTO agreements, sanctions the use of country-specific quotas. Against this background, in this case, the use of sector-specific rules of origin would tend to confirm, rather than disprove, that the rules of origin in question are designed to implement and support sector-specific trade instruments. India further argues that the fine product distinctions drawn by the United States are "completely unrelated" to the objective of protecting the integrity and effectiveness of the United States' textile quotas. India does not, however, examine, and elaborate on, why the United States' product distinctions cannot be said to support the aforementioned objective.²¹² In the light of the foregoing, we consider that India has failed to establish that the fabric formation rule cannot be said to pursue the objective of maintaining the integrity and effectiveness of country-specific United States' textile quotas.

6.93 We note in this regard that India has adduced other evidence which it considers demonstrates that the "real" objective of the fabric formation rule is to afford protection to the United States' textile industry by making the relevant quotas "more restrictive". These elements include the legislative history of section 334, notably the House and Senate reports²¹³; post-enactment statements by two United States senators²¹⁴; a statement by a United States textile importer association²¹⁵; and publications by academics and a practising lawyer²¹⁶. It should be noted that these elements are not part of section 334 itself, nor can they be said to "objectively manifest"²¹⁷ the objective of the fabric formation rule. Under the test established by the Appellate Body in *Chile - Alcoholic Beverages*²¹⁸, we are not to base our inquiry into the objective of the fabric formation rule on such elements.²¹⁹ In any event, we have carefully reviewed each of these elements. We do not consider that, individually or taken together, they are sufficient to support the conclusion that the United States is using the fabric formation rule to afford protection to its textile industry, over and above the protection it already enjoys as a result of the United States' quota regime. With respect to the legislative history, India has provided no support for its assertion that the House and Senate reports reveal that section 334 was intended by the United States Congress as an instrument to pursue trade objectives.²²⁰ With respect to the post-enactment statements by two United States senators, India states that the senators

²¹⁰ Indeed, India itself has stated that "[i]n the context of country-specific quotas, such as those permitted under the Agreement on Textiles and Clothing (ATC), the concept of origin is critical". India's first oral statement, para. 22.

²¹¹ India's reply to Panel question No. 72.

²¹² *Ibid.*

²¹³ India's first written submission, para. 57.

²¹⁴ *Ibid.*, paras. 66-68.

²¹⁵ *Ibid.*, para. 64.

²¹⁶ *Ibid.*, para. 65.

²¹⁷ Appellate Body Report, *Chile - Alcoholic Beverages*, *supra*, para. 71.

²¹⁸ *Supra*, para. 6.37.

²¹⁹ We also note that, as a matter of United States law, the legislative history, for instance, is less authoritative than the SAA. United States' reply to Panel question No. 31.

²²⁰ India's first written submission, para. 57.

in question referred to section 334 as a "very significant change in rules of origin".²²¹ However, such a characterization would not demonstrate that section 334 is "protectionist"²²². Finally, with respect to the opinions expressed by a United States' textile importer association, academics and a practising lawyer, we do not think they are particularly probative.²²³ Indeed, the Panel was struck by the paucity of public and critical comment on the legislative changes.

6.94 In sum, India has not persuaded us that the fabric formation rule does not pursue any legitimate objectives, or that any such objectives are a sham. Therefore, even assuming that the fabric formation rule rendered relevant United States textile quotas more restrictive, India has failed to establish that any restrictive effects of the fabric formation rule are not incidental to the pursuit of legitimate objectives.

6.95 Up to this point, we have focused on the fabric formation rule as it applies to certain non-apparel made-up articles. Based on certain replies given to questions from the Panel, India could be understood to challenge the fabric formation rule also as it applies to fabrics subjected to further finishing operations.²²⁴ However, neither in its written submissions nor in its oral statements has India offered specific legal arguments with respect to fabrics.²²⁵ At any rate, *mutatis mutandis*, our reasoning with respect to made-up articles applies to fabrics as well. For these reasons, we find that India has not demonstrated that the fabric formation rule as it applies to fabrics is inconsistent with Article 2(b).

6.96 In the light of the above, we find that India has failed to establish that section 334 is being used as an instrument to pursue the objective of protecting the United States' textile industry.²²⁶ Accordingly, we conclude that India has failed to establish that section 334 is inconsistent with Article 2(b).

(c) Consistency of section 405 with Article 2(b) of the *RO Agreement*

6.97 The Panel now proceeds to examine India's second claim under Article 2(b), *viz.*, that section 405 is inconsistent with Article 2(b).

²²¹ India's first written submission, para. 66; exhibit INDIA-3.

²²² India's first written submission, para. 66.

²²³ We note that the comments by the United States textile importer association were made at the time of the Congressional deliberations on what later became section 405 and sought to convince United States legislators to revisit the fabric formation rule in section 334. Exhibit INDIA-11, p. 14. The academic publication referred to by India is authored by members of an association which has prepared a report on obstacles to textile trade for the European Commission. Exhibit INDIA-12, opening footnote. The other publication referred to by India is by a private lawyer who, according to the United States, often represents importers. United States' second oral statement, para. 22.

²²⁴ India's replies to Panel questions Nos. 19 and 61.

²²⁵ We note, for instance, India's first oral statement, para. 22, and India's second written submission, para. 32, which only refer to made-up articles, not fabrics.

²²⁶ In response to question 55(b) from the Panel, India briefly addressed some of the other purposes for which section 334 is used, that is to say, purposes other than the administration of quantitative restrictions. However, India's response does not establish that, when used for one of these purposes, section 334 is used to pursue a trade objective. With respect to origin marking, the mere fact that the fabric formation rule in section 334 may mean that some goods have to be marked as originating in a different country and that this may, in some cases, affect the marketability of these goods, would not, in and of itself, warrant the conclusion that the fabric formation rule is designed to protect the United States' textile industry. Also, the example mentioned by India, silk scarves, is not subject to the fabric formation rule, but to the DP2 rule provided for in section 405. With respect to the purpose of gathering trade statistics, we are not persuaded by India's argument that the fabric formation rule is intended to protect the United States' textile industry because it skews import statistics. India's argument is based on its disagreement with the United States as to where finished fabrics and flat goods should be deemed to originate, an argument which we have already dealt with.

6.98 **India** considers that section 405 was designed and structured to favour imports from the European Communities over imports from developing countries such as India. India recalls that section 405 amended section 334 to create certain exceptions to the general rules on determining origin for fabrics and made-up articles. India notes that section 405 provides that certain products would be conferred origin, based on where they are subjected to a DP2 operation. India submits that the products that were chosen for specific exemptions and therefore, special treatment, were those products of export concern to the European Communities: bed linen, scarves and table linen. According to India, these products comprised the bulk of the European Communities textile and apparel exports to the United States. Thus, when the United States provided exceptions from the general rule for these products so that their origin would be conferred on where the product was subjected to a DP2 operation, in India's view, the United States was providing a *de facto* advantage to products from the European Communities. India notes that these products, which traditionally had been subjected to DP2 operations in the European Communities, could now continue to be exported to the United States without being conferred the origin of the country where the greige fabric was woven, and without being subject to the quantitative restrictions imposed on those countries which made the greige fabric.

6.99 India considers that section 405 created arbitrary reversion to the pre-section 334 rules of origin. *First*, section 334 established origin based on the country where the greige fabric was formed by weaving or knitting, regardless of any further finishing operations, such as dyeing and printing. India notes that, in order to address the European Communities' concerns, section 405 provided an exception to this rule for fabrics classified under the HTS as silk, cotton, man-made fibres or vegetable fibres. Such fabrics are now considered to originate in the country in which the fabric is subjected to a DP2 operation. India points out, however, that the same rule does not apply to fabrics made of wool. India notes that the origin of fabrics made of wool, whether or not they are subject to two or more finishing operations, will be determined where the basic wool fabric is formed.

6.100 *Second*, India notes that, for the products of concern to the European Communities, the United States provided in section 405 that the rule for determining their origin would revert to the pre-section 334 rules for seven out of the 16 HTS 4-digit headings. India submits that these seven HTS 4-digit headings are for those products that are of particular export interest to the European Communities.²²⁷ India recalls that for products under these seven 4-digit headings, the origin will be determined where the product is subjected to a DP2 operation.

6.101 *Third*, although section 405 provides that the determination of origin for certain products under the aforementioned seven HTS headings is based on where the product was subjected to a DP2 operation, certain exceptions have been made. India notes that the DP2 rule does not apply to products under these seven HTS headings where they are made of (a) cotton, (b) wool or (c) fibre blends with more than 16% cotton. For the products under these HTS headings made of cotton, wool, and fibre blends with over 16% of cotton, the country of origin will be the country where the greige fabric is formed.

6.102 India notes that, under the amended section 334, origin can now vary based solely on the fibre content of a product. To India's knowledge, no other country uses such a distinction to determine origin. India submits that this criterion is arbitrary and leads to absurd results. A different determination of origin results depending on the fibre content of the product that is subject to further processing. If cotton fabric is woven in India and exported to Portugal where it is subjected to a DP2

²²⁷ India notes that the seven products were the following: HTS 6213 – handkerchiefs, HTS 6214 – shawls, scarves, mufflers, HTS 6302 – bed, table, toilet, kitchen linen (changed with respect to HTS 6302.22, 29, 52, 53, 59, 92, 93, 99), HTS 6303 – curtains and bed valances (changed with respect to 6303.92 and 99), HTS 6304 – other furnishing article (changed with respect to 6304.19, 93 and 99), HTS 9404.90 – quilts, cushions, comforters (changed with respect to 9404.90.85, 95). In addition, HTS 6117.10 – shawls, scarves, mufflers, knit, was affected by section 405. India notes that this HTS number was not referred to in section 334.

operation, that fabric is now considered a product of Portugal. However, if the same cotton fabric is now used in Portugal to produce a finished sheet (which, according to India, has more value-added operations), the origin reverts back to India. The absurdity of this case, India claims, is that the determination of origin differs depending on the type of product.

6.103 India submits that the origin of section 405 confirms that it was used as an instrument to favour imports from the European Communities. India notes that, on 22 May 1997, the European Communities requested WTO consultations with the United States on section 334. India recalls that the European Communities stated in its request for consultations that the United States' rules of origin "adversely affect exports of European Community fabrics, scarves and other flat textile products to the United States of America. As a result of this change, European Community products are no longer recognized in the United States as being of European Communities origin and lose the free access to the United States market that they enjoyed before".²²⁸ India notes that, prior to the holding of formal WTO dispute settlement consultations, the United States and the European Communities entered into a bilateral agreement (*procès-verbal*). According to India, the United States Administration agreed to propose an amendment to Congress for its rules of origin for those products of concern to the European Communities, namely, silk scarves, silk accessories, and dyed and printed cotton fabrics.²²⁹ India notes that, in July 1998, at the request of the United States Administration, draft legislation was introduced in the United States Senate to implement the EC-US *procès-verbal*.²³⁰ However, according to India, the European Communities claimed the draft legislation did not meet the terms of the *procès-verbal*, and therefore initiated new dispute settlement proceedings against the United States.²³¹

6.104 India considers that, in order to avoid WTO dispute settlement, the United States once again agreed to settle. In August 1999, an amendment to the *procès-verbal* was concluded whereby the United States Administration agreed to submit legislation to Congress to amend the rules of origin set out in section 334. According to India, in order to ensure that there were no gaps between what the *procès-verbal* called for and what the draft legislation would actually include, the European Communities and the United States agreed upon specific language that the United States Administration would propose to Congress.²³² India notes that, in May 2000, the United States Congress passed section 405 of the Trade and Development Act. India points out that section 405 was virtually identical to the text agreed in the second *procès-verbal* between the European Communities and the United States.

6.105 India claims that "the only reason for the United States to change its rules of origin in 2000 was to favour imports from the European Communities over imports from other countries". In India's view, "[t]he sole objective of section 405 was to settle the trade dispute between the United States and the European Communities in a manner that singles out products of export interest to the European Communities for more favourable treatment". India submits that section 405 is therefore being used as an instrument to pursue trade objectives, *i.e.*, to favour one Member – the European Communities – over other Members.

6.106 The **United States** notes that section 405 amended section 334 in order to settle a WTO dispute brought by the European Communities alleging that section 334 had negatively affected trade in specific exporting sectors of the European Communities, most notably Italian silk products. The United States points out that it held extensive consultations with the European Communities. The United States argues that, although it did not consider that the European Communities' claims had any

²²⁸ India refers to document WT/DS85/1.

²²⁹ India refers to document WT/DS85/9.

²³⁰ 105th Congress, 2d Session. S. 2394. Introduced by Senator Roth and Senator Daniel P. Moynihan; exhibit INDIA-14.

²³¹ India refers to document WT/DS151/1.

²³² India refers to document WT/DS151/10.

merit, in order to settle the dispute, it agreed to amend section 334, creating two exceptions to the fabric formation rule. The United States notes that the *first* of these exceptions is that, for silk, cotton, man-made and vegetable fibre fabric, origin would once again be conferred by a DP2 operation. The *second* exception, according to the United States, is that, for certain textile products excepted from the assembly rule, origin would be conferred where a DP2 operation took place.

6.107 With respect to India's claims that section 405 constitutes an impermissible use of rules of origin, the United States notes, first of all, that the modifications in section 405 apply to all Members on an MFN basis. The United States recalls, in this regard, that India was a third party to the European Communities disputes; as such, India was well aware of the very specific nature of the European Communities' complaints. The United States notes that, in particular, India knew the importance of its interest with respect to the products it exports in whether a DP2 operation conferred origin. In the view of the United States, if India did not believe that the scope of the European Communities' consultation request captured its concerns, it could have sought separate consultations.²³³

6.108 The United States also submits, in this context, that, in practice, rules of origin may "favour" one Member over another just by their existence, and thus cannot, on that basis alone, be considered to pursue a "trade objective" within the meaning of Article 2(b).

6.109 The United States further argues that, as a result of extensive consultations with the European Communities, as well as representatives of its textile industry, the United States agreed that, at least with respect to goods of silk, certain cotton blends, and fabrics made of man-made and vegetable fibres (specifically silk scarves and flat products such as linens), DP2 operations were significant enough to confer origin. The United States notes that modification of section 334 to reflect this served as an appropriate mutually satisfactory solution to the issues in dispute.

6.110 The United States submits, finally, that it would be absurd to penalize a Member for reaching a mutually satisfactory settlement of a dispute with another Member, pursuant to the provisions of the DSU, where the benefits of the settlement accrue to all Members. In the view of the United States, that is precisely what India asks of this Panel. According to the United States, the likely consequence of accepting India's argument is that Members would be discouraged from achieving mutually satisfactory solutions. This would be inconsistent with provisions such as Article 3.7 of the DSU, which provides that such solutions are "clearly preferred" to "bringing a case". The United States considers, therefore, that settling a dispute with another Member, on the terms agreed to, is not a trade objective within the meaning of Article 2(b).

6.111 The **Panel** begins its examination by recalling India's claim that section 405 is inconsistent with Article 2(b) because it is being used by the United States as an instrument to pursue a trade objective. More particularly, India claims that section 405 is being used to pursue the trade objective of favouring imports from the European Communities over imports from other countries, and particularly imports from developing countries such as India.²³⁴ We understand this claim to be about imports of different fabrics (*e.g.*, wool fabric *versus* silk fabric) or flat goods (*e.g.*, cotton bed linen *versus* silk scarves or cotton bed linen *versus* polyester bed linen), not imports of the same fabrics (*e.g.*, European Communities' wool fabric *versus* Australian wool fabric) or flat goods (*e.g.*, European Communities' cotton bed linen *versus* Indian cotton bed linen).²³⁵ In any event, since section 405 applies equally to qualifying goods from all Members²³⁶, we do not see how it could be said that

²³³ The United States refers to document WT/DS85/9.

²³⁴ India's first written submission, paras. 69 and 84.

²³⁵ India's reply to Panel question No. 58(a).

²³⁶ United States' first written submission, para. 17.

section 405 is being used as an instrument to pursue the objective of favouring European Communities imports over imports of the same goods from other Members.²³⁷

6.112 For its claim to succeed, India must demonstrate, at a minimum, that section 405 is being used as an instrument to pursue the *objective* of favouring imports from the European Communities over imports from other Members. We consider that India has shown that section 405 was adopted to create exceptions from the fabric formation rule with respect to goods which are of export interest to the European Communities. Indeed, the United States itself has stated that the purpose of section 405 was to implement a settlement agreement between the European Communities and itself.²³⁸ However, a showing that the United States created exceptions for goods of export interest to the European Communities does not establish that these exceptions pursue the objective of favouring imports from the European Communities over imports from other Members.

6.113 There is no indication that the European Communities was concerned about anything other than the conditions of access of its own goods to the United States' market.²³⁹ Nor is there any evidence that the European Communities requested the United States to create exceptions from the fabric formation rule so that it could enjoy an advantage, competitive or otherwise, *vis-à-vis* other Members. The fact that the European Communities apparently showed concern about only those goods which are of export interest to itself²⁴⁰, does not require us to conclude that the European Communities sought to obtain an advantage for those goods over different goods exported to the United States by other Members.

6.114 Nor has India provided evidence to show that the United States is using section 405 to pursue the objective of favouring the European Communities over other Members. It is clear that, in enacting section 405, the United States meant to achieve the objective of settling a bilateral WTO dispute with the European Communities.²⁴¹ But settling a bilateral trade dispute does not imply an intention on the part of the disputing parties to disfavour Members which are not parties to a settlement agreement. At any rate, in the case at hand, the provisions of section 405 benefit subject goods from all Members.

6.115 It should further be noted that the United States has told this Panel that it settled the WTO dispute with the European Communities not because it saw any legal merit in the European Communities' complaint²⁴², but because, *inter alia*, it was "*persuaded* that it would be appropriate to amend Section 334 and return to DP2 for the [relevant] products".²⁴³ This statement also demonstrates that the failure of the United States to apply a DP2 rule (or another rule different from the fabric formation rule) to goods other than those of concern to the European Communities does not, in and of itself, justify the conclusion that section 405 is being used to pursue the objective of favouring imports from the European Communities over imports from other Members. The decision of the United States not to amend section 334 with respect to such other goods may simply reflect the fact that the United States is not persuaded of the appropriateness of doing so.

²³⁷ It should be noted, as well, that India has presented no evidence which would demonstrate that section 405, in practice, can only benefit relevant goods imported from the European Communities.

²³⁸ United States' second oral statement, para. 23.

²³⁹ India's first written submission, para. 71.

²⁴⁰ *Ibid.*, para. 74.

²⁴¹ The United States emphasises that not all of the European Communities' requests are reflected in section 405. United States' reply to Panel question No. 76. See also European Communities' oral third-party statement, para. 21. This tends to confirm that the United States did not intend to "favour" the European Communities, but rather to do what was necessary and acceptable to settle the bilateral WTO dispute.

²⁴² United States' first written submission, para. 37; United States' first oral statement, para. 16.

²⁴³ United States' reply to Panel question No. 79 (emphasis added); United States' reply to Panel question No. 76.

6.116 Moreover, India's assertion that the selective reversions to a DP2 rule lead to "absurd" consequences, even if conceded *arguendo*, does not assist India in establishing that the United States is using section 405 to pursue the objective of favouring the European Communities over other Members. Regardless of whether the consequences may be viewed by some as "absurd", it is entirely conceivable that the United States amended the relevant parts of section 334 for no other reason than to settle a bilateral WTO dispute with the European Communities.

6.117 We note, finally, that even if section 405 had the practical effect of favouring goods imported from the European Communities over competitive goods imported from other Members, that effect might be incidental rather than intentional. In other words, we do not think that the mere effect of favouring European Communities imports over imports from other Members would in itself justify the inference that creating such an effect is an objective pursued by the United States.

6.118 Having regard to the foregoing considerations, we find that India has failed to establish that the rules of origin set out in section 405 are being used by the United States as instruments to pursue a trade objective. We therefore conclude that India has failed to establish that section 405 is inconsistent with Article 2(b).

2. India's claim under Article 2(c), first sentence, of the *RO Agreement*

6.119 India claims that section 334 and section 405 are also inconsistent with the first and second sentences of Article 2(c) of the *RO Agreement*. Consistent with the structure of Article 2(c), the Panel will commence its examination with India's claim under the first sentence of Article 2(c). The Panel's first task in this respect is to consider the parties' interpretation of the first sentence of Article 2(c).

(a) Article 2(c), first sentence, of the *RO Agreement*

6.120 Article 2(c) provides as follows:

"Until the work programme for the harmonization of rules of origin set out in Part IV is completed, Members shall ensure that:

[...]

(c) rules of origin shall not themselves create restrictive, distorting, or disruptive effects on international trade. They shall not pose unduly strict requirements or require the fulfilment of a certain condition not related to manufacturing or processing, as a prerequisite for the determination of the country of origin. However, costs not directly related to manufacturing or processing may be included for the purposes of the application of an ad valorem percentage criterion consistent with subparagraph (a)[.]"

6.121 **India** considers that the language of Article 2(c), first sentence, that rules of origin shall not "themselves" create restrictive, distorting or disruptive effects should be read together with the language of Article 2(b) that "notwithstanding the measure or instrument of commercial policy to which they are linked, [Members shall ensure that] their rules of origin are not used as instruments to pursue trade objectives". India submits that, when the provisions in Article 2(b) and Article 2(c) are read together, it becomes clear that a measure or instrument of commercial policy may have restrictive, distorting or disruptive effects on international trade, but that the rules of origin as such (whatever the commercial policy instrument to which they are linked) should not have such adverse effects.

6.122 India also points out that the effects of the challenged rule of origin have to be "on international trade" and not only on imports. In this regard, India notes the difference between the wording used in Article 2(c) and that used in Article 3.2 of the *Agreement on Import Licensing*

Procedures, which requires that "non-automatic licensing shall not have trade-restrictive or trade-distorting effects on imports additional to those caused by the imposition of the restriction". In addition, India considers that, under Article 2(c), first sentence, it is sufficient for a complaining party to show that the challenged rule of origin creates restrictive or distorting effects for *one* Member, which could be a Member other than the complaining Member.

6.123 With respect to the phrase "restrictive, distorting, or disruptive effects", India offers the following interpretation: Rules of origin create "restrictive" effects on international trade if they reduce the level of international trade. Rules of origin create "distorting" effects on international trade if they modify the pattern of international trade by changing either the type of product traded in international trade or the direction of international trade flows. Finally, rules of origin create "disruptive" effects on international trade if, for instance, they are very complex and arbitrary in nature.

6.124 In India's view, the central interpretative issue presented by Article 2(c), first sentence, however, is whether the words "create restrictive [...] effects" refer to the effects that the rules of origin are capable of creating or whether they refer to the effects they actually create in the market place. According to the former, "*conduct-oriented*" interpretation, it would be sufficient for India to demonstrate that the incentives and disincentives faced by traders as a result of the rules of origin at issue are such that they create restrictive effects. According to the latter, "*result-oriented*" interpretation, it would be necessary to demonstrate that the regulatory framework imposed by the United States has actually produced those effects on international trade.

6.125 India is of the view that the conduct-oriented interpretation is the correct one. What is relevant, according to India, under Article 2(c) is the nature of the rules of origin that the Member adopted, not the reaction of the market to those rules. India notes in this regard that Article 2(c), first sentence, uses the term "create" rather than "have". India points out that the *New Shorter English Oxford Dictionary* defines "create" as to "cause, occasion, produce, give rise to", and it defines "have" as to "possess as an attribute, function, position, etc.". India also recalls that Article 3.2 of the *Agreement on Import Licensing Procedures* states that "non-automatic licensing shall not have trade-restrictive or distorting effects on imports additional to those caused by the imposition of the restriction". In contrast, Article 2(c), first sentence, uses the term "create", which, in India's view, implies that Members must refrain from adopting rules of origin that create a framework capable of producing such adverse effects.

6.126 India notes that, under a conduct-oriented interpretation, Members could challenge another Member's rules of origin under Article 2(c), first sentence, as soon as they enter into force. India considers this important because, in its view, the adoption of new rules of origin can immediately stop production for a particular market or purchases from particular markets. India argues that, in contrast, under a result-oriented interpretation, a violation of Article 2(c), first sentence, has to be proven through a showing of an actual restrictive, distorting or disruptive impact on international trade reflected in trade statistics. According to India, the implication of such an interpretation is that Members wishing to challenge rules of origin under Article 2(c), first sentence, would have to wait until the rules of origin have actually produced an adverse impact and trade data are available to demonstrate this. A further implication, India maintains, is that the consistency of a rule of origin would depend on the market's reaction to it and consequently on factors that normally escape the control of Members. Moreover, India argues that, under a result-oriented interpretation, it would have to be demonstrated that the change in trade flows was caused by the rules of origin and not by other factors. India considers that, in those circumstances, Article 2(c), first sentence, would become for all practical purposes unenforceable because the effect of the rules of origin and the effect of the policy instrument to which they are linked could, in practice, not be segregated.

6.127 India submits that the question of whether the rules of international trade regulate conduct or effects has been an issue on many previous occasions. According to India, in *Japanese Measures on*

*Imports of Leather*²⁴⁴, the CONTRACTING PARTIES to the GATT 1947 had to decide whether a quota restriction could be deemed to have been "made effective" within the meaning Article XI:1 of the GATT 1947 even if the quota was not exhausted and therefore did not actually restrict imports. India recalls that they decided that the mere imposition of a quota violated Article XI:1.²⁴⁵ India points out that the CONTRACTING PARTIES also had to decide whether a tax was "applied" to imported products within the meaning of Article III:2 of the GATT 1947 even if there had not yet been any imported product on which the tax had actually been imposed. According to India, the CONTRACTING PARTIES decided that the actual impact of a tax was irrelevant under Article III:2.²⁴⁶ India finally points out that the Appellate Body noted the CONTRACTING PARTIES' jurisprudence approvingly in *Japan – Taxes on Alcoholic Beverages* and ruled that "Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products and that 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".²⁴⁷

6.128 India notes that Articles III and XI of the GATT 1947 have thus never been interpreted to require the attainment or avoidance of particular effects on international trade. Instead, India argues, they have been interpreted to require the establishment of a regulatory framework that enables investors and traders to foresee under what condition they will have to compete with the products of the importing country. According to India, the purpose of Articles III and XI of the GATT is to prevent the impairment of market access concessions through non-tariff measures imposed internally or at the border. India considers that the purpose of Article 2 of the *RO Agreement* is to prevent the impairment "of the rights of Members under GATT 1994" through rules of origin, as noted in the preamble to the *RO Agreement*. India submits that, since the basic rationale of these provisions is the same, the approach to their interpretation should be the same. Just like the terms "made effective" in Article XI of the GATT and "applied" in Article III:2 of the GATT, the terms "create effects" in Article 2(b) must, in India's view, be given a meaning consistent with the basic function of the world trade order, which, India notes, is to create predictability for traders and investors. India argues that the only logical conclusion that one can draw from these considerations is that Article 2(c), just as all the other provisions in WTO law designed to prevent the circumvention of market access commitments through non-tariff measures, must be interpreted as a provision prescribing conditions of competition, not the avoidance of certain trade results. What is thus relevant, according to India, is whether the rules of origin create conditions of competition with restrictive, distorting or disruptive effects, and not whether the actual application of these rules to a specific commercial policy instrument has produced such effects.

6.129 The **United States** points out, as a preliminary matter, that the Panel must examine whether the challenged United States rules of origin, as enacted, "create restrictive, distorting, or disruptive effects on international trade", not whether the change in United States rules altered conditions of competition. The United States notes that the text of Article 2(c) does not discipline changes in rules of origin *per se*; instead, it applies to rules of origin "themselves". That Article 2(c) was not meant to discipline changes *per se* is also borne out, in the view of the United States, by the fact that Article 2(i) of the *RO Agreement* contemplates changes in rules of origin.²⁴⁸

²⁴⁴ Panel Report, *Panel on Japanese Measures on Imports of Leather* ("Japan – Leather II (US)"), adopted 15 May 1984, BISD 31S/94.

²⁴⁵ *Ibid.*, p. 113.

²⁴⁶ Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances* ("US – Superfund"), adopted 17 June 1987, BISD 34S/136, 160.

²⁴⁷ Appellate Body Report, *Japan – Taxes on Alcoholic Beverages* ("Japan – Alcoholic Beverages II"), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97, at 110.

²⁴⁸ Article 2(i) reads:

"Until the work programme for the harmonization of rules of origin set out in Part IV is completed, Members shall ensure that:

6.130 Concerning the interpretation of Article 2(c), first sentence, the United States rejects India's view. First of all, the United States rejects India's view that the Panel may assess whether rules of origin create restrictive, distorting, or disruptive effects "on international trade" by looking at the effect on one single Member's trade. In the view of the United States, this reading simply cannot be found in the words of Article 2(c), first sentence. The United States argues that if Members had wanted to proscribe rules of origin that affected one or more Members it would have been easy: the provision could have read "Members shall ensure that their rules of origin shall not themselves create restrictive, distorting or disruptive effects on another Member's trade".

6.131 The United States also rejects India's "conduct-oriented" interpretation of the terms "create [...] effects on international trade". In the view of the United States, India's conduct-oriented interpretation is inconsistent with the text of Article 2(c), first sentence. The United States submits that India's interpretation is mistaken in that it equates "effects on international trade" with "effects on conditions of competition created by a Member's conduct". The United States wonders what the terms "create [...] effects on international trade" mean under this interpretation. If the drafters used those terms instead of the terms found in GATT Articles III and XI, the United States queries, is not the logical conclusion that the drafters did not intend to draw from those articles?

6.132 The United States also disagrees with India's conduct-oriented approach because, in its view, it pre-supposes that mere adoption of a rule of origin will have an immediate impact that distorts or restricts trade. The United States argues that if the drafters of the *RO Agreement* had wanted a *per se* rule, they would have adopted one, but they did not. The United States considers that this interpretation reads out of Article 2(c) its primary element, *i.e.*, that rules of origin not create "restrictive, distorting or disruptive effects on international trade". The United States also wonders how panels should assess whether a rule of origin creates an immediate impact.

6.133 Finally, the United States rejects India's conduct-oriented interpretation because, in its view, it is, in any event, unnecessary. The United States considers that there is no need for the Panel to resort to adopting a GATT Article I, III, or XI analysis when, in addition to the terms of Article 2(c), first sentence, there is other WTO guidance, more similar to Article 2(c), first sentence, on which to rely. The United States argues that Article 6.3 of the *SCM Agreement*, which addresses effects of subsidies on imports and exports, is at least equally relevant to an analysis of Article 2(c), first sentence, as GATT cases that address discrimination among like products.

6.134 The United States submits that, contrary to India's view, Article 2(c), first sentence, does require a showing of *actual* effects on international trade. The United States argues that a determination of whether rules of origin create restrictive or distorting or disruptive effects on international trade can be made simply, by looking at trade flows. The United States also points out, however, that such an evaluation has to be qualitative as well as quantitative.

6.135 According to the United States, the second sentence of Article 2(c) indicates that rules of origin may impose strict requirements, and the preamble to the *RO Agreement* recognizes that rules of origin may pose obstacles. The United States further points out Article 2(a) of the *RO Agreement* provides that Members may maintain rules of origin that will have some effect on international trade. The United States holds the view, for example, that using *ad valorem* percentages as a criterion in non-preferential rules of origin is inherently distortive, because it can operate to "punish" inexpensive labour costs, is greatly affected by currency shifts, and requires excessive administrative burdens. In the view of the United States, all of this makes clear that an effect on international trade is not

[...]

- (i) when introducing changes to their rules of origin or new rules of origin, they shall not apply such changes retroactively as defined in, and without prejudice to, their laws or regulations[.]"

sufficient to rise to the level of a "restriction", "distortion", or "disruption" of international trade. The United States considers that this also makes common sense, as the *RO Agreement* does not operate to address constant disputes about specific origin determinations for particular products which may, for instance, have an uneven effect on one Member *versus* another. According to the United States, indications of whether rules of origin restrict, distort, or disrupt trade would be if they are overly burdensome to comply with; impose more strict requirements on some countries than on others; or cause confusion in the marketplace.

6.136 The **Panel** recalls that the text of Article 2(c), first sentence, states in relevant part: "[Rules of origin] shall not themselves create restrictive, distorting, or disruptive effects on international trade". The first element to be addressed is the term "themselves". We consider that, in the first sentence of Article 2(c), the pronoun "themselves" is used mainly to emphasise the preceding term "rules of origin". By emphasising the term "rules of origin", the pronoun "themselves" brings out very clearly that the first sentence of Article 2(c) is concerned with a Member's rules of origin, as distinct from something other than rules of origin, and that it is rules of origin, as opposed to something other than rules of origin, that must not "create restrictive, distorting, or disruptive effects on international trade".

6.137 This interpretation draws support from, and is further informed by, the provision immediately preceding Article 2(c). Article 2(b) provides that "notwithstanding the measure or instrument of commercial policy to which they are linked, [Members shall ensure that] their rules of origin are not used as instruments to pursue trade objectives". Thus, Article 2(b) contrasts rules of origin with the commercial policy instruments they are used to implement. As previously noted, Article 2(b) can be understood to mean that commercial policy instruments may pursue trade objectives, but that rules of origin may not. We consider that Article 2(b) lends force to our view that the focus in the first sentence of Article 2(c) is on rules of origin, not some other instrument or mechanism, and clarifies that the relevant other instruments or mechanisms include what Article 2(b) refers to as "the measure[s] or instrument[s] of commercial policy to which [rules of origin] are linked".

6.138 Consideration of relevant context thus leads us to the conclusion that the term "themselves" is meant to highlight that, although there may be commercial policy measures which create restrictive, distorting, or disruptive effects on international trade, the rules of origin used to implement and support these commercial policy measures must not create restrictive, distorting, or disruptive effects on international trade additional to those which may be caused by the underlying commercial policy measures.²⁴⁹ Similarly, in cases where an underlying commercial policy measure does not cause any restrictive, distorting, or disruptive effects on international trade, the word "themselves" would serve to underscore that rules of origin must not create any new restrictive, distorting, or disruptive effects on international trade.

6.139 This interpretation is consistent also with the objective of Article 2(c), first sentence, which is to guarantee a certain trade-neutrality of rules of origin.

6.140 The next element of the text of the first sentence of Article 2(c) to be considered is the term "create". The ordinary meaning of the term "create" is to "cause, occasion, produce, give rise to".²⁵⁰ Thus, it is implicit in the term "create" that a Member's rules of origin only contravene the first sentence of Article 2(c) if there is a causal link between those rules and the prohibited effects

²⁴⁹ It is worth noting in this context that Article 3.2 of the *Agreement on Import Licensing Procedures* on non-automatic licensing contains provisions along these lines. Specifically, it states that "[n]on-automatic licensing shall not have trade-restrictive or -distortive effects on imports *additional* to those caused by the imposition of the restriction" (emphasis added).

²⁵⁰ *The New Shorter Oxford English Dictionary*, L. Brown, ed., Clarendon Press, 1993, Vol. I, p. 198.

specified in the first sentence.²⁵¹ In our view, the term "create" does not imply, however, that the creation of the prohibited effects necessarily needs to be deliberate.²⁵²

6.141 Turning to the prohibited effects – *i.e.*, "restrictive, distorting, or disruptive effects" – the Panel notes that these effects constitute alternative bases for a claim under the first sentence of Article 2(c), as is confirmed by the use of the disjunctive "or". Accordingly, independent meaning and effect should be given to the concepts of "restriction", "distortion" and "disruption". In this regard, we note that the ordinary meaning of the term "restrict" is to "limit, bound, confine"; that of the term "distort" is to "alter to an unnatural shape by twisting"; and that of the term "disrupt" is to "interrupt the normal continuity of".²⁵³ Thus, the first sentence of Article 2(c) prohibits rules of origin which create the effect of limiting the level of international trade ("restrictive" effects); of interfering with the natural pattern of international trade ("distorting" effects); or of interrupting the normal continuity of international trade ("disruptive" effects).

6.142 The first sentence of Article 2(c) states that the prohibited effects must be on "international trade". India points out in this regard that the first sentence does not refer to effects on "imports". We agree with India that the phrase "effects on international trade" encompasses, but is not limited to effects on imports of the good to which the Member concerned applies the relevant rule of origin (*e.g.*, cotton bed linen). This gives rise to two issues. *First*, can the phrase "effects on international trade" also cover adverse effects on trade in goods in intermediate stages of production (*e.g.*, cotton fabric), rather than just trade in the final, or finished, goods to which the relevant rule of origin is applied (*e.g.*, cotton bed linen)?²⁵⁴ *Second*, can the phrase "effects on international trade" cover adverse effects on trade in different (but closely similar) types of finished goods? For instance, would there be a distorting effect on international trade if a rule of origin modified international trade flows by changing the type of goods traded in international trade (*e.g.*, by increasing trade in silk scarves and decreasing trade in cotton scarves)?²⁵⁵ We will address these two issues in turn.

6.143 Beginning with the issue of effects on trade in goods in earlier stages of processing – *i.e.*, "upstream" goods – it is not necessary, in this case, to resolve this issue. In our analysis of the measures at issue, we will assume, *arguendo*, that effects on relevant upstream goods can be viewed as "effects on international trade" within the meaning of the first sentence of Article 2(c).

6.144 With regard to the issue of effects on different types of finished goods, we think it is important, in considering this issue, to have regard, in particular, to the provisions of Article 2(d) of the *RO Agreement*. As we will explain below²⁵⁶, Article 2(d) does not require Members to apply the same rule of origin to "closely related" (but different) goods. Consequently, we cannot adopt an interpretation of Article 2(c), first sentence, which would effectively bar Members from doing what is permissible under Article 2(d).

²⁵¹ It is relevant to point out here that the Appellate Body has given a similar interpretation to the previously mentioned Article 3.2 of the *Agreement on Import Licensing Procedures*. Appellate Body Report, *European Communities – Measures Affecting the Importation of Certain Poultry Products* ("EC – Poultry"), WT/DS69/AB/R, adopted 23 July 1998, DSR 1998:V, 2031, paras. 126-127.

²⁵² The parties share this view. India's reply to Panel question No. 11(a); United States' reply to Panel question No. 11(a).

²⁵³ *The New Shorter Oxford English Dictionary*, L. Brown, ed., Clarendon Press, 1993, Vol. II, p. 2569; Vol. I, pp. 707 and 702, respectively.

²⁵⁴ India argues that the phrase "effects on international trade" does cover adverse effects on trade in goods in intermediate stages of production (*e.g.*, cotton fabric). *E.g.*, India's second oral statement, para. 17; India's reply to Panel question No. 56.

²⁵⁵ India considers this to be an example of distorting effects inconsistent with Article 2(c), first sentence. India's first written submission, para. 91.

²⁵⁶ *Infra*, para. 6.249.

6.145 Indeed, if we were to accept that the first sentence of Article 2(c) prohibits adverse effects on trade in a good which is different from the good subject to the relevant rule of origin, we would effectively require Members to apply a uniform rule of origin to a wide range of different goods. It could then be argued, for instance, that a rule of origin which is not uniformly applied to all competitive goods creates "distorting" effects on international trade. Potentially, therefore, the scope of Article 2(c), first sentence, would be very broad.

6.146 In view of these far-reaching potential consequences, and having regard also to the circumstance that, prior to the entry into force of the *RO Agreement*, rules of origin were not subject to significant GATT disciplines, we cannot assume that Members intended to bring adverse effects on different types of goods within the ambit of the prohibition set out in the first sentence of Article 2(c). Indeed, as the Appellate Body has said in a different context, "[t]o sustain such an assumption and to warrant such a far-reaching interpretation, treaty language far more specific [...] would be necessary".²⁵⁷ We consider that the same could be said of Article 2(c), first sentence.²⁵⁸

6.147 Therefore, we consider that it would not be appropriate to interpret the phrase "effects on international trade" as covering adverse effects on trade in different (but closely similar) types of finished goods. We construe the phrase "effects on international trade" to cover trade in the goods to which the relevant rule of origin is applied (*e.g.*, cotton bed linen). Whether, in addition, this phrase covers trade in goods in intermediate stages of production (*e.g.*, cotton fabric) is an issue which we have said we do not need to decide in this case.

6.148 Relying on the phrase "on international trade", India argues that it is sufficient for a complaining party to show that the challenged rule of origin creates restrictive or distorting effects on one Member's trade.²⁵⁹ Although it is possible to view trade between any two Members as "international trade", we are not convinced that demonstrating an adverse effect on one Member's trade would always and necessarily be sufficient. Indeed, while the use of a particular rule of origin may adversely affect the trade of one Member, it may favourably affect the trade of one or more other Members. For example, the mere fact that one Member would lose trade cannot, in our view, be regarded as conclusive, in and of itself, on the issue of whether the rule in question creates a "restrictive" effect on international trade.

6.149 Regarding the disagreement between the parties whether the phrase "create [...] effects" refers to the effects that the rules of origin are *capable* of creating or whether it refers to the effects they *actually* create in the market-place, we note that, for the purposes of our analysis, we need not resolve the parties' disagreement. In our examination of India's claims under the first sentence of Article 2(c), we will assume, *arguendo*, that India is correct in asserting that the first sentence does not require a showing of actual prohibited effects on international trade and that it is sufficient to demonstrate that the rules of origin in question "create conditions of competition with restrictive, distorting or disruptive effects on international trade"²⁶⁰, *i.e.*, that "the incentives and disincentives

²⁵⁷ Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)* ("EC – Hormones"), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135, para. 165.

²⁵⁸ In response to a question from the Panel, India argues that the plural in Article 2(c) means that that provision applies both to an individual rule of origin as well as to a Member's system of rules of origin. India's reply to Panel question No. 48. Since India, in developing its claim, does not rely on this interpretation of the text of Article 2(c), it is sufficient to note that we understand the plural in Article 2(c), first sentence, to refer to a Member's "rules of origin" taken individually, *i.e.*, to individual rules of origin as they apply to individual goods. Indeed, provisions like the second sentence of Article 2(c), the first clause of Article 2(d), Article 2(f) and Article 3(a) of the *RO Agreement* cannot reasonably be read to lay down disciplines for anything other than individual rules of origin.

²⁵⁹ India's reply to Panel question No. 11(b).

²⁶⁰ India's second written submission, paras. 48 and 60.

faced by traders as a result of the rules of origin at issue are such as to create [the prohibited] effects".²⁶¹

6.150 With the foregoing considerations in mind, we now proceed to assess the consistency of the measures at issue with the first sentence of Article 2(c).

(b) Consistency of the measures at issue with Article 2(c), first sentence, of the *RO Agreement*

6.151 India claims that section 334 and section 405 – hereafter the "measures at issue" – are inconsistent with the first sentence of Article 2(c) because they create (i) "restrictive", (ii) "distorting", and (iii) "disruptive" effects on international trade. In support of this claim, India has advanced two sets of arguments. The first set of arguments is developed mainly in India's first written submission and primarily focuses on the effects resulting from the application of the measures at issue in the implementation of the United States' textile quotas and from the changes made to United States rules of origin in 1996 and 2000.²⁶² The second set of arguments is developed in subsequent submissions and focuses on the features of the relevant United States rules of origin as such.²⁶³ As the relationship between these two sets of arguments is not clear, the Panel will address them separately.²⁶⁴ The Panel will begin its examination with the first set of India's arguments.

(i) *India's arguments as developed in India's first written submission*

"Restrictive" effects on international trade

6.152 **India** asserts that the measures at issue reduced the level of exports from countries such as India which exported greige fabric to third countries to be further processed into made-up articles before onward export to the United States because the fabric-exporting countries' quotas were debited for such further processed articles. According to India, the measures at issue thus entailed new quantitative restrictions on Indian goods exported to third countries, which goods had previously never been subject to any restrictions.

6.153 India cites an example to illustrate the restrictive effects on international trade created by the measures at issue. Based on a fax message dated 20 July 2002 from the *Cotton Textiles Export Promotion Council* in Bombay to the Permanent Mission of India to the WTO²⁶⁵, India states that, prior to the adoption of section 334, greige fabrics were sent from India to Sri Lanka where they were dyed and printed, and subjected to two finishing operations and then stitched into bed linen products. India argues that these products were then exported to the United States as Sri Lankan goods. India contends that, responding to the change in the 1996 rules of origin, India started issuing visas for such consignments from 26 December 1996 to 24 December 1998. India notes that, ultimately however, in view of the non-availability of quota in the relevant category, the operations in Sri Lanka were wound up. India points out that this meant that the export of greige fabric from India to Sri Lanka, the related finishing operations in Sri Lanka, as well as the resulting exports from Sri Lanka to the United States were terminated.

6.154 The **United States** considers that the fax message from the *Cotton Textiles Export Promotion Council* does not demonstrate a causal connection between section 334 and either the rise or fall of Indian fabric exports to Sri Lanka. The United States also notes that India's charge that it has lost business in Sri Lanka as a result of section 334 stands in stark contrast to actual United States import

²⁶¹ India's first oral statement, para. 38.

²⁶² India's first written submission, paras. 91-96.

²⁶³ India's first oral statement, para. 25; India's second written submission, para. 61; India's reply to Panel question No. 66.

²⁶⁴ We note that India has not said that the second set of arguments was somehow intended to supersede the first set.

²⁶⁵ Exhibit INDIA-15.

statistics, which, according to the United States, do not demonstrate – for trade in the HTS classifications that India has identified as being affected by sections 334 and 405 – a particular pattern that would indicate trade restriction.²⁶⁶ The United States also points out that the fax message contains information which indicates that Indian fabric exporters actually benefited from section 334, as they were able to develop new business opportunities in China. The United States further asserts that United Nations data indicates that India's exports of cotton woven fabric to the world increased between 1995 and 1996 and declined slightly in 1997, but the value of exports was higher in 1997 than in 1995.

6.155 The **Panel** notes, as an initial matter, that India's claim with respect to the (alleged) "restrictive" effects of the fabric formation rule in section 334 concerns effects on upstream goods – greige fabric – exported by fabric-forming countries such as India which are under quota in the United States.²⁶⁷ The Panel has indicated above that it is prepared to assume, *arguendo*, that such effects can be viewed as "effects on international trade" within the meaning of the first sentence of Article 2(c).

6.156 It should also be noted that India's assertion is that the fabric formation rule creates a *de facto* restriction on international trade, not a *de jure* restriction.²⁶⁸ As has been observed by another panel, in circumstances where there is no *de jure*, or formal, restriction, "it is inevitable, as an evidentiary matter, that greater weight attaches to the actual trade impact of a measure", *i.e.*, to factual evidence supporting the existence of such a restriction, even if the WTO provision prohibiting such a restriction protects competitive opportunities rather than trade flows.²⁶⁹

6.157 India has offered little factual evidence in support of its assertion that the fabric formation rule creates restrictive effects on trade in upstream goods, specifically, greige fabrics. India relies on a fax message from the *Cotton Textiles Export Promotion Council* in Bombay to the Permanent Mission of India to the WTO. In that message, the *Cotton Textiles Export Promotion Council* provides information, at the request of India's Permanent Mission, regarding what it considers to be the effects of section 334 on Indian textile trade.²⁷⁰

6.158 We are not persuaded from the fax message from the *Cotton Textiles Export Promotion Council* alone that the fabric formation rule in section 334 creates restrictive effects on India's exports of greige fabric. The fax message in question contains a number of assertions, which, however, are not supported by documentary evidence or trade data. The mere assertion, by an Indian exporters' association, that, as a result of the fabric formation rule provided for in section 334, "exports of grey fabrics from India to Sri Lanka [...] suffered a major setback"²⁷¹ is insufficient to establish that the level of exports of Indian greige fabric to Sri Lanka has decreased or that there exists a causal link between the fabric formation rule in section 334 and the alleged decrease in India's exports of greige fabric.

6.159 In any event, even if India had demonstrated that the fabric formation rule creates a restrictive effect on its exports of greige fabric, we have stated above that a showing of a restrictive effect on the trade of a single Member is not sufficient, in all cases, to establish restrictive effects "on international trade". In this case, we have no basis for finding that a showing of restrictive effects on India's exports of greige fabric would, by itself, be sufficient to establish an inconsistency with Article 2(c),

²⁶⁶ The United States refers to exhibits US-8 and US-9.

²⁶⁷ *E.g.*, India's second oral statement, para. 17. We do not understand India to argue that the DP2 rule provided for in section 405 creates restrictive effects.

²⁶⁸ India uses the term "chilling effect". India's second oral statement, para. 17.

²⁶⁹ Panel Report, *Argentina – Measures Affecting the Export of Bovine Hides and Import of Finished Leather* ("Argentina – Hides and Leather"), WT/DS155/R and Corr.1, adopted 16 February 2001, para. 11.20.

²⁷⁰ Exhibit INDIA-15, p. 1.

²⁷¹ *Ibid.*, p. 2.

first sentence. As we have previously pointed out²⁷², we were not provided with any evidence and/or data regarding:

- which countries are under quota in the United States with respect to relevant downstream goods (*e.g.*, cotton bed linen);
- which countries are important suppliers of the relevant upstream goods (*e.g.*, cotton fabric); and
- the price and quality of the upstream goods made by those countries and their production capacity.

6.160 Lacking information on the design of the United States' quota system, the market in the relevant downstream and upstream goods and the relationship between the two, we cannot simply assume that India is the only commercially viable sourcing option for Members importing the relevant greige fabric. There may be competitive suppliers other than India which are not under quota with respect to the relevant downstream goods.²⁷³ A possible decrease in Indian exports of greige fabric might then be accompanied by a corresponding increase in competitive exports by other Members, such that there would not be a restrictive effect on international trade in the relevant greige fabric.

6.161 On the basis of the foregoing considerations, we conclude that India has not established that the measures at issue create restrictive effects on international trade within the meaning of Article 2(c), first sentence.

"Distorting" effects on international trade

6.162 **India** submits that the measures at issue allow more favourable access to certain products over other products. An example is the different treatment being accorded to products based on their fibre composition, such as silk, cotton and wool. In India's view, the measures at issue also favour the products of export interest to the European Communities over products of export interest to developing countries. According to India, the measures at issue consequently create distorting effects on international trade within the meaning of Article 2(c). India also argues that the measures at issue create distorting effects because they shift origin from a third country where the fabric was dyed and printed and subjected to two further finishing operations to the country where the greige fabric was formed. Finally, India argues that, because of the new United States' rules of origin, importers have had to switch to new suppliers as traditional suppliers lost their access to the United States market, distorting historical trade patterns.

6.163 By way of example, India notes that the United States negotiated quota allocations for home textile products (*e.g.*, sheets, pillowcases, comforter shells, quilts, comforters) with various countries or customs territories, such as Hong Kong or Macau, which lacked an indigenous fabric-making industry. India submits that when section 334 entered into force, these quota allocations became useless. India points out that *Pac Fung*, for example, a Hong Kong-based manufacturer of comforter shells, bed sheets and other home textile products, manufactured these products in Hong Kong and Macau using fabric that had been woven in China. India contends that the adoption of section 334 effectively meant that *Pac Fung's* Hong Kong and Macau plants were no longer able to export products to the United States as the fabric was made in China. According to India, trade was distorted because the Hong Kong-based manufacturer's goods were now considered products of China rather

²⁷² *Supra*, para. 6.78.

²⁷³ The United States asserts that, at the time section 334 was implemented, and thereafter, six out of the top ten world exporters of cotton fabrics, accounting for 50 percent of world trade in cotton fabric, were countries which were not subject to quotas on fabric or bed linen in the United States. United States' second oral statement, para. 6. We also recall our earlier finding regarding India's claim under Article 2(b) that India has failed to establish that the fabric formation rule necessarily, or in fact, brings more imports of downstream goods under quota in the United States. *Supra*, para. 6.83.

than of Hong Kong or Macau and they were subject to Chinese quota restrictions. India submits that, since the Chinese quotas for these goods had essentially been filled, the result was that the Hong Kong manufacturer's products were shut out of the United States market. India concludes that, in order to continue to export comforter shells to the United States, the Hong Kong manufacturer had to obtain the fabric from a source other than China, thus distorting patterns of trade.²⁷⁴

6.164 The **United States** argues that changes in rules of origin for quota goods will usually have quota implications that will be different for different Members, depending on their quota levels and the nature of their exports. The United States submits that Members are, however, allowed to change rules of origin during the transition period, and any interpretation of the *RO Agreement* that would prohibit such changes for any product, including products subject to quantitative restrictions authorized by the *WTO Agreement*, can therefore not be correct. The United States also argues that product differentiation is allowed under the *RO Agreement* and that India seems to confuse differentiation with discrimination.

6.165 The United States further submits that trade data do not bear out any claim of trade distortion for trade in the HTS classifications that India has identified as being affected by sections 334 and 405.²⁷⁵

6.166 In considering India's claim of distortion, the **Panel** turns, *first*, to India's argument that the measures at issue create distorting effects on international trade because they shifted origin from a country where the fabric of a made-up article was subjected to a DP2 operation to the country where the greige fabric was formed.²⁷⁶ In our view, the mere fact that a change in a Member's rules of origin results, for a given finished good exported to that Member (*e.g.*, bed linen), in a different country of origin is not sufficient, in and of itself, to demonstrate a distorting effect on international trade. Indeed, if the first sentence of Article 2(c) prevented a Member from changing a rule of origin merely because that would involve a change of country of origin, then, contrary to Article 2(i) of the *RO Agreement*, rules of origin could never be changed.

6.167 What matters, for the purposes of Article 2(c), first sentence, is whether the new rule of origin creates distorting effects, not whether the change from the previous rule of origin to the new one creates such effects. Indeed, as noted by the United States, the previous rule may itself have created distorting effects, such that any country of origin determination resulting from that rule could be inappropriate.²⁷⁷

6.168 The *second* Indian argument which we consider is that the measures at issue result in certain finished goods enjoying better access to the United States market than other finished goods and that this creates distorting effects on international trade. Specifically, India argues that the measures at issue create distorting effects on trade in different types of finished goods (*e.g.*, silk scarves *versus* cotton scarves).²⁷⁸ We have stated above that we do not consider that the prohibition set out in Article 2(c), first sentence, covers distorting effects on trade in different types of goods. At any rate, for India's argument to succeed, India would need to demonstrate that the goods in question are in competition with each other and that the measures at issue distort trade in those goods. But India has not demonstrated that those goods which it alleges enjoy more favourable access to the United States market (*e.g.*, silk scarves) are in competition with those goods which it considers are given less favourable access (*e.g.*, cotton scarves).

²⁷⁴ India refers to *Pac Fung Leather Co. v. The United States*, 111 F.3d. 114 (Fed. Cir 1997) (exhibit INDIA-16).

²⁷⁵ The United States refers to exhibits US-8 and US-9.

²⁷⁶ India's first written submission, para. 96.

²⁷⁷ United States' reply to Panel question No. 11(f).

²⁷⁸ India's first written submission, para. 91.

6.169 Nor has India established that the measures at issue create distorting effects on trade. India's argument is that the measures at issue distort trade because, pursuant to these measures, some goods are subject to the DP2 rule, while others are subject to the fabric formation rule and because this determines whether particular exports fall within quotas in the United States. We do not consider that the fact that the United States uses a fabric formation rule for some finished goods and a DP2 rule for others is of itself sufficient to demonstrate distorting effects on trade in these goods. For example, if a country which performs a DP2 operation on a particular good is under quota in the United States for that good, a DP2 rule would not necessarily result in more favourable access to the United States market than a fabric formation rule.

6.170 For these reasons, we are unable to accept India's argument that the measures at issue create distorting effects because they result in certain finished goods enjoying better access to the United States market than other finished goods.

6.171 A related argument put forward by India is that the measures at issue create distorting effects because they create artificial incentives to modify the type of inputs used (*e.g.*, silk fabric *versus* cotton fabric).²⁷⁹ India has not elaborated on this argument or provided supporting factual information. In our view, this argument is no more than a variation of India's previous argument, except that it is concerned with inputs, or "upstream" goods, rather than with the finished goods.²⁸⁰ Notwithstanding this difference, our considerations relating to the previous argument apply, *mutatis mutandis*, to this argument as well.

6.172 The *third* Indian argument is that the measures at issue create distorting effects on international trade because they favour goods of export interest to the European Communities over goods of export interest to developing countries. To recall, such goods as silk scarves (a good of export interest to the European Communities) are subject to the DP2 rule, whereas such goods as cotton bed linen (a good of export interest to developing countries such as India) are subject to the fabric formation rule. Since India's argument concerns the trade implications of the application of different rules of origin to different goods, this argument, too, depends on the goods in question being in competition with each other and the measures at issue distorting trade. It is also premised on a reading of Article 2(c), first sentence, with which we do not agree, *viz.*, that the prohibition set out in Article 2(c), first sentence, covers distorting effects on trade in different types of goods. Even disregarding this, India has not specifically established the existence of a competitive relationship between individual goods of export interest to the European Communities, on the one hand, and developing countries, on the other.²⁸¹ Nor has India established that applying a DP2 rule to goods of export interest to the European Communities would necessarily favour those goods *vis-à-vis* goods of export interest to developing countries which are subject to the fabric formation rule.

6.173 *Finally*, we turn to India's argument that, because of the new United States rules of origin, importers had to switch to new suppliers, as traditional suppliers lost their access to the United States market, which, according to India, distorted historical trade patterns.²⁸² This argument concerns effects on "upstream" trade, specifically the sourcing of inputs of a particular type (*e.g.*, cotton fabric). We note that sourcing decisions by importers are not exclusively driven by rules of origin, such that a change in historical sourcing patterns is not necessarily attributable to a change in rules of origin. But even assuming that the measures at issue, rather than some other factor, led some importers to source particular inputs from new countries²⁸³, we do not think that these measures could, for that reason

²⁷⁹ India's reply to Panel question No. 66.

²⁸⁰ As previously pointed out, we are assuming, *arguendo*, that effects on upstream goods can be viewed as "effects on international trade" within the meaning of the first sentence of Article 2(c).

²⁸¹ India's reply to Panel question No. 58(b).

²⁸² India's reply to United States' question No. 2.

²⁸³ We note in this regard that the documentary evidence provided by India in support of the example of *Pac Fung*, the Hong Kong-based manufacturer of comforter shells, bed sheets and other home textile products,

alone, be considered to create distorting effects on international trade. India has not demonstrated, for particular inputs, that the measures at issue result in importers sourcing these inputs from countries whose inputs are not comparable in relevant respects (price, quality, etc.) to the inputs they used to obtain from other countries under the previous rules of origin. In the absence of any demonstration of this kind, we are unable to accept India's argument that the measures at issue create distorting effects on trade because some importers had to source their inputs from new supplier countries.

6.174 In the light of the above, we conclude that India has not established that the measures at issue create distorting effects on international trade within the meaning of Article 2(c), first sentence.

"Disruptive" effects on international trade

6.175 **India** argues that the measures at issue create disruptive effects on international trade because of their sheer complexity and the arbitrary nature of the criteria used. India also argues that the measures at issue undermine informed compliance by foreign producers, thereby disrupting trade, as the same product undergoing the same production operations in Sri Lanka may be a product of Sri Lanka or India depending on the product's fibre content.

6.176 As an example of the disruptive effects of the measures at issue, India again cites the Sri Lankan case referred to above. According to India, the changes in the United States' rules of origin disrupted the trade from India to Sri Lanka. India argues that, from the perspective of the importer in Sri Lanka, the process of obtaining an allocation from India's quota imposed a burden to verify that the greige fabric was Indian. India considers that, from the perspective of the exporter in India, it also imposed difficulties. India notes that its exporters of fabric usually export to a wholesaler in bulk. India points out that, in the other country, such as Sri Lanka, the processors and manufacturers of made-up items usually purchase greige fabrics from these wholesalers, and then convert them to made-up items which could then be exported to other markets, such as the United States. Due to the complexities of this commercial chain, it was difficult, according to India, for its exporters to give information on how much of their fabrics exported to other countries were subsequently exported to the United States as made-up products.

6.177 The **United States** notes that India has not demonstrated that "complexity" is a prohibited criterion. The United States points out, in addition, that India has presented no evidence that the rules of origin in question have discouraged exporters from shipping their products to the United States because they simply could not understand them. The United States considers that its regime is perfectly comprehensible to businesses engaged in importing and exporting, as is demonstrated by the fact that India supplies nearly \$3 billion in textiles and apparel products to the United States. The United States also recalls that importers have always had the right to ask for an interpretation of the rules with specific regard to their product.

6.178 The United States submits, furthermore, that trade data do not bear out any claim of trade disruption for trade in the HTS classifications that India has identified as being affected by sections 334 and 405.²⁸⁴

6.179 The **Panel** notes that India's claim of disruption is based on three separate grounds. *First*, India considers that the "sheer complexity" of the measures at issue creates disruptive effects on trade. However, rules of origin are, by their nature, complex. India has neither shown that the measures at issue are more complex than necessary, nor has it explained precisely how the alleged complexity of the measures at issue creates a disruptive effect on international trade. In a different context, India asserts that the complexity of the measures at issue is such that "traders have to regularly seek rulings

does not seem to support India's assertion that, because of the measures at issue, *Pac Fung* had to obtain its inputs from a country other than China in order to continue to export to the United States. Exhibit INDIA-16.

²⁸⁴ The United States refers to exhibits US-8 and US-9.

from the United States Customs as to the determination of origin for a particular product".²⁸⁵ Given the inherent complexity of rules of origin, it is common that traders regularly seek interpretative rulings. The mere fact that they do so does not establish, in and of itself, that the measures at issue disrupt trade.²⁸⁶ In any event, as also pointed out by the United States, this Panel has seen no evidence that traders or producers stopped exporting to the United States due to the "sheer complexity" of the measures at issue. In the light of these considerations, we are unable to accept that the measures at issue create a disruptive effect on international trade because of their "sheer complexity".

6.180 *Second*, India asserts that the measures at issue create disruptive effects on international trade because of the "arbitrary nature" of the "criteria" used. However, the measures at issue use origin-conferring criteria which are specifically identified in Article 2(a)(iii) of the *RO Agreement*. To that extent, they plainly cannot be regarded as "arbitrary" criteria. India sees as "arbitrary" the fact that, pursuant to the measures at issue, the country of origin of goods can vary based on the type of good (e.g., finished cotton fabric *versus* cotton bed linen) or the fibre composition of the finished good (e.g., made-up articles with 15% cotton by weight *versus* made-up articles with 17% cotton by weight).²⁸⁷ It is true that the distinction made by the United States between certain cotton blends of flat goods is not found in the HS heading for flat goods. However, that distinction is not without rationale, since it is based on a distinction found in the HS chapter relating to classification of cotton yarn and fabrics. Nor can distinctions based on the type of good be regarded as arbitrary, unless the goods are essentially the same. In any event, even if the criteria used in the relevant United States' rules of origin were to be characterized as arbitrary, we have not been provided with evidence that exports of foreign producers have been disrupted as a result of the alleged arbitrariness of the "criteria" used in the relevant United States' rules of origin. The only argument offered by India is that the measures at issue "undermine informed compliance" by foreign producers because the same good undergoing the same production operations in, say, Sri Lanka may be a good of Sri Lanka or another Member depending on the good's fibre content. We do not find this argument persuasive. The measures at issue do not strike us as particularly complex or difficult for foreign producers to understand. Moreover, India's argument presumes that foreign producers are somehow uninformed as to the rules of origin their exports must comply with.²⁸⁸

6.181 *Third*, India asserts that the measures at issue create disruptive effects on international trade because they result in the imposition of certain administrative burdens. India notes that a foreign producer making bed linen from Indian cotton fabric for export to the United States would, in order to obtain an allocation from India's bed linen quota, need to verify that the greige fabric is Indian. We understand this to mean that the producer in question would need to establish to the satisfaction of India's authorities that the bed linen was made from Indian fabric. It is apparent that, in order for India to be able to verify the origin of goods exported under quotas, India needs to establish a relatively complex administrative system, the operation of which may entail some administrative burden for India's producers as well as foreign producers. However, it is not clear to us that the measures at issue are in any way linked to the verification requirement referred to by India.²⁸⁹ At any rate, India has provided no information regarding the steps producers must take in order to comply

²⁸⁵ India's first written submission, para. 100.

²⁸⁶ Indeed, we note that Article 2(h) of the *RO Agreement* not only permits, but actually requires Members to issue, on request of an exporter or importer, assessments of the origin they would accord to individual goods. Thus, the issuance of origin assessments is apparently considered to be an integral part of the application of all rules of origin. Moreover, Article 2(h) also states that requests for assessments must be accepted even before trade in the good concerned begins and is normally valid for a period of three years. Thus, the assessment procedure need not disrupt trade. In the present case, India does not claim that the measures at issue are inconsistent with Article 2(h).

²⁸⁷ India's first written submission, paras. 78, 82-83.

²⁸⁸ We note in this regard that India itself considers that new rules of origin immediately change the investment and other business plans of producers and traders. India's reply to Panel question No. 26.

²⁸⁹ The Panel has not been provided with documentary evidence of that verification requirement.

with the verification requirement in question. Nor has India explained precisely how that requirement results in the measures at issue creating a disruptive effect on trade. In these circumstances, we are unable to conclude that the measures at issue create disruptive effects on international trade.

6.182 Another administrative burden which India claims results from the application of the measures at issue and creates a disruptive effect on its trade is that it is "difficult" for Indian exporters to give information on how much of their fabrics exported to third countries are subsequently exported to the United States as made-up articles. Given the legitimate right of the United States to determine the origin of goods imported under quotas, the difficulty identified by India is unavoidable. However, it is not clear to us that the measures at issue are in any way linked to the information requirement referred to by India.²⁹⁰ At any rate, India has not explained precisely how the "difficulty" identified by India creates a disruptive effect on trade. Nor has India discussed the possibility of addressing this difficulty, for instance, through arrangements for administrative co-operation between India's authorities and the authorities of countries importing fabrics from India. In these circumstances, we are unable to accept India's claim that the measures at issue disrupt trade because they result in certain administrative difficulties for Indian exporters.

6.183 In the light of the foregoing, we conclude that India has not established that the measures at issue create disruptive effects on international trade within the meaning of Article 2(c), first sentence.

6.184 Before proceeding to examine what the Panel has referred to as the second set of India's arguments, it should be noted that the Panel takes no position on whether rules of origin which create restrictive, distorting or disruptive effects on international trade would necessarily constitute rules of origin which "themselves" create "restrictive, distorting, or disruptive effects on international trade", within the meaning of Article 2(c), first sentence.²⁹¹

(ii) *India's arguments as developed subsequent to India's first written submission*

6.185 **India** argues that the first sentence of Article 2(c) is not intended to prevent the adoption of all rules of origin changing trade patterns, but only the adoption of rules of origin with features comparable to those referred to in the second sentence of Article 2(c). Along the same lines, India argues that Article 2(c) is meant to ensure that the conferral of origin does not depend on the fulfilment by producers and traders of conditions creating restrictive, distorting or disruptive effects that are not necessary to determine the origin of products and that consequently go beyond those inevitably created by any rule of origin.

6.186 With respect to the measures at issue, India asserts that the fabric formation rule and the DP2 rule create restrictive, distorting or disruptive effects whether they are applied to the current United States' textile quota regime or any other trade policy instrument. More specifically, India asserts that the United States' rules of origin themselves create restrictive, distorting or disruptive effects on international trade because they impose requirements completely unrelated to the degree of

²⁹⁰ India has not identified the legal basis for such a requirement. India's first written submission, para. 95.

²⁹¹ We also note that India has not established that the fabric formation and DP2 rules, when used for purposes other than quota administration, create the effects on international trade prohibited by Article 2(c), first sentence. For instance, with respect to the use of United States' rules of origin in support of marking, India merely states that it is "arguable" that the change in rules of origin disrupted trade. In any event, this assertion is based on the effect of a change in rules of origin, rather than on the effect of the new rules of origin themselves. India's reply to Panel question No. 55(b). With respect to the use of the fabric formation rule for the purpose of gathering trade statistics, India has also not substantiated its assertion that this rule creates a distorting effect on trade by skewing import statistics. Nor, in our view, has it explained how the fabric formation rule "might make it appear as if imports from a given country, say, India, were increasing, when in fact, they might not be", such that anti-dumping duties might be imposed against such imports when there is no basis for doing so. India's reply to Panel question No. 55(b).

manufacturing, processing or other economic activity that took place in the country deemed to be the originating country. India considers that the United States' rules of origin, by providing for distinctions based on the type of fabrics or fibre blends, rather than any criteria regarding the nature and extent of further processing in a third country, distort and disrupt trade flows between countries supplying different fibres. India also considers that trade is disrupted and restricted as it relates to those countries which supply fabric (such as cotton) for textiles that do not enjoy the exemptions specified in section 405. India submits that the differentiation between goods made of different fabrics or fibre blends is not necessary to determine in which country a sufficient amount of manufacturing, processing or other economic activity took place to justify the conferral of origin.

6.187 The **United States** argues that the United States' rules of origin at issue in this dispute reflect common international practice, are based on criteria related to production, and reflect where the most recent substantial transformation took place. The United States considers that these rules of origin themselves cannot, therefore, be found to create restrictive, distorting or disruptive effects on international trade.

6.188 The **Panel** notes that India's arguments are based on a reading of Article 2(c), first sentence, according to which rules of origin must not create restrictive, distorting or disruptive effects which are not necessary to determine the origin of goods. In considering India's arguments, the Panel will assume, *arguendo*, that this reading of Article 2(c), first sentence, is correct.

6.189 India's arguments rest on the assertion that the distinctions made in the measures at issue between goods made of different fabrics or fibre blends are not necessary to determine in which country a sufficient amount of processing or other economic activity took place to justify the conferral of origin. This is essentially a variation on India's earlier assertion, advanced in support of its claim under Article 2(b), that the fabric formation rule in section 334 neither reflects the importance of subsequent processing operations to the making of the goods to which it applies nor takes account of subsequent value-added operations. However, as we have stated in our analysis of India's claims under Article 2(b), we are not persuaded that, for the goods concerned, the United States cannot determine that fabric formation is the most significant processing operation and that a subsequent processing operation is insufficient to justify the conferral of origin, or that the United States must confer origin on the country where the most significant economic contribution to the final good has been made.²⁹² In the light of this, and having regard to the fact that India has presented no new arguments here, we find that India has failed to establish that the distinctions made in the measures at issue are not necessary to determine the origin of the relevant goods.

6.190 Since India has failed to establish the basic premise of its arguments, we need not continue our analysis. In particular, we need not decide whether India's reading of Article 2(c), first sentence, is correct. Accordingly, we conclude that, even under India's own reading, India's arguments do not establish that the measures at issue are inconsistent with Article 2(c), first sentence.

6.191 We have concluded that neither what we have referred to as the first set of Indian arguments nor what we have referred to as the second set of Indian arguments establishes that the measures at issue are inconsistent with Article 2(c), first sentence. Even considering all of India's arguments together, however, they do not support the conclusion that the measures at issue are inconsistent with Article 2(c), first sentence.

3. India's claims under Article 2(c), second sentence, of the *RO Agreement*

6.192 The Panel now turns to examine India's claims that section 334 and section 405 are inconsistent with the second sentence of Article 2(c) of the *RO Agreement*. The Panel will begin this examination by considering the provisions of the second sentence of Article 2(c).

²⁹² *Supra*, paras. 6.74-6.75. See also *infra*, para. 6.207.

(a) Article 2(c), second sentence, of the *RO Agreement*

6.193 Article 2(c) provides as follows:

"Until the work programme for the harmonization of rules of origin set out in Part IV is completed, Members shall ensure that:

[...]

(c) rules of origin shall not themselves create restrictive, distorting, or disruptive effects on international trade. They shall not pose unduly strict requirements or require the fulfilment of a certain condition not related to manufacturing or processing, as a prerequisite for the determination of the country of origin. However, costs not directly related to manufacturing or processing may be included for the purposes of the application of an ad valorem percentage criterion consistent with subparagraph (a).]"

6.194 **India** notes that the second sentence of Article 2(c) has two clauses. With respect to the *second* clause of the second sentence – "[rules of origin shall not] require the fulfilment of a certain condition not related to manufacturing or processing" – India argues that, like Article 2(a) of the *RO Agreement*, it reflects the significance that manufacturing or processing of a product has upon the determination of origin for that product.

6.195 With respect to the *first* clause of the second sentence – "[rules of origin] shall not pose unduly strict requirements" – India argues that that clause supports the view that Article 2(c) is meant to ensure that the conferral of origin does not depend on the fulfilment by producers and traders of conditions creating restrictive, distorting or disruptive effects that are not necessary to determine the origin of products and that consequently go beyond those inevitably created by any rule of origin. In India's view, this conclusion is also supported by the fourth clause of the preamble of the *RO Agreement* according to which this Agreement is "to ensure that rules of origin themselves do not create *unnecessary* obstacles to trade".

6.196 According to India, it is clear from the wording of Article 2(a) and Article 2(c) that the conferral of origin upon a product must be based on the determination of the country with which that product has a significant economic link. In India's view, it follows that the first clause of the second sentence of Article 2(c) is violated if a Member confers origin on the basis of requirements that are burdensome and are not necessary to determine the economic link between the product and the country on which origin is conferred.

6.197 The **United States** considers that the second clause of the second sentence of Article 2(c) qualifies the first clause. In other words, in the view of the United States, Article 2(c) does not bar "unduly strict requirements"; it bars "unduly strict requirements [...]" as a prerequisite for the determination of the country of origin". Similarly, Article 2(c) does not bar "requiring the fulfilment of a certain condition not related to manufacturing or process" except "as a prerequisite for the determination of country of origin".

6.198 With respect to the *second* clause of the second sentence, the United States argues that an example of the fulfilment of a certain condition not related to manufacturing or processing as a prerequisite for the determination of the country of origin would be a rule of origin that requires a particular nationality of company ownership, or requires the use of personnel of a certain religious order to achieve a certain determination of origin, or requires that a good be certified by several authorities through a time-consuming process in the exporting country in order to be declared as originating in that country.

6.199 With respect to the *first* clause of the second sentence, the United States argues that the application of a non-preferential rule of origin that involves a 60% *ad valorem* criterion would likely be viewed as "strict", but not "unduly strict". By contrast, a non-preferential rule of origin that, for example, involves an even higher *ad valorem* criterion, combined with mandating a particular technology for manufacture may be viewed as "unduly strict".

6.200 The United States further argues that the second sentence of Article 2(c) does not stand alone, but operates to articulate the type of rules of origin that "themselves" could meet the requirement of the first sentence of Article 2(c). In other words, the United States considers that the second sentence of Article 2(c) demonstrates one manner in which rules of origin can "create restrictive, distorting, or disruptive effects on international trade". Therefore, in the view of the United States, it would be necessary to show that the existence of the elements of the second sentence of Article 2(c) created actual effects on international trade.

6.201 Thus, in determining whether a requirement is "unduly strict", for example, it is necessary, in the view of the United States, to examine the actual effects on international trade. If such a requirement had a significant impact on international trade, it would, according to the United States, support a Member's claim that the requirement is "unduly strict". If there were no trade impact, it would support a Member's position that such a requirement is not "unduly strict". On the other hand, there are some such requirements that on their face would, in the view of the United States, be correctly characterized as "unduly strict", even in the absence of a trade effect. However, even if a measure could be characterized as "unduly strict" in the absence of a trade effect, it would, in the view of the United States, only be inconsistent with Article 2(c) if the complaining Member established that the measure created actual effects on international trade in violation of the first sentence of Article 2(c). The United States submits that, similarly, a rule of origin implementing a particular measure that requires the fulfilment of a manufacturing process (e.g., "assembly" as a criterion) may have an effect on international trade, but would not necessarily be seen as a rule of origin that *itself* creates "restrictive, distorting, or disruptive effects on international trade". By contrast, a rule of origin that requires the fulfilment of a condition not related to manufacturing or processing (e.g., nationality of company ownership) could, according to the United States, be viewed as a rule of origin that *itself* creates "restrictive, distorting, or disruptive effects on international trade", if the latter situation has also been established.

6.202 The **Panel** commences its analysis with the first clause of Article 2(c), second sentence, according to which rules of origin must not "pose unduly strict requirements".

6.203 The United States argues that in order for requirements to be "unduly strict" within the meaning of Article 2(c), second sentence, it would be necessary to demonstrate that the challenged rules of origin create actual effects on international trade "in violation of the first sentence of Article 2(c)".²⁹³ However, in view of the position the Panel takes on India's claim in respect of the second sentence of Article 2(c), the Panel sees no need to examine whether Article 2(c), second sentence, includes the requirement referred to by the United States.

6.204 First, we need to examine what kind of "requirements" are covered by the obligation that Members must ensure that their rules of origin not "pose unduly strict requirements". In this regard, we note the view of the United States that the clause "as a prerequisite for the determination of the country of origin" qualifies also the phrase "[rules of origin] shall not pose unduly strict requirements". While the English version of Article 2(c) may be susceptible of such an interpretation, the equally authentic French version is not.²⁹⁴ Nevertheless, the clause "as a prerequisite for the

²⁹³ United States' reply to Panel question No. 73.

²⁹⁴ The French version of Article 2(c), second sentence, reads as follows:

determination of the country of origin" is part of the immediate context of the term "requirements". Considered as relevant context, the clause at issue lends force to the argument that the "requirements" which must not be unduly strict include the kind of requirements which must be fulfilled as a prerequisite for the determination of the country of origin. Article 2(a) of the *RO Agreement* provides further contextual support for such an interpretation. The first sentence of that provision states that the "requirements to be fulfilled" must be clearly defined. It is clear to us that these requirements include the substantive requirements which must be met for a good to be determined to originate in a particular country. For these reasons, we read the term "requirements" in the second sentence of Article 2(c) as encompassing the substantive origin requirements²⁹⁵ that must be met for a good to obtain origin status.²⁹⁶

6.205 Another issue presented by the phrase "unduly strict requirements" is the interpretation to be given to the adjective "strict". The most pertinent dictionary definitions of the term "strict" are "exacting"²⁹⁷ and "rigorous"²⁹⁸. Thus, a "strict" requirement is an exacting or rigorous requirement. In the specific context of Article 2 of the *RO Agreement*, and also bearing in mind our interpretation of the term "requirements", "strict" requirements are, therefore, those requirements which make the conferral of origin conditional on conformity with an exacting or rigorous (technical) standard.²⁹⁹

6.206 The second sentence of Article 2(c) only precludes Members from imposing requirements which are "unduly" strict. The dictionary meaning of the adverb "unduly" is "more than is warranted or natural; excessively, disproportionately".³⁰⁰ Accordingly, an origin requirement can be considered to be "unduly" strict if it is excessively strict.

6.207 India invites the Panel to adopt a particular standard in determining whether origin requirements are unduly strict. Specifically, India argues that origin requirements are unduly strict if they are burdensome and need not be imposed to determine the country with which the good in question has a significant economic link. Even if we were to agree that Article 2(a) (specifically, the three origin-criteria specifically listed in indents (i) through (iii)) and the second clause of the second

"[Les règles d'origine] n'imposeront pas de prescriptions indûment rigoureuses ni n'exigeront, comme condition préalable à la détermination du pays d'origine, le respect d'une certaine condition non liée à la fabrication ou à l'ouvroison."

The Spanish text of Article 2(c), second sentence, seems to track the French version rather than the English version. It reads:

"[Las normas de origen] [n]o impondrán condiciones indebidamente estrictas ni exigirán el cumplimiento de una determinada condición no relacionada con la fabricación o elaboración como requisito previo para la determinación del país de origen."

²⁹⁵ For the purposes of this dispute, we need not decide whether the "requirements" mentioned in the second sentence of Article 2(c) would also encompass the formal, or administrative, requirements which may be imposed in order to assess compliance with rules of origin (e.g., documentation requirements).

²⁹⁶ The negotiating history of the *RO Agreement* tends to confirm that the term "requirements" refers to the substantive origin requirements that must be met for a good to obtain origin status. The first clause of Article 2(c), second sentence, appears to originate in two provisions proposed by Japan. The first of these proposed provisions states that "the *requirements to be fulfilled in the determination of origin* shall be clearly defined. [...] Rules of origin which state only what does not confer origin [...] or state only abstract conditions or *unduly strict conditions* shall be prohibited". MTN.GNG/NG2/W/52, p. 5 (emphasis added). The other provision proposed by Japan states that "[t]echnically excessive requirements as a prerequisite for the determination of country of origin shall be prohibited". *Ibid.*

²⁹⁷ *Black's Law Dictionary*, B. A. Garner (ed.), West Group, 1999, p. 1434.

²⁹⁸ *Merriam-Webster OnLine Thesaurus*, <http://www.m-w.com> (March 2003). We note that the French version of the second sentence of Article 2(c) also uses the adjective "rigoureux".

²⁹⁹ In other words, we think that the "strictness" of requirements is to be assessed from the perspective of countries wanting to obtain origin status, rather than from the perspective of countries wanting to lose origin status.

³⁰⁰ *The New Shorter Oxford English Dictionary*, L. Brown (ed.), Clarendon Press, 1993, Vol. 2, p. 3480.

sentence of Article 2(c) (specifically, the obligation not to require the fulfilment of a condition unrelated to manufacturing or processing) could broadly support the notion that origin determinations should be conditional on the existence of some economic link between the good in question and the country the origin of which it is accorded, we do not discern in Article 2(a) or Article 2(c) a requirement that there necessarily be a significant economic link. At any rate, it is not clear on what basis and how Members would distinguish between economic links that are "significant" and those that are not.

6.208 Regarding the second clause of Article 2(c), second sentence, we note that the parties have not identified specific interpretative issues. We consider that the ordinary meaning of the second clause is clear. It requires Members to ensure that the conditions their rules of origin impose as a prerequisite for the conferral of origin not include a condition which is unrelated to manufacturing or processing.³⁰¹ We note the example offered by the United States that a rule of origin would not conform to this requirement if it stated that a good can only be ascribed the origin of a country if the good has been certified by several authorities through a time-consuming process in the exporting country.

6.209 With the foregoing considerations in mind, we now proceed to assess the consistency of the measures at issue with the second sentence of Article 2(c).

(b) Consistency of the measures at issue with Article 2(c), second sentence, of the *RO Agreement*

6.210 India claims that section 334 and section 405 – hereafter the "measures at issue" – are inconsistent with the second clause of Article 2(c), second sentence ("fulfilment of a condition not related to manufacturing or processing"). In the alternative, India claims that the measures at issue are inconsistent with the first clause of Article 2(c), second sentence ("unduly strict requirements").³⁰² Accordingly, the Panel will first examine India's claim under the second clause of Article 2(c), second sentence.

(i) "*Fulfilment of a condition not related to manufacturing or processing*"

6.211 **India** asserts that the United States' rules of origin require the fulfilment of conditions not related to manufacturing or processing in three situations. *First*, when there is a distinction made between fabric of silk, cotton, man-made fibre, or vegetable fibre and fabric made of other fibres, such as wool in determining when the fabric forward rule will be applied.³⁰³ *Second*, when there is a distinction made between products classified under seven HTS 4-digit headings listed in section 405(a)(3)(C) and the products classified under the remaining 16 HTS headings in section 334(b)(2) in determining when origin will be conferred by a DP2 operation.³⁰⁴ *Third*, when within those seven HTS 4-digit headings, there is a distinction made between products made of cotton, wool, or a fibre blend with more than 16% cotton and products made of other fibres in determining when the fabric forward rule will be applied.

6.212 With respect to the first situation, India considers that there is no difference in the processing of the weaving of wool yarns into fabric from the weaving of cotton, silk or man-made fibre yarns into fabric. With respect to the second situation, India considers that there is no distinction in the processing of the products under the seven headings as compared to the remaining 16 headings. According to India, the processing of a shawl under HTS 6214 is not different from the processing of

³⁰¹ We are aware that the third sentence of Article 2(c) states that "costs not directly related to manufacturing or processing may be included for the purposes of the application of an ad valorem percentage criterion consistent with subparagraph (a)". But the third sentence opens with the word "however", which implies a contrast between the second and third sentences.

³⁰² India's second written submission, para. 43.

³⁰³ India refers to section 405(a)(3)(B).

³⁰⁴ India refers to section 405(a)(3)(C), which provided exceptions to section 334(b)(2).

a blanket under HTS 6301. With respect to the third situation, India considers that there is no difference between the processing of a bed valance made of 83% polyester / 17% cotton blend as compared to a bed valance made of 86% polyester / 14% cotton blend. India argues that under the United States' rules of origin different determinations of origin will be made in each of these situations. India submits that these distinctions constitute conditions which are not at all related to manufacturing or processing, and therefore are clearly inconsistent with the obligation in the second clause of the second sentence of Article 2(c).

6.213 India points out that a United States' attorney, an expert in the textiles and apparel sector, has noted the absurdity of these distinctions and concluded that the United States' rules of origin containing the distinctions between fabrics, products and fibre blends were "far more motivated by a desire to protect United States wool and cotton producers than by any desire to create genuinely logical changes to rules of origin". India agrees with this interpretation, and considers that the United States' rules of origin require the fulfilment of conditions not related to manufacturing or processing as a prerequisite to the determination of country of origin, which is inconsistent with the second clause of the second sentence of Article 2(c).

6.214 The **United States** notes that it does not see the value of the bifurcation of India's claim in respect of the first two sentences of Article 2(c), other than to highlight the opinions of a United States attorney who often represents importers. In the view of the United States, India has not made a prima facie case that the United States' rules of origin are unrelated to the manufacturing or processing or assembly of textile and apparel products. The United States notes that it appears to be India's opinion that the United States cannot, under the *RO Agreement*, make a distinction between the rules of origin for silk fabrics and the rules of origin for wool fabrics.

6.215 The **Panel** recalls India's argument that, for the purpose of determining the applicable rule of origin, the measures at issue make distinctions between:

- fabrics of silk, cotton, man-made fibre, or vegetable fibre, on the one hand, and fabric made of other fibres, such as wool, on the other hand;
- goods classified under seven HTS 4-digit headings listed in section 405(a)(3)(C) and goods classified under the remaining 16 HTS headings in section 334(b)(2); and, within those seven HTS 4-digit headings,
- between goods made of cotton, wool, or a fibre blend with more than 16% cotton and goods made of other fibres.

6.216 In India's view, these three "distinctions" constitute "conditions" within the meaning of Article 2(c), second sentence, which are not related to manufacturing or processing.³⁰⁵ We are not persuaded by this view.

6.217 The three distinctions identified by India are nothing more than what India itself calls them, viz., product distinctions. The distinctions are maintained by the United States in order to define the product coverage of particular rules of origin, such as the fabric formation rule and the DP2 rule. Indeed, it seems to us that, unless a country applies a uniform rule of origin to all goods, product distinctions are unavoidable.

6.218 In any event, as a matter of logic, we fail to see how a "distinction" could be viewed as a "condition". Presumably, what India means is that, pursuant to the measures at issue, goods must meet a certain definition in order to be entitled to particular rules of origin. At most, we could accept that, in a very broad sense, the product definitions impose certain "conditions". These would be conditions which must be fulfilled for a good to be subject to a particular rule of origin. However, the second clause of Article 2(c), second sentence, speaks of "the fulfilment of a certain condition [...] as

³⁰⁵ India's second written submission, para. 40.

a prerequisite for the determination of the country of origin". It does not speak of "the fulfilment of a certain condition [...] as a prerequisite for the application of particular rules of origin". We consider, therefore, that the conditions at issue in the second clause of Article 2(c), second sentence, are those that relate to the determination of the country of origin, and not the determination of the (applicable) rule of origin.³⁰⁶ Consistent with this, we think that the conditions at issue in the second clause of Article 2(c), second sentence, are those that must be fulfilled for a qualifying good to be accorded the origin of a particular country. The third sentence of Article 2(c) reinforces our view. It plainly addresses conditions used in connection with the application of a criterion for origin determination – the *ad valorem* percentage criterion. It does not address the issue of how the goods which are covered by such a criterion are defined.

6.219 In the light of the foregoing considerations, we are not convinced that the three "distinctions" identified by India can be regarded as "condition[s] not related to manufacturing or processing" within the meaning of the second clause of Article 2(c), second sentence.

6.220 India has not argued that there are other conditions in section 334 or section 405 which are unrelated to manufacturing or processing. We note, furthermore, that, in response to questions regarding the criteria for the determination of origin applied in section 334 and section 405, the United States has stated that the relevant provisions of section 334 and section 405 are based on Article 2(a)(iii) of the *RO Agreement*.³⁰⁷ Article 2(a)(iii) relates to the criterion of "manufacturing or processing operation[s]". We have no difficulty accepting that fabric formation and DP2 operations are "manufacturing or processing operation[s]".

6.221 In the light of the above, we conclude that India has not established that the measures at issue are inconsistent with Article 2(c), second sentence, on the grounds that they "require the fulfilment of a certain condition not related manufacturing or processing, as a prerequisite for the determination of the country of origin".

(ii) *"Unduly strict requirements"*

6.222 In view of the Panel's conclusion with respect to India's claim under the second clause of Article 2(c), second sentence, it is necessary to examine India's claim under the first clause of Article 2(c), second sentence.

6.223 **India** asserts that the United States' measures at issue impose strict requirements that do not assist the United States in determining the country with which the product has the most significant economic link. For example, according to India, the requirement that bed linen made from 86% polyester and 14% cotton will be conferred origin where it is subjected to a DP2 operation, whereas bed linen made from 84% polyester and 16% cotton will be conferred origin where the greige fabric is woven is "unduly strict". India submits that this requirement bears no relation to determining the country with which the bed linen has an economic link. In India's view, it constrains the manufacturer's use of certain fibres as input for finished products.

6.224 India also argues that none of the criteria for the determination of origin listed in Article 2(a) of the *RO Agreement* would require the imposition of requirements as strict as those applied by the United States.

³⁰⁶ It is worth noting that India itself has stated that Article 2(c), second sentence, is concerned with "conditions that must be fulfilled to obtain the status of originating country". India's question No. 8 to the United States.

³⁰⁷ United States' reply to India's question No. 2; United States' reply to Panel question No. 78.

6.225 The **United States** rejects India's view that there has to be an "economic link" between the country on which origin is conferred and the country where the product underwent the most significant processing.

6.226 The United States further argues that India does not even make an attempt to support its allegations that the relevant rules of origin impose "unduly strict requirements", other than for the Panel to assume that the rules set out in section 334 are burdensome. In the view of the United States, India's description of the relevant United States' rules of origin disproves this claim. The United States submits that its rules are laid out in a clear, concise manner that could not be burdensome to the ordinary, reasonable importer/exporter.

6.227 The **Panel** recalls its view that, for the purposes of this dispute, the relevant "requirements" in the sense of the first clause of Article 2(c), second sentence, are the substantive requirements for qualifying as the country of origin.³⁰⁸ In this case, they are that the goods concerned must have undergone a specified manufacturing or processing operation – fabric formation or a DP2 operation – in the country for which origin is claimed.

6.228 India provides only one example, relating to bed linen, in support of its argument that the United States measures at issue impose unduly strict requirements.³⁰⁹ However, we have difficulty understanding how this example demonstrates that the measures at issue are "unduly strict". India's example could be understood in one of two ways. *First*, India could be understood as arguing that it is "unduly strict" to "require" that bed linen be made from 86% polyester and only 14% cotton to be conferred the origin of the country where that bed linen has undergone a DP2 operation. However, such an argument would not demonstrate that it is "unduly strict", with respect to the good to which the relevant rule of origin applies, to require a DP2 operation as a condition for the conferral of origin on a country. If anything, it would demonstrate that the relevant rule of origin has a narrowly defined product scope, in the sense that it excludes from its scope bed linen made from 84% polyester and 16% cotton. This does not, however, imply a requirement to produce bed linen made from 86% polyester and only 14% cotton. There may be an incentive to do so, but plainly there is no requirement to do so.³¹⁰ India also argues that the "requirement" that bed linen must be made from 86% polyester and only 14% cotton for the DP2 rule to apply "bears no relation to determining the country with which the bed linen has an economic link".³¹¹ This assertion presupposes that the "requirement" in question is intended for that purpose. As already noted, we are not convinced it is. In our view, the purpose of the "requirement" in question is to define what goods are eligible for the DP2 rule, not to establish the existence of an economic link.

6.229 *Second*, India could be understood as arguing that for bed linen which has been subjected to a DP2 operation and which is made of 84% polyester and 16% cotton, it would be "unduly strict" to require that, for a country to qualify as the country of origin, it needs to have woven the fabric. Even were we to assume that, for the goods concerned, the fabric formation rule could be viewed as imposing a "strict" requirement, India would still need to demonstrate that the fabric formation rule is "unduly" strict.

6.230 In this respect, India appears to argue that, for the goods concerned – *i.e.*, for bed linen which has been subjected to a DP2 operation and which is made of 84% polyester and 16% cotton – the fabric formation requirement is "unduly" strict, *inter alia*, because it bears no relation to determining the country with which those goods have the most significant link, or at least a significant economic

³⁰⁸ *Supra*, para. 6.207.

³⁰⁹ India's second written submission, para. 46.

³¹⁰ We are not convinced, therefore, that the measures at issue impose any "constraints" of a legal nature on the use of cotton fibres in the making of bed linen, as India appears to suggest. India's second written submission, para. 46.

³¹¹ India's second written submission, para. 46.

link.³¹² We have previously indicated that we see no basis in Article 2 of the *RO Agreement* for a requirement that there be a significant economic link between a good and the country the origin of which it is accorded.³¹³ Even if India's view were correct, however, India has not demonstrated that there is no significant economic link between bed linen which has been subjected to a DP2 operation and which is made of 84% polyester and 16% cotton and the country in which the fabric of such bed linen was formed.

6.231 In the light of the above, we are not persuaded that India's example demonstrates the "undue strictness" of the requirements set out in the relevant United States' rules of origin. Since India does not rely on any other example, we conclude that India has not established that the measures at issue are inconsistent with Article 2(c), second sentence, on the grounds that they pose "unduly strict requirements".

4. India's claim under Article 2(d) of the *RO Agreement*

6.232 The last of India's claims concerning the statutory provisions at issue is India's claim under Article 2(d) of the *RO Agreement*. That claim is limited to section 405. As with India's other claims, the Panel begins its analysis of the consistency of section 405 with Article 2(d) by considering the provisions of Article 2(d).

(a) Article 2(d) of the *RO Agreement*

6.233 Article 2(d) provides as follows:

"Until the work programme for the harmonization of rules of origin set out in Part IV is completed, Members shall ensure that:

[...]

(d) the rules of origin that they apply to imports and exports are not more stringent than the rules of origin they apply to determine whether or not a good is domestic and shall not discriminate between other Members, irrespective of the affiliation of the manufacturers of the good concerned²[.]"

² With respect to rules of origin applied for the purposes of government procurement, this provision shall not create obligations additional to those already assumed by Members under GATT 1994.

6.234 **India's** claim under Article 2(d) is based on the second clause of Article 2(d), which provides that "[rules of origin] shall not discriminate between other Members, irrespective of the affiliation of the manufacturers of the good concerned".

6.235 India considers that Article 2(d) covers not only cases of *de jure* discrimination – that is rules of origin that explicitly distinguish between different WTO Members – but also cases of *de facto* discrimination. India recalls that the concept of *de facto* discrimination was described by the Panel in *Canada-Patent Protection of Pharmaceutical Products* in the following terms:

"de facto discrimination is a general term describing the legal conclusion that an ostensibly neutral measure transgresses a non-discrimination norm because its actual effect is to impose

³¹² *Ibid.*, paras. 45-46.

³¹³ *Supra*, paras. 6.207.

differentially disadvantageous consequences on certain parties, and because those differential effects are found to be wrong or unjustifiable."³¹⁴

6.236 India argues that the Panel in this case should, therefore, examine whether section 405 imposes differentially disadvantageous consequences and if these different effects are justifiable. In support of this view, India notes that the Appellate Body, in the context of the non-discrimination provisions of the GATT³¹⁵ and the GATS³¹⁶, interpreted those provisions as prohibiting both *de jure* and *de facto* discrimination. In the view of India, there is no reason why this approach to the principle of non-discrimination should not also apply to the prohibition of discrimination in the *RO Agreement*. India believes that the danger of circumventing the purpose of Article 2(d) through product distinctions is just as great as the danger of circumventing the most-favoured-nation provisions of the GATT and the GATS through product- or service-specific distinctions. India is of the view that the case before the Panel is a clear demonstration that arbitrary distinctions between closely related products can be used to achieve the objective of favouring one WTO Member over others.

6.237 India further argues that Article 2(d), unlike Articles I and III of the GATT 1994, does not refer to measures distinguishing between products of other Members but to discrimination between other Members. According to India, the wording of Article 2(d) reflects the fact that the very purpose of the measures regulated by this provision is to determine whether a product is a product originating in another Member. India believes that Article 2(d) can, therefore, be violated by denying a product the status of originating in a Member.

6.238 India notes that, unlike Article III of the GATT 1994, Article 2(d) does not refer to discrimination between "like" products originating in different countries or to discrimination between imported and domestic products that are "directly competitive or substitutable". In India's view, this suggests that Article 2(d) can be violated even if the products distinguished in the rules of origin are neither like nor directly competitive or substitutable. India recalls that the Appellate Body decided that the question of whether two products are "like" or "directly competitive or substitutable" within the meaning of Articles III:2 and III:4 of the GATT 1994, must be answered by examining them from the perspective of the consumer in the market of the importing country. However, in India's view, two products that are "like" or "directly competitive or substitutable" from the perspective of the consumer should be accorded a different origin if they were produced in different countries. The criteria for determining whether two products are "like" or "directly competitive or substitutable" within the meaning of Article III of the GATT 1994 can therefore not be transposed to Article 2(d).

6.239 India submits that it would be equally inappropriate to transpose to Article 2(d) the concept of "like" products used in Article I of the GATT 1994. India notes that tariffs are a negotiable (and hence legitimate) instrument of protection, while rules of origin are not. India argues that, under the GATT 1994, Members are therefore permitted to make very fine product distinctions in their tariff classifications designed to protect specific domestic industries. However, under the *RO Agreement*, Members are not to use rules of origin to pursue trade objectives. According to India, it would, for this reason, not be logical to determine the scope of the prohibition of discrimination under the *RO Agreement* by using concepts that determine the scope of discrimination under Article I of the GATT 1994.

³¹⁴ Panel Report, *Canada – Patent Protection of Pharmaceutical Products* ("Canada – Pharmaceutical Patents"), WT/DS114/R, adopted 7 April 2000, DSR 2000:V, 2295, para 7.101.

³¹⁵ Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry* ("Canada – Autos"), WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000, DSR 2000:VI, 2995, para 63.

³¹⁶ Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas* ("EC – Bananas III"), WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591, paras. 233 to 234.

6.240 India considers that rules of origin violate Article 2(d) if they result in unjustifiably differential treatment of "closely related (Indian and European Communities) products". In India's view, textile products which are comprised of different types of fabrics or different types of fibre blends are "closely related" products. India argues that a Member cannot apply different rules of origin to textile products just because they are comprised of different types of fabrics or different types of fibre blends. India recalls that, in the case of the United States measures at issue, when a scarf is made of silk, it is conferred the origin of the country where it is subjected to a DP2 operation. On the other hand, when a scarf is made of cotton, it is conferred the origin of the country where the greige fabric is formed. India submits that, from the perspective of production techniques, these scarves are virtually identical, and that it is completely arbitrary to distinguish them for the purpose of determining their origin.

6.241 The **United States** notes that the second clause of Article 2(d) is directed at precluding the type of discrimination, in the form of non-preferential rules of origin, that would include a criterion based on the national affiliation of a company or nationality of its employees.

6.242 The United States considers that India's interpretation of Article 2(d) is based on the flawed understanding that the *RO Agreement* would preclude product-specific rules of origin and that the *RO Agreement* precludes different rules of origin from applying to different products. However, in the view of the United States, Article 2 of the *RO Agreement* does not require that the same rules be used for similar products. The United States submits that, contrary to India's desire, nothing in Article 2 or any other provision of the *RO Agreement* mandates that Members use a particular rule for a particular manufacturing process, or for particular products. The *RO Agreement* clearly allows for differentiation of rules between products, as can be seen in the harmonization work programme, where Members are addressing thousands of subheadings in the tariff schedule.

6.243 The United States then turns to the question of what disciplines the *RO Agreement* imposes on a Member in distinguishing products. The United States submits that the *RO Agreement* does not require the same rule of origin for all "like" or "directly competitive" products. In the view of the United States, such a requirement is not found in the *RO Agreement* and cannot be inferred from any provision of Article 2, nor has India made a case that it should be so inferred. Moreover, according to the United States, the *RO Agreement* does not require the same rules for all products that are similar in some other sense. Again, the United States considers that such a requirement is not spelled out in the *RO Agreement* and cannot be inferred from any provision of the *RO Agreement*. The United States argues that it would, therefore, be incorrect to interpret the *RO Agreement* as barring Members from distinguishing in their rules between products – regardless of whether these products are "like", "directly competitive" or similar in some other manner, and even if such product-specific rules are perceived to be based on distinctions deemed in some sense "narrow".

6.244 The **Panel** begins its analysis by recalling India's claim that section 405 violates the second clause of Article 2(d) because it results in unjustifiably differential treatment of "closely related (Indian and European Communities) products".³¹⁷ This claim is based on three cumulative assumptions. *First*, it assumes that the second clause of Article 2(d) imposes an obligation on Members to apply the same rule of origin, or at least equally advantageous rules, to "closely related" products (e.g., silk scarves and cotton scarves) imported from different Members.³¹⁸ *Second*, it assumes that the second clause of Article 2(d) should be interpreted to prohibit not only *de jure* discrimination between Members, but also *de facto* discrimination. *Third*, it assumes that an assessment of whether rules of origin discriminate, *de facto*, between Members calls for an examination of whether those rules impose differentially disadvantageous consequences on certain Members and of whether these different consequences are justifiable.

³¹⁷ India's reply to Panel question No. 60; India's second written submission, para. 68.

³¹⁸ We note that India does not offer a definition of the concept of "closely related products".

6.245 In respect of the first of India's three assumptions, we recall that the second clause of Article 2(d) states that rules of origin "shall not discriminate between other Members, irrespective of the affiliation of the manufacturers of the good concerned". It does not state that rules of origin "shall not discriminate between closely related goods of other Members [...]". Thus, the plain terms of the second clause do not support India's reading.

6.246 Moreover, the expression "the good concerned" in the singular indicates that the second clause of Article 2(d) is not concerned with discrimination across different (but closely related) goods. Were it otherwise, the second clause would arguably have referred to "the goods concerned" in the plural. In our view, the use of the singular suggests that, for the purposes of assessing whether there is discrimination "between Members", a comparison should be made between the rule of origin applicable to a particular good when imported from one or more Members and the rule(s) of origin applicable to the same good – "the good concerned" – when imported from one or more other Members.

6.247 If the second clause of Article 2(c) were intended to preclude discrimination across different (but closely related) goods, we consider it likely that the drafters would have provided some textual guidance as to the product scope of the prohibition set forth in the second clause. Indeed, we note that other WTO non-discrimination provisions, such as Articles I, III and IX of the GATT 1994, do specify the product scope of the prohibitions they contain.³¹⁹

6.248 Finally, our reading of the second clause of Article 2(d) is consistent with the objective of that clause. In our view, the principal objective of the second clause of Article 2(d) is to ensure that, for a given good, the strictness of the requirements that must be satisfied for that good to be accorded the origin of a particular Member is the same, regardless of the provenance of the good in question (*i.e.*, Member from which the good is imported, affiliation of the manufacturers of the good, etc.).³²⁰

6.249 In view of the above considerations, we are unable to accept India's assumption that the second clause of Article 2(d) imposes an obligation on Members to apply the same rule of origin, or at least equally advantageous rules, to "closely related" products imported from different Members.³²¹

6.250 Since we have rejected the first of three cumulative assumptions underlying India's claim under Article 2(d), and since it is not necessary to our disposition of that claim, we do not decide whether the second and third of India's assumptions are correct. Accordingly, in examining India's claim that section 405 is inconsistent with the second clause of Article 2(d), we will accept these assumptions on an *arguendo* basis.

(b) Consistency of section 405 with Article 2(d) of the *RO Agreement*

6.251 **India** recalls that section 405 provides exemptions to the general rules for determining origin for certain fabrics, certain goods and certain fibre blends. India acknowledges that these exemptions are, *de jure*, applied on an origin-neutral basis. However, in India's view, these exemptions *de facto* favour goods from the European Communities since the fabrics, products or fibre blends that benefit from the exemptions are mainly the type of textile and apparel products which undergo "value-added" or substantial transformation operations in the European Communities. Therefore, India argues, these

³¹⁹ For instance, Article I of the GATT 1994 prohibits discrimination as between "like" products only.

³²⁰ The Panel notes that this is consistent with its view that Article 2 is intended to leave Members a considerable measure of discretion in designing and applying their rules of origin. *Supra*, para. 6.25.

³²¹ India could be understood as arguing as well that the second clause of Article 2(d) can be violated even if the products distinguished in the rules of origin are neither "like" nor "directly competitive or substitutable" products within the meaning of Article III of the GATT 1994. India's reply to Panel question No. 3. Our reasoning with respect to India's concept of "closely related products" would be equally applicable if India meant to argue that the second clause of Article 2(d) also prohibited discrimination as between products that are neither "like" nor "directly competitive or substitutable".

products can enter the United States without being subject to any quota restraints. India notes that, in contrast, when these products are made of certain fibres such as cotton, those products will be conferred origin where the greige fabric is woven. India asserts that it is mainly developing countries under quota restraints that export cotton fabric. According to India, this demonstrates that the effect of section 405 is to impose differentially disadvantageous consequences for developing countries such as India which export cotton fabric and products thereof.

6.252 India argues, furthermore, that the differential effects created by section 405 are unjustifiable. India considers it indisputable that the United States enacted section 405 for the sole purpose of providing favourable market access for particular textile products that were of special concern to the European Communities. In India's view, the effects of section 405 are, therefore, unjustifiable.

6.253 According to India, the effects created by section 405 are also unjustifiable because, in its view, the exemptions in section 405 (which makes distinctions between certain products) bear no relation to the manufacturing or processing of those products. Specifically, India argues that the amendments in section 405 created arbitrary and inconsistent reversions to the pre-section 334 rules of origin for a group of selected textile products, without any particular regard for the degree of further processing, assembly or other operations and how the extent of those further operations would change the nature of the products. India submits that the exceptions created by section 405 were defined solely by the types of end products imported into the United States from the European Communities and for which the European Communities expressed concern. India asserts in this regard that the manufacturing and assembly of bed linen is the same whether it is made of silk or cotton. India is of the view that these products are the same. India considers in this respect that there are no technical reasons to discriminate in terms of rules of origin between products that are identical (and thus by definition are competitive or substitutable in the market) and that undergo the same manufacturing and processing.

6.254 In addition, India notes that the United States refers to its Harmonized Tariff Schedule (general note 22) which defines "wholly of" as meaning "that the goods are [...] completely of the named material". India maintains that for section 405, however, the United States arbitrarily made more than 16% cotton as the criterion to determine the applicable rule of origin (*i.e.*, that origin would be conferred where the greige fabric is woven). India points out in this regard that the United States has noted that in response to a question from the Panel that "by establishing a rule of certain goods containing 16% or more of weight of cotton, we ensured that we would cover the products defined in our settlement agreement". India submits that by reducing the threshold of the definition of a cotton product from one that is composed *completely of* cotton to one that is merely *16% and above of* cotton, the United States effectively brought more items under the definition of cotton, which according to section 405, would be conferred origin where the greige fabric was woven.³²²

6.255 The **United States** notes that India's primary claim with respect to section 405 is its charge that because the exceptions to section 334 took into account specific products of interest to the European Communities, this "favoured" the European Communities and is discriminatory. The United States notes that, of course, any settlement has to be satisfactory to the complaining party. But the United States submits that if the settlement is applicable to all Members on an MFN basis, it will in all likelihood benefit all exporting Members. In the view of the United States, India cannot rely on *Canada-Autos* to substantiate a claim of *de facto* advantage in favour of the European Communities. The United States notes that, in that dispute, the Appellate Body was addressing an advantage given to *some* products that was based on the country of affiliation of the producers. The United States emphasizes that, in that case, the *de facto* discrimination resulted because Canada was giving advantage to some of the *same (like)* products based on nationality. The United States considers that,

³²² India considers that the "16% and more" definition is also not consistent with the definitions as set out in Chapters 50 to 55 of the Harmonized System which provides for a definition of "85% or more" as pointed out by the United States in its replies to the Panel's questions.

in this dispute, India's charges in respect of the United States' rules of origin relate to *different* products. The United States further argues that, while it is true that in that report the Appellate Body made a reference to "*de facto* advantage", Article I:1 of the GATT 1994 is not at issue in this case. The United States notes that if India had wished to make such a claim, it could have brought a dispute under that provision.

6.256 The United States further points out that India also appears to argue a "differential treatment" theory in support of its Article 2(d) claim in respect of section 405. The United States notes in this respect that Article 2(d) addresses discrimination among Members – that is, applying different rules to different Members with respect to the *same* product – not discrimination between domestic *versus* imported products, or among imported products.

6.257 The United States argues, finally, that the Panel report in *Canada-Pharmaceuticals Patents* does not save India's case either. The United States considers that this dispute is not a product-discrimination case and Article 2(d) is not about product discrimination. The United States believes that, even accepting that the Panel report in that dispute were relevant to the present dispute, India has not shown that the "actual effect" of section 405 is to impose "differentially disadvantageous consequences" on India, or China or the Philippines *and* that those differential effects are wrong or unjustifiable, as is the basis for the Panel's reasoning in *Canada-Pharmaceuticals Patents*.

6.258 The **Panel** understands India's claim to be based on three assertions: *first*, that section 405 results, *de facto*, in differential treatment of goods, by providing an advantage to goods of concern to the European Communities which it does not provide to goods of concern to developing countries like India; *second*, that the goods affected by the differential treatment are goods which are "closely related"; and, *third*, that the differential treatment of the goods in question is unjustifiable.³²³

6.259 We accept, *arguendo*, India's first assertion and, accordingly, begin by examining India's second assertion – that the (assumed) differential treatment resulting from section 405 affects "closely related" goods. We recall in this respect that we have rejected India's view that the second clause of Article 2(d) imposes an obligation on Members to apply the same rule of origin, or at least equally advantageous rules, to "closely related" products imported from different Members.³²⁴ However, this does not, in itself, dispose of India's claim under Article 2(d). The reason is that the category of "closely related goods" logically comprises, as a subset, goods which are the same. It is necessary, therefore, to examine whether India has identified goods which are the same, but are differentially affected by section 405.

6.260 We note, *first*, that it is unclear whether India is suggesting that finished cotton fabric (*i.e.*, fabric which has been subjected to a DP2 operation), and cotton bed sheets are "closely related" goods.³²⁵ These are goods in different stages of manufacturing, classified under different HS headings. It is not clear to us, therefore, how cotton fabric and cotton bed sheets could be viewed as the same products. In our view, merely that cotton fabric may be converted to cotton bed sheets does not make these goods the same. In any event, India has not made a *prima facie* case in this regard.³²⁶

³²³ India's second written submission, paras. 70-74; India's reply to Panel question No. 60.

³²⁴ *Supra*, para. 6.249. We note that, at the same time, we have accepted, for the sake of argument, India's assumptions: (i) that the second clause of Article 2(d) should be interpreted to prohibit not only *de jure* discrimination between Members, but also *de facto* discrimination and (ii) that an assessment of whether rules of origin discriminate, *de facto*, between Members calls for an examination of whether those rules impose differentially disadvantageous consequences on certain Members and of whether these different consequences are justifiable. *Supra*, para. 6.250.

³²⁵ India's first oral statement, paras. 28-29.

³²⁶ In fact, India itself seems to acknowledge that these are different "types" of product. India's first oral statement, para. 28.

6.261 *Second*, India could be understood as implying that wool fabric and other fabric, such as silk or cotton fabric, are "closely related" goods.³²⁷ India's submissions with respect to its claim under Article 2(d) do not specifically address wool fabric. We note that in the context of a different claim, India argues that there is no difference in the process of weaving wool yarns into fabric and the process of weaving cotton or silk yarn into fabric.³²⁸ Even ignoring the fact that this argument concerns a different claim, India has not provided any information on the processing of wool yarn and other yarn. Moreover, even if India were correct and there was no difference in the processing, it is not clear to us why this would detract from the fact that wool fabric, cotton fabric and silk fabric, which are classified under different HS headings, are quite different in their physical characteristics, quality and reputation. Thus, based on India's submissions, we are not convinced that wool fabric and other fabric, such as silk or cotton fabric, are the same for the purposes of the second clause of Article 2(d).

6.262 *Third*, India argues, explicitly, that silk scarves and cotton scarves are "closely related" goods. India submits that, from the perspective of production techniques, silk scarves and cotton scarves are virtually identical.³²⁹ Here again, India provides no specific information regarding the manufacturing process of scarves made of different fabric. Nor does India address why the (alleged) fact that the manufacturing process is the same makes other differences, including differences in classification under the Harmonized System, physical characteristics, quality and reputation, inconsequential. In the light of this, we consider that India's submissions are insufficient to convince us that silk scarves and cotton scarves are the same for the purposes of the second clause of Article 2(d).

6.263 We note, furthermore, that, in India's view, bed linen made of silk and bed linen made of cotton are the "same" products. This argument, too, is based on the contention that both types of bed linen undergo the same manufacturing processes.³³⁰ To that extent, *mutatis mutandis*, our observations in the preceding paragraph with respect to scarves apply equally here.³³¹ India could be understood to contend, in addition, that silk and cotton bed linen are "identical products" and, as such, competitive and substitutable in the market.³³² However, even were we to assume that silk bed linen and cotton bed linen could be determined to be the same on the basis of their competitive relationship, this would not assist India, since India has not submitted sufficient information for us to assess the nature and extent of a competitive relationship, if any. Consequently, we consider that India has not established that silk and cotton bed linen are the same for the purposes of the second clause of Article 2(d).

6.264 *Finally*, India could be understood as arguing that relevant goods made of a fibre blend with 16% or more cotton and goods made of a fibre blend with less than 16% cotton are the "same" goods.³³³ India's submissions with respect to its claim under Article 2(d) do not specifically address goods made of fibre blends. We note, however, that in the context of a different claim, India argues that there is no difference between the processing of a bed valance made of 83% polyester / 17% cotton blend as compared to a bed valance made of 86% polyester / 14% cotton blend.³³⁴ In this particular instance, it is not necessary for us to decide whether India's submissions are sufficient to establish that goods made of fabric with 16% or more cotton and goods made of fabric with less than 16% cotton are the same. This is because India has, in any event, not persuaded us that it would be

³²⁷ India says that, with respect to its claim under Article 2(d), it is challenging section 405(a)(3)(B), which deals with fabrics. India's reply to Panel question No. 19.

³²⁸ India's second written submission, para. 40.

³²⁹ India's reply to Panel question No. 60.

³³⁰ India's second oral statement, para. 20.

³³¹ We note that India has not provided any information regarding the manufacturing processes for silk and cotton bed linen.

³³² India's second oral statement, para. 20.

³³³ India's second written submission, footnote 33.

³³⁴ *Ibid.*, para. 40.

unjustifiable to apply different rules of origin to goods with 16% or more cotton and goods with less than 16% cotton.

6.265 Based on the foregoing, it is clear that, with the exception of one category of goods – goods containing fabrics made of a cotton blend – where we have made no finding, India has failed to establish that the (assumed) differential treatment resulting from section 405 affects goods which are the same. As a result, India has failed to establish its claim under Article 2(d), with the possible exception of goods made of a cotton blend.

6.266 Consistent with our conclusion in the preceding paragraph, with respect to goods made of a cotton blend, we need to proceed to examine India's third assertion that the (assumed) differential effect is unjustifiable. For the purposes of this examination, we will assume that goods made of fabric containing 16% or more cotton and goods made of fabric containing less than 16% are the same and that the different rules of origin applied to such goods as a result of section 405 provides a *de facto* advantage to goods of concern to the European Communities.

6.267 India argues that this (assumed) differential effect is unjustifiable because section 405 was enacted for the "sole purpose"³³⁵ of favouring goods of export interest to the European Communities over goods of export interest to developing countries. However, we have already found, when examining India's claim under Article 2(b), that India has not established that the United States is using section 405 to favour goods of concern to the European Communities over goods of concern to other Members.

6.268 India appears to argue that the (assumed) differential effect is unjustifiable, in addition, because there is "no technical reason" to discriminate in terms of rules of origin between goods made of fabric containing 16% or more cotton and goods made of fabric containing less than 16%.³³⁶ India considers that it is "arbitrary" to maintain such a product distinction for rules of origin purposes and to make more than 16% cotton the criterion to determine the applicable rule of origin.³³⁷ The United States has explained that the 16% cotton threshold was established in order to implement the terms of the bilateral settlement agreement between the United States and the European Communities. The United States further points out that its definition of cotton blends is consistent with the structure of the Harmonized System. The United States points out that the Harmonized System, in Chapters 50 through 55, defines yarns and fabrics as "wholly of" a given fibre if they contain 85% or more of that fibre.³³⁸

6.269 We understand the United States to argue, in essence, that it needed to define which cotton blends, if any, should be entitled to the exception set forth in section 405(a)(3)(C), *i.e.*, the DP2 rule. Apparently, the United States determined that only those goods which are, effectively, "wholly of" a fibre *other than* cotton should qualify for the DP2 rule (provided such fibre is covered by the HTS headings specified in section 405(a)(3)(C)). Thus, a bed valance made of 83% polyester / 17% cotton blend is not regarded as, in effect, a polyester bed valance. As such, it is not entitled to the DP2 rule. The (low) 16% cotton threshold would appear to be consistent with the complete exclusion from the DP2 rule of specified cotton goods which are not blends.

6.270 The 16% cotton threshold appears to be consistent with the structure of the Harmonized System, which recognizes the utility of specifying a certain percentage threshold for textile blends.³³⁹ Thus, setting a relatively low percentage threshold is consistent with the fact that cotton goods which

³³⁵ India's second written submission, para. 72.

³³⁶ India's second oral statement, para. 20.

³³⁷ India's reply to Panel question No. 60; India's second oral statement, para. 19.

³³⁸ United States' reply to Panel question No. 9.

³³⁹ See Chapter 50-55 of the Harmonized System.

are not blends are completely excluded from the DP2 rule. We are, therefore, not persuaded by India's assertion that the 16% cotton threshold is arbitrary and, hence, unjustifiable.³⁴⁰

6.271 Accordingly, we find that, with respect to goods made of a cotton blend, India has not established that the (assumed) differential effects created by section 405 are unjustifiable. As a consequence, we reject India's claim under Article 2(d), insofar as it concerns relevant goods made of a cotton blend.

6.272 In the light of all of the above considerations, we conclude that India has failed to demonstrate that section 405 is inconsistent with the second clause of Article 2(d).

E. INDIA'S CLAIMS IN RESPECT OF THE IMPLEMENTATING CUSTOMS REGULATIONS

6.273 As will be recalled, India's claims are not limited to the statutory provisions at issue in this dispute, but also concern the customs regulations contained in 19 C.F.R. § 102.21.

6.274 **India** notes that these customs regulations implement section 334 and section 405. India asserts that these regulations include provisions which are inconsistent with the United States' obligations under Article 2(b), (c) and (d) of the *RO Agreement*.

6.275 The **United States** argues that India has failed to establish a prima facie case that 19 C.F.R. § 102.21 breaches United States obligations.

6.276 The **Panel** recalls its previous conclusion that India has failed to establish that section 334 or section 405 are inconsistent with Article 2 of the *RO Agreement*. India agrees that the customs regulations set forth in 19 C.F.R. § 102.21 implement the principles contained in section 334 and 405. In these circumstances, the Panel could only uphold India's claims in respect of 19 C.F.R. § 102.21: (i) if, unlike in the case of India's claims in respect of section 334 and section 405, India had provided evidence and argument sufficient to establish an inconsistency with Article 2 of the *RO Agreement*; or (ii) if India had identified certain aspects specific to 19 C.F.R. § 102.21 which would render these regulations inconsistent with Article 2 of the *RO Agreement* independently of section 334 or section 405. However, India has done neither. Indeed, India has made few references to 19 C.F.R. § 102.21, and those references essentially summarize or reproduce the provisions of 19 C.F.R. § 102.21.³⁴¹

6.277 Accordingly, the Panel concludes that India has failed to establish that the customs regulations contained in 19 C.F.R. § 102.21 are inconsistent with Articles 2(b), 2(c) or 2(d) of the *RO Agreement*.

F. INDIA'S CLAIMS IN RESPECT OF THE APPLICATION OF THE MEASURES AT ISSUE

6.278 India also requests the Panel to find that the "application" of section 334, section 405 and the customs regulations contained in 19 C.F.R. § 102.21 is inconsistent with Articles 2(b), 2(c) or 2(d) of the *RO Agreement*.³⁴² India has not presented arguments or evidence with respect to specific instances of application, by relevant United States authorities, of the measures at issue. Nor has India argued that these measures are applied, in practice, in a manner which is not specifically provided for

³⁴⁰ We also note that India has not shown that the 16% cotton threshold operates in such a way, for instance, that producers of certain Members cannot adjust their production so as not to exceed this threshold, or can only do so at an excessive cost.

³⁴¹ E.g., India's reply to Panel question No. 21; India's second written submission, paras. 9-10, 14, 17 and 20.

³⁴² India's first written submission, para. 102.

in those measures.³⁴³ In view of the lack of specific Indian submissions on the application of the measures at issue, we see no need to examine these claims further.

6.279 Accordingly, the Panel concludes that India has failed to establish that the application of section 334, section 405 or the customs regulations contained in 19 C.F.R. § 102.21 is inconsistent with Articles 2(b), 2(c) or 2(d) of the *RO Agreement*.

VII. CONCLUSION

7.1 For the reasons set forth in this Report, the Panel concludes as follows:

- (a) India has failed to establish that section 334 of the Uruguay Round Agreements Act is inconsistent with Articles 2(b) or 2(c) of the *RO Agreement*; and
- (b) India has failed to establish that section 405 of the Trade and Development Act is inconsistent with Articles 2(b), 2(c) or 2(d) of the *RO Agreement*;
- (c) India has failed to establish that the customs regulations contained in 19 C.F.R. § 102.21 are inconsistent with Articles 2(b), 2(c) or 2(d) of the *RO Agreement*;

7.2 In the light of its conclusion, the Panel makes no recommendations under Article 19.1 of the DSU.

³⁴³ India's replies to Panel questions Nos. 19 and 62 do not contain any specific arguments in support of a challenge to section 334, section 405 and the implementing customs regulations, as applied.

ANNEX A

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| Annex A | Answers of parties to questions |
| | A-1 Answers of India to questions from the Panel following the first meeting |
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ANNEX A-1

ANSWERS OF INDIA TO QUESTIONS FROM THE PANEL FOLLOWING THE FIRST MEETING

Question 1

Do you agree with the European Communities that the concept of substantial transformation "was intentionally left out of the disciplines to be applied during the transitional period" and that, therefore, "Members are under no obligation during the transitional period to base their origin rules on the concept of substantial transformation"? (European Communities' written submission, paras. 9 and 22)

Answer 1

India's claims and arguments do not presuppose that Members must apply the concept of substantial transformation during the transitional period. Therefore, the European Communities' point is not germane to India's claims and arguments in this case.

Question 2

With reference to Article 2(b) of the RO Agreement, do you consider that the prevention of quota circumvention as that term is used by the United States would need to be viewed as a "trade objective"?

Answer 2

Yes. In the United States' first submission (para. 32) and in the oral responses of the United States delegation provided at the First Hearing, the United States used the term "prevention of quota circumvention" to refer to a situation where certain countries attempted to avoid the quotas placed on their textile and apparel products by exporting semi-finished products to third countries (not under quota or under a more generous quota) to be subjected to finishing operations, in order that those products could be conferred the origin of the third country, when they were exported to the United States.

However, this situation cannot be described as "quota circumvention." Circumvention is a term which connotes a violation of existing rules. In the context of rules of origin, quota circumvention describes situations where traders are making false declarations about the origin of their products or using other illegal means in order to evade the application of quotas. The United States has not shown any instances of illegal circumvention of section 12.130 rules. India notes that, pre-section 334, United States Customs was applying and enforcing its section 12.130 regulations. The United States' determinations of origin for such products (e.g., those exported to third countries for DP2 before being exported to the United States) were therefore reached in conformity with the then applicable section 12.130 customs regulations.

What the United States describes as "quota circumvention" is a perfectly legitimate reaction of the market to the existence of country-specific quotas, which resulted in increased quantities of textile and apparel products entering the United States. In the case before the Panel, the United States changed its rules of origin to prevent perfectly legitimate market reactions in order to maintain the protective impact of its own quota regime on textile and apparel products. The new rules of origin are therefore

being used by the United States, by its own admission, to pursue the trade objective of protecting the domestic industry. They are consequently inconsistent with Article 2 (b) of the *RO Agreement*.

(DP2 refers to dyeing and printing plus two finishing operations.)

Question 3

Does Article 2(d) of the RO Agreement cover discrimination between the products of "other Members"? If so, what kind of products, i.e., identical products, like products, directly competitive or substitutable products, etc.?

Answer 3

Article 2(d) of the *RO Agreement*, unlike Articles I and III of the GATT, does not refer to measures distinguishing between *products* of other Members but to discrimination between other Members. The wording of Article 2(d) of the *RO Agreement* reflects the fact that the very purpose of the measures regulated by this provision is to determine whether a product is a product originating in another Member. Article 2(d) can therefore be violated by denying a product the status of originating in a Member.

Unlike Article III of the GATT, Article 2(d) of the *RO Agreement* does not refer to discrimination between "like" products originating in different countries or to discrimination between imported and domestic products that are "directly competitive or substitutable". This suggests that Article 2(d) can be violated even if the products distinguished in the rules of origin are neither like nor directly competitive or substitutable. The Appellate Body decided that the question of whether two products are "like" or "directly competitive or substitutable" within the meaning of Articles III:2 and III:4, must be answered by examining them from the perspective of the *consumer* in the market of the importing country. However, two products that are "like" or "directly competitive or substitutable" from the perspective of the consumer should be accorded a different origin if they were produced in different countries. The criteria for determining whether two products are "like" or "directly competitive or substitutable" within the meaning of Article III of the GATT can therefore not be transposed to Article 2(d) of the *RO Agreement*.

It would be equally inappropriate to transpose to Article 2(d) of the *RO Agreement* the concept of "like" products used in Article I of the GATT. Tariffs are a negotiable (and hence legitimate) instrument of protection, while rules of origin are not. Under the GATT, Members are therefore permitted to make very fine product distinctions in their tariff classifications designed to protect specific domestic industries. However, under the *RO Agreement*, Members are not to use rules of origin to pursue trade objectives. It would, for this reason, not be logical to determine the scope of the prohibition of discrimination under the *RO Agreement* by using concepts that determine the scope of discrimination under Article I of the GATT.

Question 4

With reference to Article 2(a) of the RO Agreement, could Members use criteria for determining origin other than those specified in indents (i)-(iii)?

Answer 4

The general obligation in Article 2(a) is that Members must ensure that when issuing "administrative guidelines of general application, the requirements to be fulfilled are clearly defined." The words "in particular" preceding the three examples in indents (i) to (iii) support the interpretation that when one of those three types of administrative guidelines is used, then the specific requirements listed in that

indent must be used. It is conceivable that a Member could use other criteria other than those set out in the three indents to determine origin provided those criteria comply with the general obligation in the first sentence of Article 2(a).

However, India has not made any claims based on Article 2(a). India's claims and arguments do not require the Panel to address the question whether a Member may or may not apply criteria other than those specified in Article 2(a). India's view is that a Member's compliance with Article 2 (a) does not provide a justification for inconsistencies with Article 2(b), 2(c) and 2(d) of the *RO Agreement*.

Question 5

Could India elaborate on the type of quotas to which Indian exports become subject pursuant to section 334? (India's first written submission, paras. 54 and 91). Are those quotas for (i) India's fabric exports, (ii) quotas for finished products (e.g., bed linen) made of Indian fabric or (iii) other quotas?

Answer 5

Section 334 establishes origin for fabrics and certain made-up articles based on the country where the greige fabrics are formed by weaving or knitting, regardless of any further finishing operations, such as dyeing and printing. In view of this change in origin criteria under section 334, India's exports of greige fabrics become subject to quotas, as further finishing operations like dyeing and printing are not recognized for conferring origin. For example, India's exports of greige fabrics to Portugal, when subjected to dyeing, printing and two finishing operations in Portugal and exported to the United States, would attract debits to India's quotas on greige fabrics under the provisions of the "fabric forward" rule established by section 334.

Exports of finished products (e.g. bed linen) made of Indian fabric are also subjected to quotas as section 334 (b)(2) provides the special rule that "notwithstanding the wholly assembled rule", the origin of certain flat goods under certain headings such as bedding articles (quilts, comforters, bed linen, mattresses, blankets), home furnishing (wall hangings, table linens), would be determined where the greige fabric was woven.

These items when made from Indian fabrics and exported from a third country after finishing to the United States become subject to quota limits set out for these products by the United States for India.

The range of restrictions imposed on Indian exports of fabrics or finished products by the United States were notified in the Memorandum of Understanding signed between the Governments of United States of America and India on December 31, 1994. These were subsequently notified to the WTO within 60 days as mandated by the ATC.

The imposition of quotas on greige fabrics under the "fabric forward rule" were made pursuant to the implementation of section 334(b)(2). The quota limits for greige fabrics and for finished products are however set out in the MOU referred to above.

(Questions 6 to 10 for the United States only)

Questions 11 (a) to (d)

With reference to Article 2(c) of the RO Agreement, could the parties answer the following questions:

- (a) *Does Article 2(c) prohibit rules of origin which create the specified effects even in cases where those effects are entirely unintentional?*

Answer 11 (a)

Yes. There is no intent requirement in Article 2(c). It establishes criteria that the rules of origin themselves must meet. It contains no wording that could be construed to require the Panel to distinguish between effects that were intended and those were not.

- (b) *Does the phrase "restrictive [...] effects on international trade" mean that a complaining Member must show a net restrictive effect on international trade? Or would it be sufficient to show that the trade of one Member has been adversely affected, even if the trade of another Member has been favourably affected? In the latter case, could that one Member be a Member other than the complaining Member?*

Answer 11 (b)

For the reasons explained at the First Hearing and further elaborated in the response to question 26 below, India does not believe that Article 2(c) requires a showing of actual restrictive or distorting effects demonstrated through trade statistics and therefore does not believe that the task before the Panel is to determine whether trade statistics show a *net* effect of the United States' rules on international trade.

Moreover, Article 2(c) does not refer to the effect on *imports* but the effect on *international trade*. As correctly pointed out by the European Communities, this implies that the restrictive or distorting effects covered by Article 2(c) include those that affect third Members. The reference of international trade makes clear that the rationale of Article 2(c) is not merely to protect expectations regarding the level of imports but also expectations regarding the trade between third countries. Therefore, even if a mere shift of the benefits of the conferral of origin from one Member to another without an overall reduction in trade were not deemed to be "restrictive" within the meaning of Article 2(c), the resulting change in the pattern of trade would nevertheless have to be regarded as "distorting" within the meaning of that provision.

For the reasons indicated by the GATT panel on *United States – Section 337 of the Tariff Act of 1930* (BISD 36/387, para.5.14), each instance of a restrictive or distorting effect must be considered separately, not the net effect of all effects taken together. India is therefore of the view that it is sufficient for the complainant to show that the rule of origin creates restrictive or distorting effects for one Member, which could be a Member other than the complaining Member.

- (c) *Could it be said that rules of origin inherently create "restrictive" effects on international trade, inasmuch as they may require traders to fulfil certain requirements (e.g., the preparation of certificates of origin, etc.)? If so, would this suggest that Article 2(c) implies some sort of a de minimis exception? If so, what would constitute a de minimis restrictive effect? In answering this question, please address the relevance of the second sentence of Article 2(c) ("unduly strict requirements") and the fourth preambular paragraph of the RO Agreement ("unnecessary obstacles to trade")*

Answer 11 (c)

It may be said that rules of origin, by their very nature, have effects on international trade. These effects are mainly administrative, as described in the example in the question. However, it is not correct to say that rules of origin inherently create "restrictive" effects on international trade. Such an interpretation would render meaningless the prohibition against rules of origin having "restrictive ... effects on international trade", unless there were a *de minimis* exception.

However, there is no *de minimis* exception in Article 2 (c). The *de minimis* concept, when it appears in WTO law, is usually spelled out in the Agreement. For example, in the rules governing *trade remedies*, that is the rules which accord Members the right to prevent injury to their domestic industry by offsetting the impact of increased imports, dumping or subsidization, it makes sense to curtail the right to *react* to changes in the market to prevent injury by a *de minimis* exception. However, Article 2(c) of the *RO Agreement* is a rule governing *trade policy conduct*. Such rules have consistently been interpreted to require the establishment of conditions of competition for trade permitting producers and traders to plan, not the attainment or prevention of a particular impact in the market. It does not make sense to provide a *de minimis* exemption for actions that are inconsistent with a rule of trade policy.

As noted by two GATT panels, if a government considers that a measure inconsistent with a rule of conduct has no impact in the market, it should have no difficulty bringing that measure into consistency with that rule (See GATT cases: *Italian Discrimination against Imported Agricultural Machinery* in BISD 7S/66-67 and *Canada - Administration of Foreign Investment Review Act* in BISD 30S/168).

The second sentence of Article 2(c) requires that rules of origin shall not impose requirements that are unduly strict or require the fulfilment of a condition not related to manufacturing or processing. This suggests that the aim of Article 2(c) is to ensure that Members do not confer origin on the basis of unnecessary requirements that create adverse trade effects. This conclusion is supported by the fourth recital of the preamble of the *RO Agreement*, according to which this Agreement is "to ensure that rules of origin *themselves* do not create *unnecessary* obstacles to trade".

It is clear from Article 2 (a) and Article 2 (c) that the process of conferring origin upon a product is the process of determining with which country a product presented to customs has a significant economic link according to the origin criterion chosen by the importing Member. It follows that Article 2(c) is violated if a Member confers origin on the basis of requirements with restrictive or distorting effects on international trade that need not be imposed to determine the degree or nature of the link between a product and the economy of the WTO Member seeking the conferral of origin for that product.

- (d) ***How should the Panel assess whether particular rules of origin create "distorting" effects on international trade? What do you compare the existing rules of origin with?***

Answer 11 (d)

In economics, a governmental measure is generally considered to be "distorting" if it creates incentives or disincentives for economic operators that modify the operation of the market. In evaluating whether a rule of origin creates distorting effects, it is therefore necessary to determine whether it creates incentives or disincentives for producers or traders that modify the pattern of production or trade.

Question 12

In their submissions, the parties have referred to "visa requirements". Could the parties provide information regarding the legal basis in United States law for these requirements and how they operate? Also, please address whether these requirements are imposed in order to administer textile and apparel quotas or textile and apparel rules of origin.

Answer 12

The legal basis in the United States law for the visa requirements was clarified by the United States delegation at the First Hearing of the parties. The visa and certification system is part of an administrative arrangement to monitor the textile and apparel quotas.

Each shipment of textile and textile products subject to specific and group restraints are required to be visaed by the Government of India with a circular shaped stamp (the visa) before entry or withdrawal from warehouse for consumption into the United States.

The shipment is visaed or certified by the placing of original stamped markings (the visa or exempt certification) in blue ink on the front of the invoice (Special Customs Invoice Form 5515, successor document or commercial invoice when such form is used). Each visa includes its number and date and the signature of the issuing official. The visa numbers are in a standardized nine digit letter format beginning with one numeric digit for the last digit of the year of export followed by the two character alpha country code specified by the international organization for which the visa was issued. Each visa also states the correct categories and quantities in the shipment in applicable categories and units. Any amendment to the visa stamp will be done by mutual agreement. The visa systems are published in the Federal Register.

Any shipment which is not accompanied by a visa in accordance with the foregoing provisions is denied entry by the United States Government unless the Government of India specifically authorizes entry and appropriate charges to its quota.

As explained above the visa requirements have been imposed to administer the textile and apparel quotas. However, customs invoice No. 5515 on which the visa stamp is placed provides for a column (Sr.No.7) referring to the origin of the goods. The visa requirements also help identify the origin of the goods.

Question 13 for the United States only

Question 14

With reference to Article 2(c) of the RO Agreement, could the parties answer the following additional questions:

- (e) *What is the relationship between the first and second sentences of Article 2(c)? Do they provide for distinct and independent obligations, such that the second sentence adds an obligation which is not already covered by the first sentence? Or does the second sentence simply spell out one aspect, or consequence, of the obligation set out in the first sentence?*

Answer 14 (e)

The second sentence elaborates upon and spells out specific aspects of the obligation set out in the first sentence. The first sentence provides that the rules of origin shall not themselves have restrictive, distorting or disruptive effects on international trade whereas the second sentence provides that they shall not pose unduly strict requirements or require the fulfilment of a certain condition to manufacturing or processing, as a pre-requisite for the determination of the country of origin.

- (f) *Is it appropriate to evaluate the trade effects of rules of origin introduced by a Member after the entry into force of the RO Agreement by comparing those rules with rules of origin applied by the same Member before the entry into force of the RO Agreement, i.e., with rules of origin which were not subject to the RO Agreement?*

Answer 14 (f)

For the reasons elaborated at the First Hearing of the Panel and further elaborated in the response to question 26 below, India does not consider that a comparison of trade volumes in a pre-RO Agreement and post-RO Agreement context has to be made. The rules of origin of the Member introduced or maintained by the Member after the entry into force of the WTO Agreement need to be assessed in the light of the obligation set out in Article 2(c) of the RO Agreement not to establish conditions of competition with restrictive or distorting effects on international trade. What is relevant is therefore whether the United States rules of origin adopted and maintained after the entry into force of the RO Agreement establish such conditions of competition.

Question 15

Do the parties consider that Article 2(b)-(e) of the RO Agreement could be relied on to challenge a change in rules of origin per se, as opposed to the specific rules of origin in force at the time a challenge is brought? In other words, could a panel uphold claims under Article 2(b)-(e) that a change in rules of origin of itself is contrary to these provisions?

Answer 15

There is nothing in Article 2(b)-(e) that prevents Members from changing their rules of origin provided they meet the requirements set out in these provisions. India does not claim that the United States violated these provisions merely because it changed its rules of origin. India claims that the United States violated these provisions because it imposed and maintained rules of origin inconsistent with these provisions.

Question 16

With reference to Article 2(b) of the RO Agreement, do the parties consider that the term "used" should be interpreted to mean that a panel should assess whether rules of origin are used as instruments to pursue trade objectives as of the time they were adopted or as of the time of establishment of the panel?

Answer 16

The Panel should assess the consistency of the United States rules of origin as maintained at the date of the establishment of the Panel. In the case before the Panel, the United States rules of origin were originally adopted, and subsequently maintained, to pursue trade objectives.

Question 16 bis

The European Communities suggests that Article 2(c) of the RO Agreement requires a showing of actual restrictive or distorting effects and that such actual effects would need to be demonstrated through trade statistics (European Communities' written submission, paras. 28 and 32). At the same time, the European Communities argues that protectionist intent would be indicated if what the EC calls a "quota-effect" could be demonstrated, i.e., if it could be demonstrated, for instance, that certain products which used to be quota-free before certain rules of origin entered into force are subject to a quota after the entry into force of those rules (European Communities' written submission, paras. 23-24). Would a clear demonstration of such a (potential) "quota-effect", when there is no demonstration of actual adverse impact on the trade of a Member, be sufficient to establish restrictive or distorting effects under Article 2(c)?

Answer 16bis

Paragraphs 23 and 24 of the European Communities' written submission refer to the "quota-effect" in the context of determining protectionist intent under Article 2 (b) of the *RO Agreement*, not in the context of "trade effects" under Article 2 (c). For the reasons explained at the First Hearing and further elaborated in the response to question 26 below, India does not believe that Article 2(c) requires a showing of actual restrictive or distorting effects demonstrated through trade statistics.

The immediate impact of a restrictive rule of origin is to change the investment and other business plans of producers and investors engaged in international trade. Once these plans have been changed and carried out, this impact may be reflected in the trade statistics. It is completely artificial to claim that rules of origin create restrictive or distorting effects within the meaning of Article 2(c) only *after* the decisions of producers and traders are reflected in the trade statistics, after, say, a period of one or two years. A new rule of origin can stop all production and trade for a particular market on the day on which the rule is adopted. There would be no rationale for excluding such immediate effects on international trade from the coverage of Article 2(c).

Given that market conditions constantly change and that rules of origin are only one of many factors that determine trade flows, the Member cannot foresee how precisely producers and traders will react to a new rule of origin. Members control and foresee only the conditions of competition that they impose. If the Panel were to rule that the actual trade effects of a rule of origin were to determine its legal status under Article 2(c), it would therefore have to presume Article 2(c) does not regulate the rules of origin adopted by Members, but the reaction of producers and traders to those rules. However, so far, all rules of conduct governing non-tariff measures have always been interpreted to regulate what Members should do, not what producers or traders have done.

The European Communities' interpretative approach to Article 2 (c) can also not be reconciled with its own behaviour. In its dispute with United States on measures affecting textiles and apparel products³⁴⁴, the European Communities twice brought claims under Article 2(c) immediately upon the adoption of new rules of origin by the United States, *without awaiting the impact of the new rules to show up in trade statistics*. Why? Because the Italian producers of silk scarves and other

³⁴⁴ United States – Measures Affecting Textiles and Apparel Products, WT/DS85/1, G/RO/D/1, G/TBT/D/13, 3 June 1997 and United States – Measures Affecting Textiles and Apparel Products (II) WT/DS151/1, G/TMB/N/341, G/RO/D/3, G/TBT/D/19, G/L/279, 25 November 1998.

manufacturers in the European Communities felt the restrictive effects of the new rules of origin immediately and urged the European Communities to intervene before the new rules had caused actual trade damage.

Question 17

With reference to Article 5.1 of the Agreement on Textiles and Clothing, which is referenced in the Senate Report (exhibit IND-10, p. 125), could the parties please answer the following questions:

- (a) ***What is the meaning of the term "circumvention" as that term is used in Article 5.1? Please provide documentary support if available (e.g., WTO documents, negotiating documents, views of experts, etc.)?***

Answer 17 (a)

A useful reference guide to responding to questions at 17 (a), (b), & (d) is the "Drafting History of the Agreement on Textiles & Clothing" by Marcelo Raffaelli and Tripti Jenkins published by the ITCB, Geneva.

At page 101 of the above referenced volume, it is stated that "circumvention has never been defined". References to circumvention were included in the Short Term Agreement (STA) at paragraph D, Long Term Agreement (LTA) (Article 6), MFA '74 (Article 8) and in the 1981 and 1986 Protocols of Extension of the MFA (paras 14 & 16 respectively).

The Agreements, as well as the two Protocols mentioned above, only stated "how" circumvention could occur, not "what" is circumvention. Under the STA, the arrangement could be circumvented or frustrated "by non participants, or by transshipment or by substitution of directly competitive textiles". The drafting history of the ATC points out that the STA was mainly concerned with circumvention by the "replacement of cotton by other fibres" i.e., through the substitution of directly competitive textiles.

Article 6 of the LTA explains the problems in each case viz. (i) "trans-shipment; (ii) substitution of directly competitive textiles", and (iii) Non-participants. An important element brought out while discussing "the deliberate substitution for cotton of directly competitive fibres" under Article 6(b) of the LTA, is the matter of "intention".

The argument regarding "intention" according to the drafting history of ATC (Page 104) was revisited in the Protocol of Extension 1981 which introduced the concept of "where evidence is available regarding the country of true origin and "the circumstances of circumvention."

However, the drafting history also records that the opening offered in paragraph 14 of 1981 Protocol viz. "adjustment of charges to existing quotas" enabled the European Communities to "negotiate" provisions which gave the importing country, the right to take measures unilaterally, if it concluded that circumvention (as defined by the importing country) had taken place".

As the drafting history points out (Page 105) "Both the European Community and the United States chose to interpret circumvention as occurring when imports of a restricted product from a certain country of origin entered their respective customs territory through another country, irrespective of the existence or not of will on the part of the restrained party, of exceeding its quota. Even a re-routing done entirely under the responsibility of a third party and/or of an importer in the United States or European Communities was considered by them as circumvention because their view was that since the economic benefit accrued to the producers in the country of origin, an adjustment should be made to the country's quota".

In the ATC, the drafting history points out, the "element of intention" continues to be relevant in paragraph 3 of Article 5, where the paragraph ends stating "Members should endeavour to clarify the circumstances of any such instances of circumvention or alleged circumvention including the respective roles of the exporters or importers involved". The drafting history further argues that (i) origin of the (above) phrase, (ii) its inclusion, (iii) the reference to role of importers (the first ever of its kind) make "the matter of intention (very) relevant".

The mention of the role importers may have played in circumvention in Article 5.3 "might prove there was no intention to circumvent the Agreement on the part of the restrained member or of its exporters".

The above discussion and the forms of cooperation mentioned in Article 5.3 of the ATC gives a clear indication that acts of circumvention must be examined in the context of their circumstances which can be verified with reference to forms of cooperation like "plant visits and contacts", case by case basis" and "respective roles of the exporters or importers involved".

While circumvention may have never been formally defined, Articles 5.3 and 5.4 of ATC set out that "intention is recognized as relevant when taking action to address cases of circumvention". Due regard in Article 5.4 of the ATC must be given to "the actual circumstances and the involvement of the country or place of true origin" while taking appropriate action like "denial of entry of goods" and "adjustment of charges to restraint levels to reflect the true country or place of origin".

India also notes that in the Senate Report (Exhibit IND-10), under the heading "Rules of Origin for Textile and Apparel Products" (section 334), the following reference is made to Article 5.1 of the Agreement on Textiles and Clothing (ATC): "In light of the emphasis in Article 5 of the Textiles Agreement, on preventing circumvention of textile and apparel quotas ... the Committee believes that it is appropriate to establish a definitive rule of origin for textile and apparel products. The Committee believes that the new rules, once promulgated, will more accurately reflect where the most significant production activity occurs, providing the United States with a more accurate indication of the source of textile and apparel products..."

However, on page 123 of the same Senate Report, under the heading "Textile transshipments" (section 333), another reference is made to Article 5.1 of the ATC. Specifically, the Report states that the *section 333* of the URAA adds a new section to Title IV to address specifically the problem of textile transshipments: "Article 5 of the Textiles Agreement provides that Members should establish legal and administrative procedures to take action against the circumvention of textile quotas by transshipment, re-routing, false declarations of origin or falsification of official documents and obligates Members to cooperate fully to address the circumvention problems...."

Article 5.1 of the ATC provides that: "Members agree that circumvention by transshipment, re-routing, false declaration concerning country or place of origin, and falsification of official documents, frustrates the implementation of this Agreement to integrate the textiles and clothing sector into GATT 1994. Accordingly, Members should establish the necessary legal provisions and/or administrative procedures to address and take action against such circumvention...."

From a review of the term "circumvention" as defined in the Article 5.1 of the ATC, it would seem that *section 333*, rather than *section 334*, was enacted to implement Article 5.1 since it tracks the language of Article 5.1 more directly, and addresses more specifically the type of circumvention noted in Article 5 of the ATC. This would imply that *section 334* was passed for reasons other than to prevent circumvention within the meaning of Article 5.1 of the ATC. India's argument is that *section 334* was passed to pursue trade objectives.

- (b) *Does "circumvention" as that term is used in Article 5.1 cover both quota "evasion" (i.e., illegal action such as fraud, etc.) as well as quota "avoidance" (i.e., legal action intended to minimise the impact of a quota, etc.)?*

Answer 17 (b)

The term "circumvention" as used in Article 5.1 only covers quota evasion, not quota avoidance. The *New Shorter Oxford English Dictionary* defines "circumvention" as a "deceitful or fraudulent conduct perpetrated against a person." Therefore, there must be an element of fraud present in an act of circumvention. Quota avoidance which is defined above as a legal action intended to minimize the impact of a quota does not involve fraud, and therefore, cannot, be correctly considered to be circumvention.

The term "circumvention" has not been specifically defined but is referred to in Article 5 of the ATC in the following contexts: (i) occurrence of circumvention (Art. 5.1), (ii) relevance of intention (Art. 5.3), (iii) presence of "sufficient evidence" (as a result of investigation) (Art. 5.4), (iv) circumstances of the circumvention (Art. 5.4) (v) Appropriate remedies (Art. 5.4) like "denial of entry of goods" or "where goods have been entered, having due regard to the actual circumstances and the involvement of the country or place of true origin, the adjustment of charges to restraint levels to reflect the true country or place of origin".

Given its reference to "false declarations concerning country or place of origin" and "falsification of official documents," Article 5.1 makes its intentions clear regarding the type or form of circumvention it is addressing.

The requirement to prevent false declarations of the "real origin of the goods" also implies the attempts to check "illegal evasion" rather than "legal avoidance".

- (c) *Does outward processing -- e.g., the shipment of Indian greige fabric to Sri Lanka, where the fabric is converted to bed linen and then exported to the United States -- constitute quota "circumvention" within the meaning of Article 5.1, in cases where no fraud, false declaration, etc. is involved?*

Answer 17 (c)

In the light of the reasoning in its answer to question 17 (a), India considers the answer to question 17 (c) to be no. Clearly, outward processing does not constitute quota circumvention.

Circumvention within the meaning of Article 5.1 of the ATC is conduct involving "transshipment, re-routing, false declaration, concerning country or place of origin and falsification of official documents". The example relating to export of Indian greige fabrics to Sri Lanka where the fabric is converted to bed linen and then exported to the United States is a legitimate trade activity carried out on the basis of "comparative advantage". The operations were based on investments made in the processing sector in Sri Lanka. This activity cannot be termed as quota circumvention within the meaning of Article 5.1 as no fraud or false declaration etc. was involved. The intention of the circumvention provisions in Article 5.1 is not to prevent legitimate changes in trade patterns based on investment decisions but rather to prevent deliberate efforts to get *RO Agreement* und the provisions of the ATC by false declarations or false documents with a view "to frustrating the implementation of the ATC."

- (d) *What is "circumvention by transshipment"? Would this necessarily involve some illegal action such as fraud, false declaration, etc., or could the mere fact that shipments are*

transiting through third countries with or without alterations made to the goods concerned be considered "circumvention"?

Answer 17 (d)

Circumvention by transshipment necessarily involves some fraud. However, such fraud could be carried out by shipments transiting through third countries without any alterations being made to the goods themselves. In recognition of this, Article 5.5 of the ATC provides that "some cases of circumvention may involve shipments transiting through countries or places with no changes or alterations made to the goods contained in such shipments in the place of transit."

"Circumvention by transshipment" seen in the context of Article 5.1 and in relation to the other forms of circumvention mentioned therein such as resorting to "false declaration", "falsification of official documents" would indicate that there must be an intention or an attempt to get *RO Agreement* and the provisions of the ATC with a view to frustrate or 'cheat' its implementation.

There is an implicit recognition that even though circumvention could take place through "mere transit of goods without altering or changing" the "circumstances of such circumvention" may have to be examined in relation to "evidence available regarding the country of true origin" as mentioned in Article 5.4 of the ATC.

Question 17 bis

At p. 118, under the heading "Rules of Origin", the SAA appears to provide the objectives which the "country-of-assembly rule" "will serve". Could the parties address whether, and if so why, the four objectives mentioned thereafter, at pp. 118 and 119, also apply to the fabric formation rule in section 334? (US-6; para. 58 of India's first written submission; para. 29 of the United States' first written submission) If the four objectives mentioned in the SAA do not apply to the fabric formation rule, what are its objectives?

Answer 17 bis

The four objectives listed in the SAA can only reasonably apply to the country of assembly rule. In India's view, these objectives cannot be met through the fabric formation rule, and therefore they cannot be said to apply to that rule. As the four objectives do not apply to the fabric formation rule, the fabric formation rule must be said to have been passed to achieve different objectives. As India has explained in its first submission and in its oral statement, the rule was passed to bring more products under quota whereas previously they had been quota free or subject to more generous quota. This rule of origin was therefore used to protect the United States' domestic industry.

Question 18

Is India challenging sections 334 and 405, per se, or the 1996 and 2000 changes in rules of origin?

Answer 18

India is challenging section 334 and section 405 *per se*. The sections are part of United States legislative changes made in 1996 and 2000.

Question 19

Could India please indicate, for each of its claims under Article 2 of the RO Agreement, which aspects of section 334 and/or section 405 and the implementing customs regulations it is challenging? (Example: With respect to the claim under Article 2(b), the aspect of section 334 which is being challenged is the fabric formation rule as provided for in section 334(b)(...)(...), etc.) It would be appreciated if India could reference not only the relevant subsections of section 334 and/or section 405 but also of 19 U.S.C. § 3592 (exhibit IND-7).

Answer 19

With respect to the claim under **Article 2 (b)**, India is challenging the following specific provisions of the legislation and customs regulations:

Section 334 (b) (1) (C) - the fabric formation rule. The country of origin of a fabric is where the fabric is woven, knitted, needled, tufted, felted, entangled or created by any other fabric-making process.

Section 405 (a) (3) (B) - amendment to fabric formation rule

19 U.S.C. §3592 (b) (1) (C) - consolidated fabric formation rule

19 C.F.R. §102.21

Section 334 (b) (1) (D) – the wholly assembled rule. The country of origin of a product is the country where the components of the product are wholly assembled.

Section 405 (a) (3) (C) - amendments to the wholly assembled rule to exempt products of concern to the European Communities and providing exceptions for goods made of cotton, wool or fibre blends consisting of 16% or more of cotton.

19 U.S.C. §3592 (b) (1) (D) – consolidated wholly assembled rule

19 C.F.R. §102.21

Section 334 (b) (2) – "special rules" – Articles under certain HTS headings will be classified where yarn or fabric formed, not where article is assembled.

Section 405 (a) (3) (B) - Certain fabrics such as silk, cotton, wool, MMF or vegetable fibre deemed to originate where subject to DP2

19 U.S.C. §3592 (b) (2) (B) - Certain fabrics such as silk, cotton, wool, MMF or vegetable fibre deemed to originate where subject to DP2

Section 405 (a) (3) (C) - Products classified under certain HTS headings deemed to originate where subjected to DP2 not where greige fabric formed, except for cotton, wool, fibre blends with more than 16% cotton.

19 U.S.C. §3592 (b) (2) (C) - Products classified under certain HTS headings deemed to originate where subjected to DP2 not where greige fabric formed, except for cotton, wool, fibre blends with more than 16% cotton.

19 C.F.R. 102.21

With respect to the claim under **Article 2(c)**, India is challenging the following specific provisions of the United States legislation and customs regulations:

Section 334 (b) (1) (C) - the fabric formation rule. The country of origin of a fabric is where the fabric is woven, knitted, needled, tufted, felted, entangled or created by any other fabric-making process.

Section 405 (a) (3) (B) - amendment to fabric formation rule

19 U.S.C. §3592 (b) (1) (C) - consolidated fabric formation rule

19 C.F.R. §102.21

Section 334 (b) (1) (D) – the wholly assembled rule. The country of origin of a product is the country where the components of the product are wholly assembled.

Section 405 (a) (3) (C) - amendments to the wholly assembled rule to exempt products of concern to the European Communities and providing exceptions for goods made of cotton, wool or fibre blends consisting of 16% or more of cotton.

19 U.S.C. §3592 (b) (1) (D) – consolidated wholly assembled rule

19 C.F.R. §102.21

Section 334 (b) (2) – "special rules" – Articles under certain HTS headings will be deemed to originate where yarn or fabric formed, not where article is assembled.

Section 405 (a) (3) (B) - Certain fabrics such as silk, cotton, wool, MMF or vegetable fibre deemed to originate where subject to DP2

19 U.S.C. §3592 (b) (2) (B) - Certain fabrics such as silk, cotton, wool, MMF or vegetable fibre deemed to originate where subject to DP2

Section 405 (a) (3) (C) - Products classified under certain HTS headings deemed to originate where subjected to DP2 not where greige fabric formed, except for cotton, wool, fibre blends with more than 16% cotton.

19 U.S.C. §3592 (b) (2) (C) - Products classified under certain HTS headings deemed to originate where subjected to DP2 not where greige fabric formed, except for cotton, wool, fibre blends with more than 16% cotton.

19 C.F.R. 102.21

With respect to the claim under **Article 2 (d)**, India is challenging the following specific provisions of the United States legislation and customs regulations:

Section 405 (a) (3) (B) - Certain fabrics such as silk, cotton, wool, MMF or vegetable fibre deemed to originate where subject to DP2

19 U.S.C. §3592 (b) (2) (B) - Certain fabrics such as silk, cotton, wool, MMF or vegetable fibre deemed to originate where subject to DP2

Section 405 (a) (3) (C) - Products classified under certain HTS headings deemed to originate where subjected to DP2 not where greige fabric formed, except for cotton, wool, fibre blends with more than 16% cotton.

19 U.S.C. §3592 (b) (2) (C) - Products classified under certain HTS headings deemed to originate where subjected to DP2 not where greige fabric formed, except for cotton, wool, fibre blends with more than 16% cotton.

19 C.F.R. 102.21

India will further elaborate upon the specific aspects of the challenged provisions in the second written submission.

In addition, please indicate whether your claims concern all qualifying products or only some (Example: Claim X concerns only made-up non-apparel textile articles made from vegetable fibre). Also, please indicate what aspects of the "application" of section 334 and/or section 405 as well as the customs regulations India is challenging..

India's claims cover all qualifying products which have been impacted by the United States' rules of origin in section 334 and section 405 (as consolidated in 19 U.S.C. §3592) and the customs regulations.

With respect to the application of section 334 and/or section 405, India notes the following:

1. Under section 334 the "fabric forward" rule enshrined in sec.334 (b)(1)(c), 334(b)(2)(a) is applicable to all fabrics, made-up articles.
2. Under section 405, the application of "fabric forward" rule to fabrics made from wool.
3. Application of the "fabric forward" rule under section 405 to products falling under HTS Nos. 5609, 5807, 5811, 6209.00, 5040, 6301, 6305, 6306, 6307.10, 6307.90, 6308 and 9404.90 – other than 940490.85, 95.
4. Application of "fabric forward" rule under section 405 to cotton and wool items contained in HS Lines in Chapter 63 other than 6302.22, 6302.29, 6302.52, 6303.92, 6302.99, 6304.19, 6304.93, 6304.99.
5. Application of "fabric forward" rule to blended made-up articles where the cotton component is 16% or more by weight.
- 6.

Question 20

Specifically with respect to India's claim under Article 2(c) of the RO Agreement, could India clarify whether that claim relates to the first sentence thereof, the second sentence, or both?

Answer 20

India's claims cover both sentences. As noted in its request for the establishment of the Panel, India considers that the rules of origin at issue (a) require the fulfilment of certain conditions not related to manufacturing or processing, (b) pose unduly strict requirements and (c) create restrictive, distorting and disruptive effects on international trade. India will elaborate these claims in its second submission.

Question 21

Could India submit a complete version of the customs regulations (exhibit IND-17)? It seems that 19 C.F.R. section 102.21(e) is missing from the document submitted (see India's written

submission, para. 53)? Could India elaborate on the relevance of 19 C.F.R. section 102.21(e) to this dispute?

Answer 21

The complete version of the customs regulations is attached.

The relevance of 19 C.F.R. section 102.21 (e) – which addresses the tariff shift rules - to this dispute is best explained in the following excerpt from the Informed Compliance Publication on Textiles and Apparel Rules of Origin by United States Customs. The underlined section, in particular, addresses one of India's main complaints in this dispute.

"All textile and apparel products are listed by 4-digit to 10-digit HTS classifications or groups of classifications in the tariff shift rules. The tariff shift rules simply explain the requirements to change the country of origin of textile and apparel products (as shown in the preceding section) by using tariff classifications rather than textile or apparel product descriptions. A tariff shift states that, for any given classification, to change the country of origin of a textile or apparel product there must be a shift from one Harmonized Tariff Schedule (HTS) classification to another as listed in the tariff shift rules and/or the processing which occurs must meet any other requirement that is specified in the tariff shift rules in customs regulation §102.21(e).

One group of classifications in the tariff shift rules is 5208 through 5212, which contain the classifications for cotton woven fabrics. The tariff shift rule for classifications 5208-5212 (as amended in interim regulations) states that:

- a) A change from greige fabric of heading 5208 through 5212 to finished fabric of heading 5208 through 5212 by both dyeing and printing when accompanied by two or more of the following finishing operations:
bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or
- b) If the country of origin cannot be determined under (1) above, a change to heading 5208 through 5212 from any classification outside that group, provided that the change is the result of a fabric forming-making process.

To confer country of origin to a cotton woven fabric, a greige fabric must have been dyed and printed and accompanied by two or more specified finishing operations. For example, a greige fabric formed in China which is imported into Pakistan where it is dyed, printed, shrunk and permanently embossed will be country of origin Pakistan.

In the alternative, the creation of the fabric must be from some product other than another cotton woven fabric; for example, the fabric could be formed from cotton yarns, or from polyester and cotton yarns, from fibers or any other product except cotton woven fabric (e.g., joining two narrow fabrics). The second requirement of creating a fabric from a fabric forming process must also be met. This tariff shift rule merely restates the fabric rule (in the section above) using tariff classification terms or definitions.

The result is that the determination of the country of origin is defined in objective tariff classification shifts rather than subjective terms such as "substantial assembly" or "new commercial product". By using HTS classifications, there is no doubt when a change in the country of origin occurs. If a shipper knows the classification of a textile product he is exporting, he merely has to locate the classification in the tariff shift rules to see if the required change of classifications

occurred when the product was produced or manufactured. If the tariff shift has occurred and any other listed requirement is met, then the country of origin is changed by the processing.

For example, the tariff classification for 5204 through 5207 (cotton yarns) states that the tariff shift must be from any other heading provided that the change or shift results from a spinning process. This defines the country of origin for spun yarns (see above). The tariff shifts for 5208 through 5212 require a shift from classifications for yarns, fibers or filaments that results from a fabric making process, or a change from greige fabric to finished fabric that is both dyed and printed when accompanied by two or more specified finishing operations. Similarly, shifts for 6302 require that the country of origin of certain linens must be from the fabric forming process, i.e., the country in which the fabric was woven and not the country in which the fabric for the linens were cut and sewn, while certain other linens may originate in the country where the fabric comprising the good was both dyed and printed when accompanied by two or more specified finishing operations." (emphasis added.)

Question 22

Does India agree with the United States' statement that section 334 was intended, in part, to bring about greater certainty and clarity as compared to the previous practice of interpreting substantial transformation on a case-by-case basis" (United States' first written submission, paras. 25 and 29)?

Answer 22

India does not agree with the *United States'* statement that section 334 was intended, in part, to bring about greater certainty and clarity as compared to the previous practice of interpreting substantial transformation on a case-by-case basis. In this regard, India would note that the case-by-case determination process, as evidenced by the *Cardinal Glove* case, was abandoned by the enactment of the section 12.130 regulations. The section 12.130 regulations were a set of "concise, predictable, published rules." The United States did have regulations in effect through section 12.130, plus a large body of customs rulings, which applied to virtually every production scenario. It is India's understanding that the section 12.130 regulations were promulgated in accordance with the requirements of the United States Administrative Procedure Act (APA) and that interpretative customs regulations issued pursuant to the APA are presumed to be correct, unless clearly arbitrary, capricious, an abuse of discretion or otherwise not in accordance with the law.

Question 23

Could India elaborate on how para. 53 of its first written submission supports its conclusion that section 334 is used as an instrument to pursue trade objectives?

Answer 23

Paragraph 53 of India's first submission, read together with paragraph 54, explains how the fabric forward rule operated to protect the domestic industry of the United States. The paragraph is part of India's demonstration that the design, structure and architecture of section 334 reveal the objective of protecting the domestic industry.

Question 24

Please address the United States' argument that "India does not address the possibility that Sri Lankan producers may have decided to weave their own fabric or to source it from elsewhere". (United States' first written submission, para. 41)

Answer 24

One has to acknowledge that changing the rule of origin to a fabric forward rule will confer origin on those countries that have loom capacity. However, looms are not inexpensive items that can be moved *RO Agreement* und easily. It is not as if the Sri Lankans can "simply snap their fingers" and decide to weave their own fabric. Setting up weaving mills is a capital intensive project. One may conclude that countries with loom capabilities would be "winners" in such an arrangement. But the United States never amended its quota allotments to account for the fact that the change in origin to the location of the looms (i.e., to where the fabric was formed) would impact on origin for quota purposes.

Countries such as Sri Lanka, with a low loom capacity and a growing sewing/dyeing business were adversely affected by the *United States'* change in rules of origin because they were limited as to the amount of Indian fabric they could use because of the quota allotments. The restrictions on which country Sri Lanka could source or input materials from decreased the amount of goods Sri Lanka could send to the United States, thereby resulting in protection to the United States industry.

In addition, India notes that the United States' argument as to the Sri Lankan response is effectively an acknowledgement by the United States that section 334 did restrict and distort trade. It acknowledges that the likely response to section 334 would either be (a) to force a shift of investment in loom facilities from other countries into Sri Lanka or (b) to shift the supply of fabric from India to other countries whose quota remained open and who would still be willing to issue visas for goods not produced in their country.

Question 25

With reference to Article 2(b) of the RO Agreement, could India please answer the following questions:

- (a) *Does India consider that the prevention of quota circumvention as that term is used by the United States would need to be viewed as a "trade objective"?*

Answer 25 (a)

Yes. See answer to Question 2.

- (b) *At para. 35 of its oral statement, India appears to reject the European Communities' approach to the interpretation of Article 2(b) which India understands as being based purely on intent and suggests that the Panel should follow the approach adopted by the Appellate Body in interpreting Article III:2 of the GATT 1994. But India then goes on, at para. 36 of its oral statement, to say that "[w]e fully recognise that the intentions expressed during the legislative history, by themselves, cannot constitute a violation of Article 2(b)." (emphasis added) Is India suggesting then that a qualified Article III:2 approach should be adopted, which looks both at intent of legislators and the design and structure of rules of origin?*

Answer 25 (b)

India believes that the objectives that a Member pursues with rules of origin should be determined by examining their design, structure and architecture. If, as in the case before the Panel, the statements by those that participated in the drafting of the legislation confirm the objectives revealed by the legislation's design, structure and architecture, those statements can be taken as additional evidence. This is justified because, in the absence of any indications to the contrary, it can reasonably be

assumed that the intentions of those who promoted the legislation are reflected in the legislation's design, structure and architecture.

In the statements cited by the Panel, India rejects the idea expressed by the European Communities that Article 2(b) is exclusively about intent. In the view of India, this provision is violated by the adoption of rules of origin that reveal through their design, structure and architecture that a trade objective is being pursued. Article 2(b) is thus not about intent as such, but about the intent revealed in the legislation. India believes that its approach is fully consistent with the approach adopted the Appellate Body (see for instance, *Chile – Taxes on Alcoholic Beverages*, WT/DS87/AB, WT/DS110/AB, paras. 69-71).

Question 26

Preface to the answers to questions 26 (a)-(e)

The obligation set out in Article 2(c) of the *RO Agreement* to refrain from adopting rules of origin that create restrictive or distorting effects can be interpreted in two ways.

First, Article 2(c) of the *RO Agreement* could be interpreted to require Members to prevent rules of origin from having a restrictive or distorting *impact on international trade flows*. The restrictive and distorting effects referred to in this provision would then be the effects that occur *after* producers and traders have adjusted to the new rules. The impact of the new rules on the investment and other business plans of producers and traders affected by the rules would not be taken into account in determining whether they have a restrictive or distorting effect on international trade.

According to this "result-oriented" interpretation, it is not the nature of the rule of origin but its actual impact in the market place that counts. Members would therefore be free to adopt any rule of origin. Their only obligation under Article 2(c) would be to modify the rules of origin if they generate a restrictive or distorting impact on international trade reflected in trade statistics. According to the result-oriented interpretation of Article 2(c), the purpose of this provision would be to protect expectations on the volume, direction and product-composition of trade. A complaint could therefore not be brought against rules of origin themselves immediately upon their adoption, but only against the trade impact generated by them after some time. Moreover, the complainant would have to bear the burden of demonstrating that the change in the volume, direction and product-composition of trade was attributable to the rule of origin, and not to other factors. If the respondent is found to have caused a restrictive or distorting impact on international trade, it would not be required to change its rules of origin, but to prevent them from having a restrictive or distorting impact. The interpretation thus presupposes that Members know and control what the actual impact of changes in their rules of origin in the market will be. A violation of Article 2(c) would thus not depend exclusively on what the Member does, but would be triggered by what producers and traders do.

Second, Article 2(c) of the *RO Agreement* could be interpreted as requiring Members to refrain from adopting and maintaining rules of origin which establish *conditions of competition with restrictive or distorting effects on international trade*. According to this "conduct-oriented" interpretation, the incentives and disincentives created by the rules of origin themselves, not their actual impact in the market would be decisive. The immediate consequence of a new rule of origin changing the incentives and disincentives for producers and traders is to change their investment and other business plans. Only later on, after the new investment and business plans are carried out, will the rule of origin change the actual pattern of trade. According to the conduct-oriented interpretation the immediate impact of the rule of origin on the decisions of producers and traders involved in international trade would be taken into account in assessing whether a rule of origin creates restrictive or distorting effects on international trade.

According to this interpretation, the purpose of the provision would be to ensure that Members do not adopt and maintain rules of origin creating conditions of competition that operate to restrict or distort trade. A complaint could therefore be brought against new rules of origin immediately upon their adoption, and not only when the producers and traders have actually reacted to the new conditions of competition. Members would be held responsible for the rules of origin they adopted, not for the reactions of the market to their rules of origin. Their obligation under Article 2(c) would thus not go beyond what they can control or foresee.

All GATT and WTO panels and the Appellate Body have interpreted the rules governing tariff concessions and non-tariff measures as rules requiring the establishment of conditions of competition. The 1990 Panel on *EEC - Payments and Subsidies to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* summarised the GATT jurisprudence on this issue as follows:

The CONTRACTING PARTIES have consistently interpreted the basic provisions of the General Agreement on restrictive trade measures as provisions establishing conditions of competition. Thus they decided that an import quota constitutes an import restrictions within the meaning of Article XI:1 whether or not it actually impeded imports and that an internal tax on imported products does not meet the national treatment requirement of Article III whether or not the tax is actually applied to imports. A previous panel pointed out that Articles III and XI are "to protect expectations of the contracting parties as the competitive relationship between their products and those of other contracting parties. Both Articles are not only to protect current trade but also create predictability to plan future trade". In past Article XXIII:1(b) cases, the CONTRACTING PARTIES have adopted the same approach . . . In none of these cases did they consider the trade impact of the change in competitive conditions to be determining. It is of course true that, in the tariff negotiations in the framework of the GATT, contracting parties seek tariff concessions in the hope of expanding their exports, but the commitments they exchange in such negotiations are commitments on conditions of competition for trade, not volumes of trade.

The approach of the CONTRACTING PARTIES reflects the fact that governments can often not predict with precision what the impact of their interventions on import volumes will be. If a finding of nullification or impairment depended not only on whether an adverse change in competitive conditions took place but also on whether that change resulted in a decline in imports, the exposure of the contracting parties to claims under Article XXIII:1(b) would depend on factors they do not control... Moreover, the contracting parties facing an adverse change in policies could make a claim of nullification or impairment only after that change has produced effects. . . The Panel further noted that changes in trade volumes result not only from governmental policies but also from other factors, and that, in most circumstances, it is not possible to determine whether a decline in imports following a change in policies is attributable to that change or to other factors. (BISD 37S/130-131).

If the Panel were to interpret Article 2(c) as to require Members to prevent rules of origin from having an actual restrictive or distorting impact on the volume, direction or composition of international trade, it would be the first panel in the history of the multilateral trade order to interpret a rule governing a non-tariff measure to require the attainment or avoidance of specific trade results.

The adoption of a rule of origin can immediately stop production for a particular market or purchases from particular markets. *It is thus the very adoption of a rule of origin that can have serious restrictive or distorting effects on international trade.* It cannot reasonably be assumed that the drafters meant to exclude from the coverage of Article 2(c) the immediate restrictive or distorting effects that rules of origin can create by forcing enterprises to change their business plans. The purpose of the *RO Agreement* is, according to its Preamble, to "further the objectives of the GATT 1994" and to "ensure that rules of origin do not nullify or impair the rights of Members under the GATT 1944". The drafters of the *RO Agreement* therefore expected the rules of the *RO Agreement* to

be interpreted in a manner consistent with the basic objectives of the GATT, in general, and the market access rights accorded under it, in particular.

Question 26

With reference to Article 2(c) of the *RO Agreement*, could India please answer the following questions:

- (a) *Regarding the term "create" as it appears in Article 2(c), is there a difference in meaning between the phrase "origin rule X has a trade-restrictive effect" and the phrase "origin rule X creates a trade-restrictive effect"?*

Answer 26 (a)

Article 2 (c) refers to effects, not an effect. Article 2 (c) refers to effects *on international trade*, not on imports or on trade. Article 2 (c) refers to the rules of origin *themselves* and not to their application to a particular commercial policy instrument. All of these differences with Article 3.2 of the Agreement on Import Licensing are signposts for the interpretation that Article 2 (c) prohibits rules of origin *creating* conditions of competition entailing restrictive, distorting or disruptive effects on international trade. India's response in the preface to answer 26 (a) to (e) clearly shows that Members should not, and cannot, be held to violate WTO law because of the response of the market to their regulations.

- (b) *Following on from the previous sub-question, if there were a difference, what would be the rationale for using the term "create" in Article 2(c) of the RO Agreement and the term "have" in Articles 2(a) and 3.2 of the Agreement on Import Licensing Procedures? What would justify regulating Members' use of rules of origin differently from Members' use of import licensing?*

Answer 26 (b)

India considers that both Article 2(c) of the *RO Agreement* and Article 3.2 of the Agreement on Import Licensing Procedures require Members to establish certain conditions of competition, not merely certain trade results because Members neither control the actual market impact of their rules of origin nor that of their licensing procedures. However, India believes that the term "create" in Article 2(c) of the *RO Agreement* brings this idea out more clearly than the term "have" in Article 3.2 of the Agreement on Import Licensing Procedures.

- (c) *Would India agree that Article 6.3 of the SCM Agreement contemplates a showing of "actual" adverse effects? If so, is there any reason why the Panel, when interpreting the phrase "create [...] effects", should not seek inspiration from the provisions of Article 6.3 as well as the case law on Articles III and XI of the GATT 1994? (India's oral statement, paras. 40-42)*

Answer 26 (c)

India agrees that Article 6.3 of the SCM Agreement contemplates the showing of actual adverse effects. However, this provision does not require Members to attain or avoid any particular market impact. It merely describes various market situations caused by a subsidy that trigger the right of adversely affected Members to request

authorisation to take countermeasures. In other words, Article 6.3 of the SCM Agreement is a provision according a trade remedy once a subsidy has caused serious prejudice. It cannot inspire the interpretation of a provision that does not accord a remedy against restrictive or distorting effects caused by rules of origin but establishes the obligation to refrain from adopting rules of origin bound to create restricting or distorting effects.

Article 6.3 is comparable to the provisions governing safeguard measures, anti-dumping duties and countervailing measures according to which Members are permitted to offset the impact of increased imports, dumping and subsidisation in their domestic market. However these provisions do not regulate which market impact Members must achieve or avoid. They permit Members to react to a market impact that has already occurred.

Article 2 (c) of the *RO Agreement* does not require the demonstration of actual adverse effects. For the reasons described above, it is difficult to see on what grounds provisions that regulate the right of redress when increased imports, dumping and subsidisation cause injury or serious prejudice could inspire an interpretation of Article 2(c) of the *RO Agreement*, which does not set out a right of redress against rules of origin having caused restrictive or distorting effects but an obligation to refrain from adopting rules of origin that create restricting or distorting effects.

- (d) *India argues that Article 2 of the RO Agreement "must be interpreted as a provision prescribing conditions of competition, not the avoidance of certain trade results". (India's oral statement, para. 43) Inter alia, India supports this position by reference to the case law on Article III of the GATT 1994. The GATT Panel in US - Superfund (BISD34S/136), para. 5.1.9) stated that "Article III:2, first sentence, obliges contracting parties to establish certain competitive conditions for imported products in relation to domestic products. Unlike some other provisions in the General Agreement, it does not refer to trade effects." (emphasis added) Thus, assuming the case law on Article III were relevant, could it not be said that Article 2(c) of the RO Agreement constitutes a provision which refers to trade effects?*

Answer 26 (d)

The issue is not whether Article 2(c) refers to trade effects or not. The issue is whether the effects on international trade referred to in this provision include the immediate effects created by the rules of origin themselves (including their effects on investment decisions and other business plans) or whether this provision covers only their indirect impact on trade flows reflected in trade statistics. All the considerations set out in paragraph 5.19 of the panel report cited by the Panel point to the conclusion that the relevant effects are those caused by rules themselves. The panel report therefore, notwithstanding its reference to trade effects, therefore clearly supports India's position.

The terms "trade effects" do not appear in the GATT. Actual trade effects are relevant under GATT and WTO law only in the field of trade remedies. The reference in the *US- Superfund* panel report to the other provisions in the GATT referring to trade effects must therefore be understood to be a reference to provisions of Article VI of the GATT, which refer to the injurious effects caused by dumping and

subsidisation. As pointed out above, a provision permitting reactions to measures having caused injurious effects cannot inspire the interpretation of a rule establishing an obligation not to create certain effects.

- (e) *India claims that the United States' rules of origin at issue in this dispute create distorting effects because they "shifted origin from a third country where the fabric was dyed and printed and subjected to two further finishing operations to the country where the greige fabric was formed" (India's first written submission, para. 96, emphasis added). Does this not imply that Members cannot introduce changes to their rules of origin, given that different rules of origin are almost bound to produce different trade effects?*

Answer 26 (e)

India is not arguing that Members cannot change their rules of origin. India is arguing that Members may not change their rules of origin for purposes and in a manner inconsistent with Articles 2(b), 2(c) and 2(d).

Question 27

With reference to a statement made at the meeting by counsel for India in which a distinction was drawn between concessions made in tariff negotiations and the adjustment made to rules of origin at the request of another Member, can India comment on the following hypothetical example? Assume that in the framework of multilateral tariff negotiations Member X requests Member Y to grant a tariff concession with respect to product Z (of which Member X is the principal supplier) and Member X obtains that concession on an MFN basis. Assume further that Member Y refuses to grant a tariff concession with respect to product Q (of which Member R is the principal supplier). In those circumstances, could it be said that Member X has obtained from Member Y a de facto advantage contrary to Article I of the GATT 1994? Is this different from the United States providing, at the request of the European Communities, for exceptions from the fabric formation rule with respect to specified products and regardless of the "origin" of those products?

Answer 27

According to the provisions of the GATT, tariffs may be used as instruments to pursue trade objectives. They may in particular be structured so as to afford protection to a domestic industry and to favour a supplier offering a counter-concession in trade negotiations. The GATT panel on *Japan – Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber* therefore found that a tariff classification going beyond the Harmonized System's structure is "a legitimate means of adapting the tariff scheme to each contracting party's trade policy interests, comprising both its protection needs and its requirements for the purposes of tariff-and trade negotiations" (BISD 36S/198, para. 5.9).

According to the provisions of the *RO Agreement*, rules of origin may *not* be used as instruments to pursue trade objectives. Members may therefore *not* adapt their rules of origin for their protection needs and their requirements for the purposes of tariff-and trade negotiations. The *RO Agreement* resembles in that respect the WTO agreements governing technical regulations, import licensing procedures, SPS measures and the GATT provisions on internal taxes and regulations and quantitative restrictions. All of these agreements and provisions are to ensure that Members do not use non-tariff measures to pursue trade objectives.

It follows from the above that the scope of prohibition to discriminate between other Members in Article 2(d) cannot be determined in the light of the GATT rules governing tariff concessions. If rules of origin could be used for the same purposes as tariffs, Members would have to negotiate not only

tariff concessions but also commitments on to the rules of origin applicable to the products for which the tariff concession is granted. The *RO Agreement* is to ensure that this is not necessary. The scope of prohibition to discriminate between other Members in Article 2(d) of the *RO Agreement* must consequently be determined in the light of the objectives of this Agreement.

Question 28

With reference to a comment made at the meeting by counsel for India in which mention was made of Article 4.1 of the ATC, how does India administer the quotas affected by the rules of origin at issue in this case? Does it allocate those quotas on a first-come, first-served basis or does it use a different method?

Answer 28

India allocates the quotas in different country/categories under restraint on the basis of specified systems of allotment. These systems of allotments are:

- (i) Past Performance Entitlement (PPE) System
- (ii) Manufacturer Exporters Entitlement (MEE) System
- (iii) First-come-first-served Ready Goods Entitlement (RGE) System
- (iv) Powerloom Exporters Entitlement (PEE) System

The annual level for each country/category is distributed for allocation under the above systems of allotment as per the table below:

DISTRIBUTION OF ANNUAL LEVEL

| System | Percentage of Annual level distribution for | | | |
|--|---|---------|------------------------------------|--------------------|
| | Yarn | Fabrics | Made-ups Millmade/ Powerloom | Madeup Handloom |
| Past Performance Entitlement (PPE) | 55% | 55% | 55% | 55% |
| Manufacturer Exporters Entitlement (MEE) | 15% | 15% | 15% | - |
| Ready Goods Exporters Entitlement (RGE) | 30% | 15% | 15% | 45% |
| Powerloom Exporters Entitlement (PEE) | | 15% | 15% | - |
| Total | 100% | 100% | 100% | 100% |

Each of the above systems of allotment is briefly explained below:

PAST PERFORMANCE ENTITLEMENT (PPE) SYSTEM

PPE System is based on export performance in a calendar year preceding the year immediately before the allotment year. Thus the "base period" for allotment of PPE in the year 2003 is the export performance in the year 2001. Exporters who have export performance by way of actual shipments in the relevant country/category, (in this case in US Group II made-ups) during the Base period are eligible to get allotment under this system. Entitlements are calculated pro rata based on the value of exports during the base year by the applicants in each country/category. The allotments are restricted to the average annual export performance of India in the country/category during the base period. Quota allotted under this system is transferable to fellow exporters.

MANUFACTURER EXPORTERS ENTITLEMENT (MEE) SYSTEM

Allotments under the MEE system are made to manufacturer exporters who have undertaken substantial modernisation and upgrade of technology in their plant and machinery during the base period. The base period for MEE allotment for the year 2003 is 1-7-1999 to 30-6-2002. Allotments under the system are made in respect of goods manufactured in the modernised and upgraded production units and quantity is distributed on the basis of level of investment made by the applicant. Eligible applicants can opt for allotments in a maximum of 5 country/categories.

The investment made in the spinning, weaving, processing and state of the art processing machinery for the purpose of allotment of the MEE quota are given weightage as follows:

| <u>Sr. No.</u> | <u>Section</u> | <u>Weightage</u> |
|----------------|---|------------------|
| a) | Spinning, stitching machines/other machines | 1 |
| b) | Weaving Machines | |
| | i) Machines other than shuttleless looms | 2 |
| | ii) Shuttleless looms | 3 |
| c) | Knitting Machines | 2 |
| d) | Processing machines, effluent treatment plant and Air pollution control equipment. | 3 |
| e) | State-of-the-art processing machines and State-of-the-art effluent treatment plant | 4 |

Processing machinery used for fibre/yarn dyeing/processing is given weightage of its value coupled with the spinning section machinery weightage for the allotment of yarn quota.

These allotments are non-transferable.

READY GOODS EXPORTERS ENTITLEMENT (RGE) SYSTEM

Quota under this system of distribution is allotted on a first-come-first-served basis and is opened for distribution 4 times in a year i.e. during January, April, July and October, on pre-determined dates. On a particular day when available quantities are over subscribed, eligibility for allotment is decided on the basis of higher unit value realisation among the applications received on that day.

Quotas are also opened under the system on dates other than the pre-determined dates in case substantial quantities become available by way of surrenders/non-shipment flexibilities.

These allotments are non-transferable.

POWERLOOM EXPORTERS ENTITLEMENT (PPE) SYSTEM

The quotas under the PEE system are allotted to applicant powerloom manufacturers in the small scale sector each owning at least 12 powerlooms by himself or along with his family members in the same village/town/city. The units are required to establish their identity on the basis of their having obtained or applied for powerloom permit. Allottee powerloom manufacturers are permitted a choice up to 7 countries/categories. Allotments are also determined under this system on the basis of differential weightage depending on the size of the loom holdings.

These quotas are not transferable but the quotas can be "clubbed" by the shippers for exports.

Questions 19 to 36 for the United States only and Question 37 to 41 et seq. for the Third Parties.

ANNEX A-2

ANSWERS OF THE UNITED STATES TO QUESTIONS FROM THE PANEL FOLLOWING THE FIRST MEETING

For both parties:

1. Do you agree with the European Communities that the concept of substantial transformation "was intentionally left out of the disciplines to be applied during the transitional period" and that, therefore, "Members are under no obligation during the transitional period to base their origin rules on the concept of substantial transformation"? (European Communities' written submission, paras. 9 and 22)

1. Yes. There is no basis for a Member to challenge another Member's rules of origin because it disagrees with the substance of those rules. It is specifically the substance of rules of origin that is the subject of negotiations during the current harmonization process (and including the parameters of substantial transformation).

2. With reference to Article 2(b) of the RO Agreement, do you consider that the prevention of quota circumvention as that term is used by the United States would need to be viewed as a "trade objective"?

2. No. Limits on textile and apparel imports are, under the WTO *Agreement on Textiles and Clothing* (ATC), entirely consistent with WTO obligations, and Members are entitled to take steps to ensure that they are not circumvented. In fact, Article 5.1 of the ATC requires Members to establish legal provisions and administrative procedures to address and take action against such circumvention. If preventing quota circumvention were determined to be a "trade objective" for purposes of Article 2(b), then Members would be severely hampered in their ability to ensure compliance with textile and apparel quotas and to comply with Article 5 of the ATC. Origin determinations that allow traders and customs officials to draw bright lines ensure transparency and predictability, and allow importers, exporters, and Members to work together to prevent circumvention. The United States, in enacting section 334, sought to address growing uncertainty in country of origin determinations caused by the myriad of origin claims which differed only slightly from each other, and that United States Customs officials were addressing on a case by case basis in different offices. Addressing such uncertainty also addressed circumvention of textile and apparel quotas.

3. Does Article 2(d) of the RO Agreement cover discrimination between the products of "other Members"? If so, what kind of products, i.e., identical products, like products, directly competitive or substitutable products, etc.?

3. In Article 2(d), the *RO Agreement* mandates, in relevant part, that Members ensure that "the rules of origin that they apply . . . shall not discriminate between other members, irrespective of the affiliation of the manufacturers of the good concerned." This provision does not speak of discrimination "between products." The first clause of Article 2(d) is aimed at ensuring that rules applied to imported goods are not more stringent than those used to determine domestic origin. The second clause is directed at precluding the type of discrimination, in the form of non-preferential rules, that would include a criterion based on the national affiliation of a company or nationality of its employees. The *RO Agreement* clearly allows for differentiation of rules between products, as can be seen in the harmonization work program, where Members are addressing thousands of subheadings in the tariff schedule.

For the United States

6. Does the United States agree that "favouring one Member over another" would qualify as a "trade objective" within the meaning of Article 2(b) (India's first written submission, para. 69; European Communities' written submission, para. 11)?

4. As the United States indicated at the meeting with the Panel the United States believes that the phrase "favouring one Member over another" begs the question posed by Article 2(b). Rules of origin may favor one Member over another just by their existence, and thus cannot, on that basis alone, be considered a "trade objective" within the meaning of Article 2(b). For example, some Members may believe that a coffee product should originate based on where it is grown, while others may believe it should originate based on where the coffee beans are roasted. Whichever rule is chosen will "favor" some Members over others. Similarly, with watches, some Members may believe that origin should be conferred by assembly, others by the origin of certain components. Again, whichever rule is chosen will, in some Member's view, "favor" some Members over others.

5. Similarly, changes in rules of origin for quota goods will usually have quota implications that will be different for different Members, depending on their quota levels and the nature of their exports. In accordance with the terms of bilateral textile agreements incorporated into the ATC, there are several examples where United States textile and apparel quotas appear to treat imports from India more favorably than those of other WTO Members, for example with respect to duck fabric, skirts, cotton terry towels, as well as the annual growth rates for certain categories. However, Members are clearly allowed to change rules of origin during the transition period, and any interpretation of the *RO Agreement* that would prohibit such changes for any product, including products subject to quantitative restrictions authorized by the WTO Agreement, can therefore not be correct.

7. Could the United States confirm that wherever the fabric formation rule is applicable pursuant to section 334 and section 405, operations subsequent the formation of the greige fabric, such as dyeing, printing and two or more finishing operations, as well as cutting, sewing and assembly, will not confer origin? (see paras. 23, 35 and 53 of India's first written submission)

6. No. Under section 334 this is true. However, where section 405 applies, this is not true. Section 405 modifies the fabric formation rule. If a fabric or textile product is one of the products identified in section 405, four or more operations subsequent to formation of the greige fabric does confer origin (dyeing *and* printing and two or more finishing operations).

8. With reference to the United States' statement that "United States' rules take into account which finishing operations merit changing origin, and that may vary based on the type of product" (United States' first written submission, para. 34), could the United States explain why the origin criteria for, e.g., silk scarves are different from the origin criteria for cotton scarves? Why is it that dyeing and printing of the fabric along with at least two finishing operations are considered as origin-conferring in the case of silk scarves, but not in the case of cotton scarves?

7. Silk scarves and cotton scarves are different products, with different rules that reflect -- as is the case with all product-specific rules -- a determination based on assessing the relative importance of various operations or inputs to the final product. Consultations with the European Communities led to the conclusion as reflected in section 405, providing an exception to the rules in section 334 for certain specific products.

9. What is the rationale for using different origin criteria for cotton blends with more than 16% cotton and those with 16% or less? (see India's first written submission, paras. 81-82)

8. In Chapters 50 through 55 of the Harmonized System, there are distinct provisions for yarns and fabrics containing 85 % or more of a particular fiber. These provisions generally define such

products as "wholly of" any given fiber. The Harmonized Tariff Schedule of the United States (HTSUS), general note 22 defines "wholly of" as meaning "that the goods are, except for negligible or insignificant quantities of some other material or materials, composed completely of the named material. By establishing a rule for certain goods containing 16% or more by weight of cotton, we ensured that we would cover the products defined in our settlement agreement. In negotiating the settlement agreement, the United States and the European Communities agreed, in order to resolve the dispute, to a definition of blends containing cotton that is consistent with the structure of the Harmonized System.

10. What is the basis for the United States' contention that the "customs regulations implementing [sections 334 and 405]" are not measures which are before this Panel (United States' first written submission, note 15)? WT/DS243/5/Rev.1 refers to "the customs regulations implementing these Acts" (second paragraph).

9. In stating that India's claims regarding the customs regulations implementing section 334 and 405 should not form part of this dispute, the United States intended to indicate that India has not attempted to meet its burden with respect to these regulations. India has not made any claims with respect to the regulations in either its first submission or its oral statement. Moreover, India indicated at the meeting with the Panel that it was reconsidering its Article 2(e) claims relating to the administration of the rules of origin.

For both parties:

11. With reference to Article 2(c) of the RO Agreement, could the parties answer the following questions:

(a) Does Article 2(c) prohibit rules of origin which create the specified effects even in cases where those effects are entirely unintentional?

10. At the meeting with the Panel, the United States indicated there has to be a clear causal connection between the effects and the rules, because rules of origin will always have an effect on international trade. Article 2(c) recognizes that rules may create unintentional effects, but directs Members to ensure that their rules do not impose *unduly* strict requirements, or require the fulfilment of conditions *not related* to the basis for the origin determination. *See also*, answer to question 11(c).

11. In addition, as was discussed in the United States' answer to question 6, any change to a rule of origin may, in the view of the exporting Members concerned, affect different Members differently, or "more favorably." It is for just this reason that Members have had difficulty in reaching agreement on harmonized rules of origin. With respect to products subject to quota, this is particularly true. However, the *RO Agreement* cannot be interpreted to prevent changes to rules of origin of products subject to such restrictions, as the *RO Agreement* clearly authorizes such changes. A "trade effects" analysis would result in a *de facto* standstill requirement, a result that is clearly inconsistent with the *RO Agreement*.

(b) Does the phrase "restrictive [...] effects on international trade" mean that a complaining Member must show a net restrictive effect on international trade? Or would it be sufficient to show that the trade of one Member has been adversely affected, even if the trade of another Member has been favourably affected? In the latter case, could that one Member be a Member other than the complaining Member?

12. Yes, the plain language of the provision indicates that there has to be a restrictive effect on *international* trade. As such it would not be sufficient to show a trade effect on only one Member. If the Members had intended to make the standard Member-specific, they would have made that clear. They did not because to adopt a standard where a party merely had to allege that there was a negative

impact on its industry alone is not realistic. It does not take into consideration many factors such as natural changes in trading patterns, competition among companies and countries, migration of industries and newly developing industries (based on labor rates, availability of natural resources, etc.). Instead, Members agreed to require actual demonstration of alleged effects. As noted in the United States' answer to question 6, any change in a rule of origin may be viewed as favoring one Member over another, so a Member-specific analysis is not appropriate.

(c) Could it be said that rules of origin inherently create "restrictive" effects on international trade, inasmuch as they may require traders to fulfil certain requirements (e.g., the preparation of certificates of origin, etc.)? If so, would this suggest that Article 2(c) implies some sort of a de minimis exception? If so, what would constitute a de minimis restrictive effect? In answering this question, please address the relevance of the second sentence of Article 2(c) ("unduly strict requirements") and the fourth preambular paragraph of the RO Agreement ("unnecessary obstacles to trade").

13. As indicated above, rules of origin inherently create "restrictive" effects on international trade. For example, ascertaining the origin of a product for purposes of trading with countries without clear origin rules can be extremely burdensome and trade restrictive. However, the United States does not believe that this suggests a *de minimis* standard for evaluating whether rules have a restrictive effect. Furthermore, we believe that this evaluation has to be qualitative as well as quantitative. As Article 2(c) indicates, rules of origin may impose strict requirements, and the preamble recognizes that rules may pose obstacles. This implies that for rules to be inconsistent with 2(c), a "*de minimis*" standard is inappropriate; a far higher standard must be met. This is borne out by the fact that Article 2(a) provides that Members may maintain rules of origin that will have some effect.

14. For example, the United States holds the view that the use of *ad valorem* percentages as a criterion in nonpreferential rules of origin, is inherently unstable and distortive because it can operate to "punish" inexpensive labor costs, is greatly affected by currency shifts, and requires excessive administrative burdens. Nonetheless, the *RO Agreement* sanctions the use of *ad valorem* percentages as nonpreferential rules of origin and does not even place a limit on the percentage that could be used for such a rule. Therefore with terms like "unduly" and "unnecessary" and the lack of limitations in Article 2(a), Article 2(c) would imply a standard far greater than "*de minimis*."

(d) How should the Panel assess whether particular rules of origin create "distorting" effects on international trade? What do you compare the existing rules of origin with?

15. Whether particular rules create "distorting" effects on international trade can only be assessed by determining if there is a causal connection between the rules and international trade flows. That causal connection has to have an effect on international trade that reaches the level of a distortion. This is necessary because many elements, including changes in consumer preference, can cause changes in trade patterns that could be mistaken for distortions. At the very least, it can be concluded that if imports in the products at issue are unchanged or have increased, it cannot be said that trade has been restricted or distorted. The existing rules do not have to be compared to any other factor.

(e) What is the relationship between the first and second sentences of Article 2(c)? Do they provide for distinct and independent obligations, such that the second sentence adds an obligation which is not already covered by the first sentence? Or does the second sentence simply spell out one aspect, or consequence, of the obligation set out in the first sentence?

16. The second sentence clarifies and provides an example of the conduct proscribed by the first sentence. Imposing "unduly strict requirements" as a "prerequisite for the determination of the country of origin" would be one way to "create restrictive effects on international trade" through rules of origin. Thus, the first clause of the second sentence is an instance of a violation of the first

sentence. Similarly, to "require the fulfilment of a certain condition not related to manufacturing or processing as a prerequisite for the determination of the country of origin" would be one way to "create restrictive effects on international trade" through rules of origin. Thus, the second clause of the second sentence is another example of a violation of the first sentence. The second sentence also makes clear that "strict requirements" are allowed; it is only "unduly strict" requirements that are prohibited.

(f) Is it appropriate to evaluate the trade effects of rules of origin introduced by a Member after the entry into force of the RO Agreement by comparing those rules with rules of origin applied by the same Member before the entry into force of the RO Agreement, i.e., with rules of origin which were not subject to the RO Agreement?

17. No. First, such an analysis would necessarily presume that the rules in place prior to the *RO Agreement* did not themselves create restrictive, disruptive or distorting effects on trade, and that therefore any country that changed its rules adversely affected international trade. (It also creates the improper inference that countries that have not "changed" their rules are in compliance with this provision.) This was clearly not the intent of Article 2(c). Second, with respect to the United States change, such an analysis would be an "apples to oranges" comparison, since the old system called for a case-by-case determination, which did not always produce identical conclusions and similar results were not always based on identical fact patterns. Moreover, since Article 2(c) addresses the "rules themselves" it is clear that the appropriate subject of examination is the rules under their own terms, not in comparison to prior rules, or other Members' rules.

12. In their submissions, the parties have referred to "visa requirements". Could the parties provide information regarding the legal basis in United States law for these requirements and how they operate? Also, please address whether these requirements are imposed in order to administer textile and apparel quotas or textile and apparel rules of origin.

18. The legal basis in United States law for "visa requirements" is section 204 of the Agricultural Act of 1956. Visa requirements were originally developed to assist in the administration of quantitative restrictions established under the Multifiber Arrangement (MFA), in force from January 1, 1974 to December 31, 1994. Generally, whenever a quantitative restriction was established, the United States offered to establish a visa arrangement with the affected exporting country. An effective visa arrangement allows the authorities of the exporting country to control and allocate the export rights for goods subject to a quantitative restriction in the United States. Generally, once a visa arrangement is established, the United States will not allow entry, and will not debit applicable quantitative restrictions, unless the importer has secured and can produce a valid visa issued by the authorities of the exporting country. Under the terms of the visa arrangement, the visa is a certification from the authorities of the exporting country that the goods covered by the visa originate in the territory of that country, and that the exporter is authorized to export goods subject to the relevant quantitative restriction. A separate document, the Special Textile Declaration, is required for importations of textile products for United States Customs to determine the proper country of origin for those products. In certain cases, visa arrangements are established at the request of an exporting country, even in the absence of a quota restriction, in order to control exports and help deter illegal circumvention.

19. Visa arrangements for WTO members were notified to the Textile Monitoring Body as administrative arrangements pursuant to Article 2.17 of the Agreement on Textiles and Clothing.

For the United States

13. Could the United States please submit relevant portions of the SAA? Exhibit US-5 appears to contain the Senate Report, and not the SAA.

20. Exhibit US-6 was distributed at the meeting with the Panel on December 13, 2002.

14. *Could the United States elaborate further on how the fabric formation rule in section 334 advances each of the objectives stated by the United States at paras. 5, 11 and 29 of its first written submission as well as in exhibits US-5, IND-9 and IND-10? Please address "circumvention" and "transshipment" separately.*

21. As we noted at the meeting with the Panel and as is discussed in the United States Answers to Preliminary questions by the Panel, question 2, the objectives outlined in the SAA with respect to section 334 largely addressed problems that the United States Customs Service was encountering with respect to origin determinations for textile and apparel products - assembled products, not fabrics and fibers. See SAA at 769/113 ("The principles set forth in section 334 will have the greatest significance for the rules of origin applicable to textile and apparel products other than fibers, yarns, or fabrics.") The fabric formation rule is applicable to fabrics and fibers. The fabric formation rule reflects the United States' judgment that the most substantial transformation in manufacturing fabric is the transformation from yarn to fabric. India would apparently prefer that the United States maintain rules allowing minor processing to change the origin of what is basically fabric - as in a bedsheet.

22. In addition, section 334 addressed circumvention by not recognizing cutting (as in cutting the edges of a bedsheet) as conferring origin; it prevents transshipment by setting an objective and predictable standard for identifying the origin of the product and making it more difficult to falsify documentation from importers; and it facilitates harmonization by having a clearly published standard and by bringing the practice in line with that of the European Communities and Canada (where cutting did not confer origin). The reference in the SAA to transshipment has the same meaning as "circumvention" as that term is used in the ATC; it is common in the United States to refer to circumvention as transshipment. Thus, it is not possible to address the terms separately.

For both parties:

15. *Do the parties consider that Article 2(b)-(e) of the RO Agreement could be relied on to challenge a change in rules of origin per se, as opposed to the specific rules of origin in force at the time a challenge is brought? In other words, could a panel uphold claims under Article 2(b)-(e) that a change in rules of origin of itself is contrary to these provisions?*

23. No. As the United States noted in answer to question 11(f), it is not the change that must be examined under Article 2(b)-(e), but rather the rules in force at the time of the challenge. Indeed, Article 2(i) demonstrates that when the *RO Agreement* imposes a specific obligation on changes in rules of origin it did so explicitly. Article 2(b)-(e) applies to the rules themselves, and 2(i) to changes.

16. *With reference to Article 2(b) of the RO Agreement, do the parties consider that the term "used" should be interpreted to mean that a panel should assess whether rules of origin are used as instruments to pursue trade objectives as of the time they were adopted or as of the time of establishment of the panel?*

24. The United States does not consider that the determination of whether the rules at issue are used as instruments to pursue trade objectives depends on the timing of the examination of those rules. However, as we explained in answer to question 15, the issues in Article 2(b)-(e) are generally best addressed at the time of challenge, or establishment of the Panel. However, this would not preclude an examination of prior events to the extent that they offer relevant evidence. In considering Article 2(b), additional analysis as of the time of adoption may be relevant.

17. *The European Communities suggests that Article 2(c) of the RO Agreement requires a showing of actual restrictive or distorting effects and that such actual effects would need to be demonstrated through trade statistics (European Communities' written submission, paras. 28 and*

32). At the same time, the European Communities argues that protectionist intent would be indicated if what the European Communities calls a "quota-effect" could be demonstrated, i.e., if it could be demonstrated, for instance, that certain products which used to be quota-free before certain rules of origin entered into force are subject to a quota after the entry into force of those rules (European Communities' written submission, paras. 23-24). Would a clear demonstration of such a (potential) "quota-effect", when there is no demonstration of actual adverse impact on the trade of a Member, be sufficient to establish restrictive or distorting effects under Article 2(c)?

25. No. As discussed in the United States Answers to Preliminary questions by the Panel, question 6, changes in rules of origin for quota goods will usually have quota implications that will be different for different Members, depending on their quota levels and the nature of their exports. The "quota effect" analysis would mean that any origin determinations that have a "quota effect" are impermissible, with the result of forcing a country to make no determinations at all, or at very least make no changes to existing rules (for the United States, that would mean a case by case determination). Or, in the alternative, a Member changing its rules of origin would be forced to exempt products subject to quota from those rules. The resulting case by case determination for the "quota protected" products would be burdensome and defeat the purpose of implementing uniform transparent written rules of origin for such products, as encouraged by the *RO Agreement*.

26. The European Communities' analysis is based on an assumption that the appropriate topic for comparison is the market before and after changes to rules. The United States does not accept this comparison. In a given case, a change to rules of origin could eliminate disruptive, distorting, or disruptive effects produced by the former rules; or, it could be that, while the change in rules had an impact on trade, the result was a more transparent and more easily administered system, with benefits to trade, and rules that more accurately reflect commercial realities (i.e., reflect the important role of assembly). As a result, such changes would facilitate trade, and would not restrict, distort, or disrupt it. Indications of whether rules restrict, distort, or disrupt trade would be if they are overly burdensome to comply with; impose more strict requirements on some countries than on others; cause confusion in the market place (e.g., for coffee, if a country were to prohibit coffee grown in a particular country from being so marked, despite consumer reliance on this as an indication of quality, resulting in a dramatic decrease in exports from that country, disrupting the coffee market).

18. With reference to Article 5.1 of the Agreement on Textiles and Clothing, which is referenced in the Senate Report (exhibit IND-10, p. 125), could the parties please answer the following questions:

(a) What is the meaning of the term "circumvention" as that term is used in Article 5.1? Please provide documentary support if available (e.g., WTO documents, negotiating documents, views of experts, etc.)?

(b) Does "circumvention" as that term is used in Article 5.1 cover both quota "evasion" (i.e., illegal action such as fraud, etc.) as well as quota "avoidance" (i.e., legal action intended to minimise the impact of a quota, etc.)?

27. The ATC does not define the term "circumvention" but provides illustrative examples of practices aimed at evading quotas that can result in circumvention of the ATC in Article 5.1 and Article 5.5: transshipment, re-routing, false declaration concerning country of origin and falsification of official documents.

(c) Does outward processing -- e.g., the shipment of Indian greige fabric to Sri Lanka, where the fabric is converted to bed linen and then exported to the United States -- constitute quota "circumvention" within the meaning of Article 5.1, in cases where no fraud, false declaration, etc. is involved?

28. Outward processing resulting in products that meet United States rules of origin is not circumvention, provided that the products undergo substantial processing, in accordance with United States rules, in the second country.

(d) What is "circumvention by transshipment"? Would this necessarily involve some illegal action such as fraud, false declaration, etc., or could the mere fact that shipments are transiting through third countries with or without alterations made to the goods concerned be considered "circumvention"?

29. "Circumvention by transshipment" means shipping goods through a third country in order to disguise their true country of origin.

30. In *The Drafting History of The Agreement on Textiles and Clothing*, commissioned by the textile exporting country caucus, the International Textiles and Clothing Bureau, authors Marcelo Raffaelli and Tripti Jenkins trace the development of the concept of circumvention through the ATC's predecessor agreements, the Multifiber Arrangement (and its protocols of extension), the Long Term Arrangement on International Trade in Cotton Textiles, and the Short Term Arrangement on International Trade in Cotton Textiles.

31. In their commentary on ATC Article 5, they explain that the concept of circumvention, as used in that provision, was based on the previous experience of these predecessor agreements,³⁴⁵ and entails a very broad description of the concept of circumvention – violations of customs law (such as illegal transshipment) are only one way that circumvention could occur. Other ways that circumvention could occur include "substitution of directly competitive textiles" for restrained textiles; and acts of omission by an importing country, if it did not take measures to restrain non-participants whose exports were causing market disruption, while at the same time subjecting participating exporters to restraints.³⁴⁶ Raffaelli and Jenkins also note that the element of "intention" was, at least originally, an important element, *including with respect to "legal" circumvention*.

32. Indeed, in discussing the negotiations which led to the 1986 Protocol of Extension to the Multifiber Arrangement, another expert observer recounted how the expansion of the MFA (to include restraints on products of silk-blend and non-cotton vegetable -- SBOV – fibers in addition to cotton, wool and man-made fibers) was done in response to the growing substitution of directly competitive SBOV articles for their cotton or man-made counterpart. Brenda Jacobs, in *Renewal and Expansion of the Multifiber Arrangement*,³⁴⁷ notes the growing use of "blends engineered to avoid the application of cotton, wool, and man-made fiber quotas." She recounts that the Long-Term Arrangement on International Trade in Cotton Textiles, which preceded the MFA, contained a provision, "Substitution of directly competitive textiles," which allows an importing country to restrain imports whenever it had "reason to believe that imports of products in which this substitution has taken place to have increased abnormally, that is that this substitution has taken place solely in order to circumvent the provisions of this Arrangement."

19. At p. 118, under the heading "Rules of Origin", the SAA appears to provide the objectives which the "country-of-assembly rule" "will serve". Could the parties address whether, and if so why, the four objectives mentioned thereafter, at pp. 118 and 119, also apply to the fabric formation rule in section 334? (US-6; para. 58 of India's first written submission; para. 29 of the United States' first written submission) If the four objectives mentioned in the SAA do not apply to the fabric formation rule, what are its objectives?

³⁴⁵ Attached as Exhibit US-7, page 101.

³⁴⁶ *Id.*, page 103.

³⁴⁷ Law and Policy in International Business, v. 19, 1987, pages 7 - 50.

33. The objectives do apply to the fabric formation rule but were specifically aimed at textile and apparel products, where the primary issue of concern was where significant assembly of those products took place. Combating circumvention through illegal transshipment is furthered by having a clearly stated fabric formation rule. This removed uncertainty and ambiguity which existed under the previous case by case determination of origin, specifically with respect to goods such as towels, linens or fabrics.

For the United States:

31. As a matter of United States law and for purposes of determining the purpose of section 334, is there a difference in the weight to be accorded to the SAA, on the one hand, and the House and Senate Reports, on the other hand?

34. The SAA is the definitive statement of the United States government, reflecting the views of both the Executive and Legislative branches of government with authority in enacting legislation, and as such is more authoritative than the House and Senate reports. The legislative history in those reports demonstrates only the intent of one house of Congress, while the SAA reflects the position of the Administration, a position which has been approved by the Congress.

32. Does it matter, for purposes of United States law or otherwise, whether the Panel conducts its examination in terms of sections 334 and 405, taken together, or in terms of 19 U.S.C. § 3592 (exhibit IND-7)?

35. While the United States is not aware that it makes a difference, in terms of United States law or otherwise, as noted in answer to question 37, section 334 and section 405 have different purposes, so to the extent that the Panel considers those purposes/objectives relevant, they should be examined separately.

33. Does the United States agree with India's statement that "the following are practical examples of the application of the section 12.130 rules of origin for certain products such as silk scarves or bed linen. Silk fabric was woven in China and then exported to a third country, for example, Italy, where it was dyed and printed and subjected to two specified finishing operations. If that fabric was then made into a silk scarf and exported to the United States, that scarf would be determined of Italian origin" (India's first submission, para. 15)? Were such origin determinations made on a case-by-case basis or by direct application of section 12.130?

36. Origin determinations were case by case, but also based on CFR 12.130. Although not elaborated upon in the question, bed linens are a good example of how origin was determined in the past. On a case by case basis, production processes and finishing processes were evaluated to decide if they were significant enough to constitute a substantial transformation.

34. Section 334(b) incorporates the following provisions: "Except as otherwise provided for by statute, a textile and apparel product, for purposes of the customs laws and the administration of quantitative restrictions, originates in a country [...]" (emphasis added). Could the United States please identify relevant commercial policy instruments (e.g. trade statistics, origin marking, application of MFN tariff rates, etc.) for which the rules of origin provided for in section 334 are used?

37. Section 334 is used to determine country of origin for purposes of gathering trade statistics, determining the appropriate country of origin for marking purposes, administering most favored nation rates of duties (NTR), and administering quota and visa requirements.

35. Could the United States submit a copy of the following publication: United States International Trade Commission, Pub. No. 1695, The Impact of Rules of Origin on United States Imports and Exports (1985)? Is there a later government publication of this type?

38. While this publication is out of print, we have located a copy that is now being transmitted to Geneva. The United States will provide it to the Panel and India as soon as possible.

36. Regarding the anti-circumvention rationale of section 334, could the United States answer the following questions:

(a) What are the commercial policy instruments to which the fabric formation rule is linked and the circumvention of which that rule is intended to deter?

39. The fabric formation rule is linked to all of the commercial policy instruments identified in the United States' answer to question 34, and reflects the United States determination of when/where the most important or significant process or transformation takes place. *See also* answers to questions 2, 18 and 19.

(b) With reference to the phrase "reduce circumvention of quota limits through outward processing" in the House Reports (IND-9, p.146), could the United States explain the concept of "circumvention through outward processing"?

40. "Circumvention of quota limits through outward processing" refers to the concern with shippers/exporters trying to perform as little as possible processing in a third country to confer origin and still avoid a particular quota restraint. Many of these operations were minor to the production of the textile good. *See also* answer to question 18.

(c) Is the reduction of circumvention through outward processing a reason why the United States continues to maintain section 334?

41. The reduction of all forms of circumvention was a goal of section 334. So were improving transparency and predictability, and advancing international rules of origin harmonization.

(d) With reference to the phrase "reduce circumvention of quota limits through outward processing" in the House Reports (IND-9, p.146), could the United States explain which quotas were being circumvented? Specifically, to use United States imports of silk scarves made in the European Communities from Chinese silk fabric as an example, was it (i) China's quota for silk fabric, (ii) China's quota for silk scarves or (iii) another Chinese quota which was being circumvented?

42. The United States has never maintained quotas on silk scarves or silk fabric from China. Combating circumvention was a goal expressed with respect to section 334, which was intended to prevent circumvention, in general, by providing greater certainty and predictability, rather than being directed at specific cases of circumvention.

(e) Were the quotas affecting articles currently subject to the fabric formation rule more prone to circumvention than the quotas, if any, affecting articles currently subject to the assembly rule?

43. No. Quota utilization is generally the primary factor in assessing whether a quota is "prone to circumvention." This can change from year to year, as utilization rises or falls according to market demand. However, the current assembly rules make it harder for importers to circumvent and make it easier for customs officers to detect circumvention.

(f) Are quotas more prone to circumvention in a situation where dyeing, printing and two or more finishing operations confer origin on made-up non-apparel textile products than in a situation where fabric formation confers origin?

44. The United States cannot say that this statement is necessarily true. Generally, any product that is subject to quota restrictions that are filled, i.e., any product that quota restrictions effectively limit imports of, is the most likely candidate for circumvention (these are usually products that are in high demand).

37. Please elaborate on how section 405 advances the purposes asserted in the SAA -- which does not address section 405 -- for section 334? (United States' oral statement, paras. 9 and 22)

45. The purpose of the exceptions to the rules in section 334, contained in section 405, were to settle the WTO dispute with the European Communities. At the same time, we do believe that section 405 advances the purposes expressed in the SAA.

38. With reference to Article 2(c) of the RO Agreement, could the United States provide its views as to how the phrase "create [...] disruptive effects on international trade" should be interpreted? Could the United States give examples of cases where rules of origin might create such effects?

46. See answers to questions 11 and 17.

ANNEX A-3

ANSWERS OF THE UNITED STATES TO QUESTIONS FROM INDIA FOLLOWING THE
FIRST MEETING

1. Does the United States use criteria for the determination of origin other than those listed in Article 2(a) of the RO Agreement? If so, what are those criteria?

1. No, the United States does not use criteria for the determination of origin other than those listed in Article 2(a), although clearly Article 2(a) is not an exclusive list, either for origin determinations of textile and apparel products, or any other products.

2. Please indicate the criterion or criteria for the determination of origin on which the "fabric forward rule" set out in section 334 is based.

2. The determination of origin in section 334 is based on the third criteria in Article 2(a), manufacturing or processing operations.

3. Please indicate on which criterion or criteria for the determination of origin the following product distinctions foreseen in sections 334 and 405 are based:

- Articles made from cotton and articles made from wool;
- Articles made from fabrics with different fibre blends; and
- The HTS headings listed in section 334 and the HTS headings listed in section 405.

3. See United States Answer to Panel questions, question 9.

4. As explained paragraph 28 of India's oral statement, under sections 334 and 405, a country may forego the status of originating country by further processing a product in its territory, depending on the type of product or the fibre content of the product. Please indicate on which criterion or criteria for the determination of origin the United States based the rule that leads to this result.

4. As the United States explained at the meeting with the Panel, India's assertions in paragraph 28 regarding the exceptions in section 405 are based on a disagreement with the United States as to where the most significant or important manufacturing or assembly of a product has taken place.

5. Is the United States aware of any other Member of the WTO that:

- Applies the "fabric forward" rule,
- Makes distinctions of the type referred to in question 3,
- Does not recognize further processing of a product as origin-conferring.

If so, who are these Members and what are their practices?

5. Of the approximately 38 Members that have submitted rules to the WTO and that have non-preferential rules of origin, as the United States has indicated in its submissions, to our knowledge the European Communities and Canada have rules similar to the United States rules for assembled textile products. The United States has not surveyed other Members' rules of origin regimes.

6. *Does the United States itself use rules of origin for products other than textiles and apparel products according to which:*

- *The further processing on an input cannot change the origin of a product under any circumstances,*
- *The origin depends on the blend of raw materials used in the production of an input, and*
- *The further processing of a product deprives the processing country of its status of originating country?*

6. The United States does not agree with India's interpretation of its rules of origin for textile and apparel products. Subject to this *caveat*, United States rules of origin for non-textile and apparel products are not based on any of the factors listed above. As we have noted before, sometimes further processing of an input will not change origin – it depends on whether that further processing causes a substantial transformation.

7. *Is the United States of the view that requirements to be met by producers and traders as a result of the "fabric forward" rule and the different treatment of (a) articles made from cotton and articles made from wool and (b) articles made from fabrics with different fibre blends are "unduly strict requirements" within the meaning of Article 2(c). If not, why not?*

7. No. In the first place, we note that the rules of origin for the two products referenced are consistent with the requirements of Article 2, and a comparison of the two rules is irrelevant for purposes of Article 2(c). These rules relate to different products. See also, United States Answers to Panel questions, question 11.

8. *According to Article 2(c), "rules of origin . . . shall not require the fulfillment of certain conditions not related to manufacturing or processing". In relation to this provision India has the following questions:*

- *Would the United States agree that Article 2(c) of the RO Agreement implies that, in the case of a rule of origin designed to determine the origin of a product manufactured or processed in more than one country, Article 2(c) implies that the conditions to be fulfilled must in some way be related to the degree of manufacturing or processing that the product underwent in the different countries? If not, why not?*

8. No, there is no basis in the text for India's suggestion.

- *The United States rules of origin distinguish between a made-up article consisting of fabric containing 85% man-made fibre and 15% cotton and a made-up article consisting of 80% man-made fibre and 20% cotton. Please explain how this distinction can be reconciled with the requirement set out in Article 2(c) of the RO Agreement that all conditions that must be fulfilled to obtain the status of originating country must relate to manufacturing or processing.*

9. As the United States has explained, Article 2(c) does not prescribe that Members must use the same rules to determine the origin of different products. See also United States Answers to Panel questions, question 9, and our response to question 7 above.

9. *Would the United States agree that conferring origin on the basis of narrow product distinctions designed to favour the exports from one Member over those from others would, in principle, be a trade objective covered by Article 2(b) of the RO Agreement and discrimination within the meaning of Article 2(d) of the RO Agreement? If not, why not?*

10. No. *See* United States Answers to Panel questions, question 6.

10. *Would the United States agree that, for the purpose of determining whether a rule of origin is used as an instrument to pursue trade objectives within the meaning of Article 2(b) of the RO Agreement, the circumvention of quota limits through transshipments, false declarations and other illegal means should be distinguished from the avoidance quota limits through the reallocation of production and other legal means and that rules of origin designed to prevent the avoidance of quota limits should be deemed to pursue trade objectives? If not, why not?*

11. Assessing whether a distinction exists between circumvention and "reallocation of production" cannot be undertaken in a vacuum, without a fact pattern as a context. Experience shows that "reallocation of production" encompasses a broad spectrum of activity in the trading world, ranging from complete production to merely sewing on labels - - with numerous points in between. Maintaining the integrity of trade instruments is also a matter that can extend beyond merely making direct actions at addressing illegal behavior, and can include providing certainty through the establishment of product-specific rules of origin. *See also* United States Answers to Panel questions, question 18.

ANNEX A-4

ANSWERS OF INDIA TO QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING

For both parties:

46. *Could the parties please indicate whether the attached tables accurately reflect the United States rules of origin at issue in this dispute?*

Answer 46: Yes, the attached tables accurately reflect the United States rules of origin at issue in this dispute.

47. *The parties have offered slightly different descriptions of the rules or origin regime applied to textile products before section 334 was enacted. India suggested that that regime, set out in CFR 12.130, was a DP2 regime. The United States, on the other hand, seems to suggest that origin determinations were made based on CFR 12.130, but also case by case. In the light of this, the Panel would appreciate it if the parties could provide clarification with respect to the following two points:*

(a) *What discretion, if any, did United States Customs officer enjoy in applying the DP2 rule apparently established by CFR 12.130?*

Answer: India considers that 19 C.F.R. 12.130 provided for legal certainty and predictability, and afforded little discretion to the United States Customs officers. The regulation begins with the general criteria that will be used to determine origin for textiles and textile products. The regulation continues with specific examples of operations that usually will, or will not, confer origin. (India has included the relevant excerpts of 19 C.F.R. 12.130 in INDIA- Exhibit 8 at pages 46 to 47.)

In this regard, India recalls its answer to question 22 from the Panel following the first meeting. India noted that the case-by-case determination process, as evidenced by the *Cardinal Glove* case, was abandoned by the enactment of the section 12.130 regulations. The section 12.130 regulations were a set of "concise, predictable, published rules." The United States did have regulations in effect through section 12.130, plus a large body of customs rulings, which applied to virtually every production scenario. It is India's understanding that the section 12.130 regulations were promulgated in accordance with the requirements of the United States Administrative Procedure Act (APA) and that interpretative customs regulations issued pursuant to the APA are presumed to be correct, unless clearly arbitrary, capricious, an abuse of discretion or otherwise not in accordance with the law.

(b) *If there was discretion under CFR 12.130, could it be said that, by the same token, United States Customs officers currently enjoy the same discretion in applying the DP2 rule as provided for section 405?*

Answer: Customs officials do not have much discretion in administering the DP2 Rule as set out in section 405. This is because regulations made pursuant to a specific statutory directive are considered to have the force and effect of law. See, e.g., *Chevron USA Inc. v. Natural Resources Defense Council*, 467 US 837 (1984)

[INDIA- Exhibit 19]. Such regulations are normally given considerable deference by the courts.

48. Article 2(b), (c) and (d) of the RO Agreement refers to "rules of origin" in the plural. Do the parties agree that, notwithstanding the use of the plural, the provisions in question reflect a concern with individual rules of origin as they apply to individual products, rather than with a Member's system of rules of origin?

Answer 48: The WTO agreements contain many provisions in which the plural is meant to include the singular. For instance, the references to "price undertakings" in Article 8.5 of the Anti-Dumping Agreement, "import restrictions" in Article XIII:2 of the GATT and "phytosanitary measures" in Article 3:1 of the SPS Agreement are meant to extend to each individual undertaking, restrictions and measure that a WTO Member may take. In the view of India, the obligations set out in Articles 2(b), 2(c) and 2(d) therefore apply both to an individual rule of origin as well as to the Member's system of rules of origin.

49. Both parties have argued that the protection of a domestic industry would be a trade objective within the meaning of Article 2(b) of the RO Agreement. On what basis do you reach this conclusion?

Answer 49: The basis for India's argument that the protection of a domestic industry against import competition is a trade objective within the meaning of Article 2 (b) of the *RO Agreement* is the textual interpretation of the words. India's interpretation was set forth in paragraphs 41 to 48 of India's first submission. In particular, in paragraph 46, we stated that "one way to assess whether a rule of origin is being used as an instrument to pursue a trade objective is to assess whether it achieves the same results as a measure or instrument of commercial policy." A measure or instrument of commercial policy could be used to regulate foreign trade so as to protect the domestic industry. Therefore, any rule of origin that was being used as an instrument to regulate foreign trade so as to protect the domestic industry would be a trade objective.

The Panel on *European Communities – Trade Description of Sardines* determined the meaning of the terms "legitimate objectives" in Article 2.4 of the TBT Agreement in their context and in the light of the objectives set out in the Preamble of that Agreement (WT/DS231/R, paras. 7.118-7.122). In the present case, a similar approach would support the conclusion that the protection of a domestic industry is a "trade objective" within the meaning of Article 2(b) of the *RO Agreement*. According to its Preamble, the *RO Agreement* is "to further the objectives of the GATT 1994". The GATT 1994, in turn, is according to its Preamble, to expand the production and exchange of goods through the reduction of tariffs and other barriers to trade. One of the fundamental purposes of the *RO Agreement* thus is to ensure that the barriers to trade that Members agreed to reduce in the framework of the GATT 1994 are not indirectly re-established through the use of rules of origin protecting domestic industries.

50. For purposes of the application of Article 2(b), does it make a difference whether rules of origin are adopted by a Member of its own volition or at the request of a trading partner?

Answer 50: India considers that it does not make a difference whether a rule of origin is adopted by a Member on its own volition or at the request of a trading partner. For example, a rule of origin that is being used as an instrument to pursue trade objectives may either be developed by a Member on its own volition or to address a request made by a trading partner. However, the issue is whether the rule of origin is being used to pursue a trade objective.

In any case, an agreement between two Members cannot affect the rights of third Members (see Article 3.5 of the DSU and Article 34 of the Vienna Convention on the Law of Treaties).

51. With reference to Article 2(d) of the RO Agreement, please elaborate on the meaning and purpose of the first clause ("the rules of origin that they apply to imports and exports are not more stringent than the rules of origin they apply to determine whether or not a good is domestic"). Please provide an example of a typical situation which the first clause is meant to address.

Answer 51: India's claim with respect to Article 2(d) refers to the second clause of Article 2(d), that is, "...Members shall ensure that ... the rules of origin ... shall not discriminate between other Members, irrespective of the affiliation of the manufacturers of the good concerned." India considers that the first clause of Article 2(d) ("the rules of origin that they apply to imports and exports are not more stringent than the rules of origin they apply to determine whether or not a good is domestic") is not at issue in this dispute.

52. Why is a provision equivalent to (i) Article 2(b) of the RO Agreement and (ii) to Article 2(c) of the RO Agreement no longer necessary after the transition period? (see Article 3 of the RO Agreement)

Answer 52: India notes that the obligations set out in Article 2 (a), Article 2 (b) and Article 2 (c) are no longer included in Article 3 following the harmonization period. This is presumably because the harmonized rules would be those agreed upon by all WTO Members. The process of arriving at a harmonized system of rules of origin must entail the elimination of those rules which are being used to pursue trade objectives or that create adverse effects on international trade. Such agreed rules would, therefore, by definition, be those that are not used to pursue trade objectives and which do not create restrictive, distorting or disruptive effects on international trade. Indeed, it would be difficult for a Member to be able to challenge an agreed rule of origin in a post-HWP period as being used to pursue trade objectives or creating restrictive, distorting or disruptive effects.

53. Why is a provision equivalent to Article 2(d) necessary after the transition period? (see Article 3(c) of the RO Agreement)

Answer 53: This is because even with harmonized rules it would still be possible to discriminate between Members. After the transition period, it might be possible a Member could prescribe more stringent conditions for imports in terms of labelling as compared to products made by domestic producers. In addition, a Member could apply a harmonized rule such as DP2 but exclude products from a specific Member from the application of this rule.

54. With reference to 19 C.F.R. § 102.21, please answer the following questions:

(a) What is the legal status and nature of the regulations set forth in 19 C.F.R. §. 102.21 in United States law?

Answer: Section 102.21 has the force and effect of law. It was enacted following "notice and comment" rulemaking under the Administrative Procedure Act, pursuant to a specific statutory directive contained in the statute it implements. It is a regulation entitled to judicial deference. See *Chevron USA Inc. v. National Resources Defense Council*, 467 US 837 (1984).

Regulations having the force and effect of law are binding on both the importer and the government alike. For practical purposes, they have the same legally binding effect as a law enacted by Congress, and United States Customs is not free to depart from them.

(b) Would the Panel have the authority to find that 19 C.F.R. §102.21, as such, is contrary to the United States' WTO obligations?

Answer: Yes, section 102.21 implements statutes passed by Congress, and because that regulation includes provisions which are inconsistent with the United States' WTO obligations, the Panel should have the authority to find that the regulation is contrary to the United States WTO obligations, just as if it were a law enacted by Congress in violation of those obligations. In addition, the customs regulations are within the terms of reference of the Panel.

(c) If the Panel were to find that sections 334 and/or 405 are inconsistent with Article 2 of the RO Agreement, would the Panel need to make additional findings in respect of 19 C.F.R. § 102.21?

Answer: If section 334 and section 405 (as consolidated in 19 USC. 3592) are found to be inconsistent, then their implementing regulations would be of no legal validity. However, India has specifically challenged the WTO-consistency of the customs regulations. Therefore, for the sake of completeness, India considers that the Panel should also find that the customs regulations are WTO-inconsistent.

55. If there were no United States quota regime, could it be said that (i) the fabric formation and (ii) the DP2 rule, in and of themselves, or as such:

(a) Create restrictive, distorting or disruptive effects on international trade?

In Article 2 (c) , the term "themselves" makes clear that fundamental purpose of Article 2(c) is to set standards that rules of origin must meet *irrespective of the specific commercial policy instruments to which they are being linked*. India has demonstrated, and the United States has failed to refute, that the fabric formation rule and the production distinctions made under the DP2 rule "require the fulfilment of a certain condition not related to processing", "impose unduly strict requirements" and "create restrictive, distorting or disruptive effects on international trade" *whether they applied to the current quota regime or any other instrument of commercial policy*. It is thus the rules in and themselves or as such that fail to meet the standards set out in the two first sentences of Article 2(c).

It has to be kept in mind that the rules of origin determine the conditions of competition for producers and traders under the quota regime currently in place, under other instruments of commercial policy currently being applied by the United States *and commercial policy instruments that the United States might adopt in the future*. For instance, if the United States were to apply in 2004 a safeguard measure in the form of an import quota allocated among supplying countries in accordance with Article XIII:2(d) of the GATT, the production distinctions made under the DP2 rule would determine the allocation of the quota shares among supplying countries.

(b) Are designed to pursue trade objectives?

The reference to the "use" of rules of origin as instruments to pursue trade objectives in Article 2(b) makes clear that this provision sets standards that rules of origin must meet *when linked to a particular instrument of commercial policy*. India has demonstrated that the fabric formation rule served to make the this regime more protectionist and that product distinctions made under the DP2 rule served to single out products of export interest to the European Communities for more favourable treatment.

Obviously, the major restrictions, distortions and disruptions resulting from the United States' adoption of the section 334 and 405 rules of origin are observed in the operation of the United States' textile quota regimes. However, in our judgment, there are other ways in which these new rules could be viewed as serving trade objectives.

The United States marking requirement is intended, at least in part, for the protection of domestic manufacturers, by advising the purchaser of the origin of an imported good lest that information influence his or her purchasing decision. As the fabric formation and DP2 rules are used for marking purposes as well as quota administration, they can create restrictive or distorting effects on international trade.

Thus, for example, one of the European Communities' complaints directed at the origin rules dealt with the treatment of hand-painted silk scarves. The silk fabric was formed in China, but set to Europe, where it was cut and sewn into scarves which were hand-painted and sold by design houses such as Hermes. Before section 334 was adopted, these goods were marked as "Product of France", or whichever country the decorating was performed in. Silk scarves were not subject to United States textile quotas. However, the adoption of section 334's "fabric formation" rule required manufacturers to mark those scarves as "Products of China", rather than "Product of France", a change which affected the products' marketability and value. Arguable, the required change in marking disrupted trade in these goods, even though no quotas were involved.

Furthermore, since goods which are not properly marked with country of origin are considered "restricted" goods under United States law, subject to exclusion from the country and subject to the assessment of a 10% *ad valorem* special "marking duty", the adoption of these rules could be seen as forcing a change in country of origin, admissibility, and marking requirements for certain products, and creating or changing restrictions on trade.

In addition, the country of origin, as determined under section 334 and 405, is used to designate the country of origin on United States Customs entry forms; entry data, in turn, is used to compile United States import statistics. Thus, assume that an imported fabric not subject to the DP2 rule is valued at \$100 when it enters the United States. It is made with \$10 worth of Chinese-formed "greige" fabric, with an additional \$90 in added value generated in Spain, where dyeing, printing and other value added processes are performed. Where the origin of the product is determined under the "fabric formation" rule, the goods will be recorded, for United States statistical reporting purposes, as being \$100 worth of fabric made in and imported from China.

There are a number of ways in which this type of statistical reporting could have a distorting effect on international trade. Obviously, it skews import statistics. For example, if an antidumping investigation were being conducted with respect to Chinese-origin finished fabrics, and it became necessary to determine the level of imports of such fabric, the import statistics would report as being of Chinese origin the fabrics which had undergone value-added operations in Spain, and would ascribe the entire value of the import to China. Statistical reporting of this kind might make it appear as if imports from a given country, say, India, were increasing, when in fact, they might not be.

56. Could the parties please address whether, and if so, how the following statement by the Appellate Body is relevant to the present dispute:

The requirement to prevent trade distortion found in Articles 1.2 and 3.2 of the Licensing Agreement refers to any trade distortion that may be caused by the introduction or operation of licensing procedures, and is not necessarily limited to that part of trade to which the licensing procedures themselves apply. There may be situations where the operation of licensing procedures, in fact, has restrictive or distortive effects on that part of trade that is not strictly subject to those procedures.³⁴⁸

³⁴⁸ Appellate Body Report, *European Communities – Measures Affecting the Importation of Certain Poultry Products* ("EC – Poultry"), WT/DS69/AB/R, adopted 23 July 1998, DSR 1998:V, 2031, para. 121.

Answer 56: The ruling of the Appellate Body quoted by the Panel clarifies two issues. First, it clarifies that the trade distortions that Article 1.2 and 3.2 of the Licensing Agreement are intended to prevent include the distortions caused by *the introduction* of licensing procedures, not only those caused by their operation. If a provision in the Licensing Agreement prohibiting licensing procedures with "trade-restrictive or -distortive effects" is interpreted to cover also the effects caused by the introduction of the procedures, the provision in the *RO Agreement* prohibiting rules of origin that "create restrictive, distorting or disruptive effects" should similarly be interpreted to cover also effects that the introduction of rules of origin creates (rather than just the effects caused by the operation of the rules). The ruling thus supports the view of India that restrictive and distorting effects within the meaning of Article 2(c) of the *RO Agreement* include effects that are not reflected in trade statistics.

Second, the ruling of the Appellate Body makes clear that the terms "trade distortions" have to be interpreted broadly to cover also the impact of a licensing procedure on that part of international trade that is not strictly subject to the licensing procedures. The Appellate Body's approach confirms the view of India that the terms "distorting effects on international trade" in Article 2(c) have to be interpreted to cover also the adverse effects of a rule of origin on the trade between the exporting Member and a Member other than the Member applying the rule of origin.

57. *Please recall the following headings and subheadings of the HS96 for bed linen:*

"63.02 (bed linen, table linen, toilet linen and kitchen linen)

6302.10 - bed linen, knitted or crocheted

- other bed linen, printed;

6302.21 - of cotton

6302.22 - of man-made fibres

6302.29 - of other textile materials

- other bed linen

6302.31 -- of cotton

6302.32 -- of man-made fibres

6302.39 -- of other textile materials"

Please answer the following questions:

(a) *Based on HS96 above, is it correct that the most widely traded bed linen is made of either cotton or man-made fibres?*

Answer: It is true that, on a year-to-year basis, *United States* trade in bed linen primarily involves bed linens of cotton or man-made fibres. However, this conclusion flows from the trade patterns themselves, rather than the structure of the HS.

(b) *Since cotton bed linen is normally bleached or white-dyed, but not dyed and printed, is the DP2 rule appropriate?*

Answer: It is not true that bed linen is either dyed or printed but not both dyed and printed. In some situations, cotton bed linen is both dyed and printed, especially in pastel shades other than white and printed with motifs like flowers, geometrical patterns and cartoon characters etc. Moreover, the Harmonized System HS96 provides for a separate HS classification for printed bed linen like 6302.21 – other bed linen printed – of cotton piece; 6302.31 - other bed linen of cotton (i.e., other than printed).

Dyeing and printing along with at least two finishing operations may be carried out on all cotton products. For example, the following products (other than bed linen) are subject to DP2 operations:

- pillow covers
- cushion covers
- bed covers
- table linen
- kitchen linen
- curtains and,
- napkins.

For India:

58. *With reference to section 405, please answer the following questions:*

(a) India claims that section 405 favours products of export interest to the European Communities over products of export interest to developing countries (e.g., paras. 69 and 84 of India's first written submission). Would section 405 not favour products of export interest to any country, not just developing countries?

Answer: Section 405 would disfavour products of export interest to other countries if those countries had a strong production base in cotton products, wool products, or blended products where cotton was more than 16%. The reference to developing countries was made because these countries have a large capacity in cotton related products, and in most cases, are subjected to the quota regime for these products.

(b) How did the legislative changes effected through section 405 adversely affect India, or India's conditions of competition?

The legislative changes effected by section 405 adversely impact on India's market access and have also changed the conditions of competition by conferring origin for a specific set of products based on the DP2 rule and excluding from the DP2 rule finished products made from cotton, wool or fibre blends with more than 16% of cotton. This rule and its exceptions have adversely affected India because India is a cotton-producing country. Exports of fabric sent to third countries and converted into made-up items through the DP2 rule were being determined as Indian for origin purposes. This further restricted the negotiated access to the *United States* market enjoyed by these products prior to the implementation of section 334 and section 405.

The conditions of competition were affected as processed and finished goods from Indian products in third countries could only be exported to the United States if India were in a position to supply the relevant quotas on an unlimited basis. As quotas were limited, India's trade opportunities were limited to the same extent as the quotas.

By excluding wool and cotton related products from the coverage of the DP2 rule, the United States effectively distorted the international trading system, thus, disadvantaging certain countries with cotton capacity, such as India. This adversely affected India's conditions of competition.

59. *Could India identify where in its submissions India has stated, and supported, a claim that the "wholly assembled" rule set out in section 334(b)(I)(D) is inconsistent with Article 2(b) and (c) of the RO Agreement? (see India's reply to question No. 19 (pp. 15 and 16))*

Answer 59: India included the reference to the wholly assembled rule, as set out in section 334(b)(I)(D) in its reply to *question No. 19* in order to provide the general context of the measures at issue. India is not challenging the "wholly assembled rule." However, the Panel needs to be aware of

the wholly assembled in order to understand the exceptions to this rule as set out in section 334 (b)(2) and section 405 (a) (3) (c) which India is challenging. See paragraph 16 of India's Second Submission.

60. *With reference to India's claim under RO Agreement 2(d) of the RO Agreement, is India claiming that section 405 violates Article 2(d) because it results in (unjustifiably) differential treatment of "closely related [Indian and European Communities] products"? (para. 68 of India's Second Submission). If not, please clarify further on what is India's claim under Article 2(d).*

Answer 60: India's claim is that section 405 violates Article 2(d) because it results in (unjustifiably) differential treatment of closely related (Indian and European Communities) products. We used the term closely related because the goods concerned are made of fabrics of different fibres. When a scarf is made of silk, it is conferred origin where subjected to DP2, however, when it is made of cotton, it is conferred origin where the greige fabric is formed. From the perspective of production techniques, the products are virtually identical, and it is completely arbitrary to distinguish them for the purpose of determining their origin.

61. *With reference to para. 8 of India's second oral statement, could India please elaborate on its statement that "the fabric forward rule, by definition, increases the quantities of textile imports that would be conferred the origin of the countries that are under quota"?*

Answer 61: This statement is certainly true with respect to "countries having a textile-making industry that are under quota". If Country A has a fabric-forming industry, then the "fabric forward rule" ascribes that country as the country of origin for:

- (1) Fabrics formed in Country A (including non-quota countries) and exported to the United States; and
- (2) Fabrics formed in Country A, which are subjected to further processing operations in another country and then shipped to the United States; and;
- (3) Non-apparel made-up articles that are produced in other countries (including non-quota countries) using fabric formed in Country A.

Prior to the adoption of the section 334 rules, only products in (1) would have been recognised as being products of Country A. Following section 334, countries with fabric-making capacity would, by definition, tend to have their quota allocations consumed more quickly, if they issued textile visas covering the products described in (2) and (3) above. On the other hand, if fabric-producing countries declined or refused to issue textile documents for products in categories (2) and (3), then those products would be refused admission into the United States. In such a case, fabric finishers and producers of made-up articles who wish to ship to the United States would presumably stop sourcing fabric from Country A, and look for fabric from another country not subject to quota restrictions.

By the same token, where a country had value-added manufacturing facilities (cut & sew) but no fabric-forming facilities, the extension of the "fabric forward" rule to cover made-up goods essentially meant that none of the made-up goods that these countries had formerly shipped to the United States would be recognized as originating in the countries in question. Accordingly, certain countries which did not have fabric forming industries [(e.g. the Philippines, Hong Kong, Macau)] often found themselves in a situation where the United States had allocated them a quota for the shipment of certain quantities of made-up textile products to the United States, but the United States would not recognize any such products as originating in those countries! The quota allocations given to these countries therefore became useless.

62. With reference to India's reply to question No. 19, does India's per se challenge to sections 334 and 405 concern all quantifying products? Does India's challenge to the application of sections 334 and 405 cover only the products explicitly or implicitly specified in India's reply to question No. 19. If so, why is there such a difference? (e.g., under point 3, why is HTS 6302.53 covered, but not HTS 6302.52?)

Answer 62: As noted in India's reply to *question No. 19*:

India's claims cover all qualifying products which have been impacted by the *United States* rules of origin in section 334 and section 405 (as consolidated in 19 U.S.C. §3592) and the customs regulations. That is our claim.

In order to provide more detail, India *noted* certain specific provisions and HTS headings in the paragraph which followed the setting out of our claims. This listing was provided for illustrative purposes without any intention to circumscribe the qualifying products to the HTS headings listed.

Therefore, the omission of 6302.52 and 6302.53 should not be considered determinative of the scope of India's challenge.

63. With reference to India's reply to question No. 5 (3d para.), does the reference to "these products" mean that it would be the quota for bed linen which is debited?

Answer 63: In the reply to *question No. 5*, India used bed linen as an example. So, the reference to "these products" is not only a reference to the quota for bed linen, but rather to any finished product that was subject to a quota.

To clarify, wherever finished products are manufactured out of Indian fabrics by a third country and exported to the United States, the quotas for the finished products under the "fabric forward rule" are applied to India. Both greige fabric and the finished product (say, bed linen of 100% cotton or polyester cotton with 80% polyester and 20% cotton) are under quotas by the United States.

64. India claims that section 334 is being used "to protect the United States domestic industry". Could India be more specific regarding which part of the United States domestic industry would benefit from any protection? For instance, would it be the United States producers (if any) of cotton fabric, the United States producers (if any) of bed linen, etc.?

Answer 64: Section 334 protected United States domestic textile manufacturing interest in a variety of ways.

First of all, it protected *United States* manufacturers of fabric from competition by foreign fabric manufacturers. Assume, for instance, that an Indian fabric maker sold cotton cloth to an Indian manufacturer of bed sheets and to a Philippine manufacturer of bed sheets, both of whom exported their products to the United States. Under section 12.130, the Indian-produced bed sheet would enter the United States under an Indian quota while the Philippines-manufactured bed sheets would enter under a Philippine quota. Under section 334, however, both sets of bed sheets would have had Indian origin. If India had already used up its quota for the bed sheets in question, the Philippine bed sheets, made from Indian fabric could not be shipped to the United States. The United States fabric producer thus received a measure of protection from Indian-made fabrics.

American fabric producers were also conferred a competitive advantage, over other fabric producers, in supplying the Philippine manufacturer of bed sheets in the example given above. If that manufacturer sourced fabric from China or Turkey, etc., it would become subject to the quota limits placed on bed sheets from those countries. The *only* way the Philippine producer could have manufactured bed sheets which would be recognized as having "Philippine" origin, and thus eligible

to use the "Philippine" quota allocation, would be to manufacture those products using United States-origin fabrics. As previously indicated, the United States did not follow its "fabric forward" rule when dealing with products made with United States-origin fabric, but held such goods to originate in the last country where they underwent processing.

Thus, *United States* fabric makers and producers of non-apparel textile articles were both protected from import competition, and given a competitive advantage, by virtue of the enactment of the section 334 Rules.

65. *Do you agree with the United States statement that "any change in a rule of origin may be viewed as favouring one Member over another, so a member-specific analysis is not appropriate." (see United States' reply to question No. 11(b) (emphasis added), but also para. 19 of the United States' Second Submission)*

Answer 65: India does not agree with the *United States'* statement. A change in a rule of origin may be carried out for various reasons. For example, during the transition period, a Member may move from a system based on Article 2 (a) (i) to one based on Article 2 (a) (iii). This would be a WTO-consistent change that would not favour one WTO Member over another. A Member-specific analysis is certainly appropriate, especially under Article 2 (d). Of course, any changes must be consistent with the other provisions of Article 2.

66. *Does any modification of trade flows or patterns, or any creation of incentives to modify trade flows or patterns, amount, ipso facto, to a "distortion" of international trade within the meaning of Article 2(c) (see United States' first written submission, para. 14)?*

Answer 66: No, not as a general rule. However, in this fact situation, the United States rules of origin as set out in section 334 and section 405 and the implementing customs regulations do distort trade.

India notes that the terms "distorting effects on international trade" have to be interpreted in their context and in the light of the objectives of the *RO Agreement*. The context makes clear that the first sentence of Article 2(c) is not intended to prevent the adoption of all rules of origin changing trade pattern but only the adoption of rules of origin with features comparable to those referred to in the second sentence of that provision. The Preamble of the *RO Agreement* makes clear that one of the purposes of the *RO Agreement* is to ensure that rules of origin do not create "unnecessary obstacles to trade" and are prepared in a "consistent and neutral" manner. A distortive effect can therefore not be deemed to arise from a rule of origin that is necessary, consistent and neutral.

The Dictionary of Economics (edited by John Eatwell and published in 1987 by Macmillan Press) notes that "the failure to achieve aggregate production efficiency, in the sense of not producing on the boundary of the set of production possibilities given available resources and technology, is deemed a distortion." The United States' rules of origin reduce aggregate production efficiency by creating artificial incentives to modify inputs, the sourcing of inputs and methods of production. In the view of India, these distortions are created by rules of origin that are not necessary, consistent and neutral. Article 2(c) first sentence prohibits such rules.

67. *China stated that the effects of a Member's rule of origin could be that "trade between two particular Members is "restricted" or "disrupted" while trade between one of those Members and a third Member is correspondingly enhanced and liberalized"? (China's reply to question No. 41(b)). Does such a redistribution of trade constitute a trade "restriction" within the meaning of Article 2(c) of the RO Agreement?*

Answer 67: China's point refers to distortion, rather than restriction or disruption. The complete sentence in China's reply to *question No. 41(b)* is "[a] "distorting" effect on international trade,

therefore, must reasonably encompass a scenario in which trade between two particular Members is "restricted" or "disrupted" while trade between one of those Members and a third Member is *correspondingly* enhanced and liberalized." Such an example of trade redistribution is being cited as an example of trade distortion, and not trade restriction.

68. *With reference to para. 45 of India's Second Submission, could India elaborate further on why "conferral of origin upon a product must be based on the determination of the country with which that product has a significant economic link"?*

Answer 68: As noted by rules of origin commentators, there are essentially three different methods for determining origin: "the technical test (i.e. the product resulting from a process or operation in the exporting country must have its own specific properties and composition that it did not have before the process or operation), the economic test (i.e. work done, expenditure, or material, added value), and the custom classification test (i.e. the process or operation in the exporting country results in a product that is classified under a different heading of the custom tariff classification than before the process or operation)."³⁴⁹ All of these methods have one common element, namely, that the product is conferred the origin of the country where value is added and the nature of the product is modified. The three examples set out in Article 2(a) are all examples that reflect this common element. This is the basis for India's statement that there must be recognition of the country with which the product has a significant economic link.

69. *With reference to India's reply to question No. 28, could India address whether foreign producers operating outside India's territories (e.g., European Communities producers) could have access to India's textile quotas for imports into the United States? If so, are foreign producers making use of such possibility?*

Answer 69: Indian textile quotas are allotted to exporters having operations in India and which are registered with the relevant authorities. To that extent, foreign producers operating outside India's territory, like European Communities producers, cannot have access to Indian textile quotas for imports into the United States, except through registered exporting firms in India.

70. *With reference to exhibit IND-17, it appears that the panel still does not have a complete version of 19 C.F.R. § 102.21 (at paras. 14, 17 and 20 of its Second Submission, India references sub-sections (e)(1) and (e)(2), for instance, which do not appear to be included in IND-17). If that is correct, could India please submit a complete version of 19 C.F.R §102.21 (if available, please also submit an electronic version)?*

Answer 70: India has attached the complete version of 19 C.F.R. §102.21. We also attach the customs regulations in pdf format.

71. *Does India wish to comment on the new United States exhibit US-7bis?*

India notes that the Panel had asked the following question to the United States:

Could the United States submit a copy of the following publication: United States International Trade Commission, Pub. No. 1695, The Impact of Rules of Origin on *United States* Imports and Exports (1985)? Is there a later government publication of this type? (emphasis added.)

India notes that the United States has instead provided the following report: "Standardization of Rules of Origin, Report to the Committee on Ways and Means, US House of Representatives on

³⁴⁹ J. Bourgeois, "Rules of Origin: An introduction," in Rules of Origin in International Trade: A Comparative Study, Edited by Edwin Vermulst, Paul Waer and Jacques Bourgeois (University of Michigan Press, 1994) at pp 1-2.

Investigation No. 332 – 239 under section 332 of the Tariff Act of 1930," USITC Publication [19...unreadable]. **May 1987.**

This is a completely different report. It does not include the quotation referred to by India in footnote 5 of India's First Submission. Nor does it include other very useful information with respect to the economic impact of rules of origin.

However, India has obtained a copy of the USITC Pub. No. 1695 directly from the US International Trade Commission. We attach this Report as India EXHIBIT – 20.

India wishes to comment on Report Pub. No. 1695, which is the Report actually requested by the Panel.

With respect to the substance of the No. 1695 report, India notes that it contains very useful information with respect to the predictability and clarity that the 19. C.F.R. 12.130 regulations would bring (see page 30 *et seq.*) as well as the difficulty in quantifying the economic impact of rules of origin.

India has made clear throughout these proceedings that it does not consider that the Panel is required to address the trade data cited in order to examine the adverse trade effects, and that Article 2(c) would be reduced to inutility if it were interpreted to required the complainant to demonstrate the economic impact of rules of origin through trade statistics. In this regard, India would note that the US ITC has itself acknowledged the difficulty associated with quantifying the economic impact of a rule of origin. The US ITC has noted:

Although there is general agreement that rules of origin do have an economic effect on trade, the effect of a rule of origin cannot be isolated from all the other factors that contribute to business decision-making. Therefore, it is not possible to quantify the economic impact of a rule of origin.³⁵⁰

Measuring the effects requires data on all of the factors affecting trade flows, and it is not possible to isolate the effect of applying a rule of origin from all of the factors affecting trade flows, and it is not possible to isolate the effect of applying a rule of origin from all of the other factors that contribute to business decision making.³⁵¹

72. *Would the United States be in breach of Article 2 of the RO Agreement if, in selecting a rule of origin among a range of alternative rules, it selected the one which it deems most suitable for protecting the integrity and effectiveness of the textiles quota system, a programme which is legitimately designed to protect the domestic textile industry?*

Answer 72: In the view of India, the United States is not using its rules of origin to protect "the integrity and effectiveness" of its quota system but to render that system more restrictive.

As the Preamble of the *RO Agreement* makes clear, "clear and predictable" rules of origin are desirable. However, the Preamble also makes clear that it is not sufficient for rules of origin to be clear and predictable. They must also not "impair rights of Members under the GATT" and be "prepared and applied in an impartial, transparent, predictable, consistent and neutral manner". In the

³⁵⁰ United States International Trade Commission, "The Impact of Rules of Origin on US Imports and Exports," Report to the President on Investigation No. 332-192 under section 332 of the Tariff Act of 1930, Publication No. 1695, May 1985, p. 7.

³⁵¹ *Ibid.* page 77.

case before the Panel, the United States did not adopt rules of origin to protect the integrity and effectiveness of its textiles quota system but to render it more restrictive and skew its operation in favour of the European Communities. If the considered opinion of the United States were that its previous rules of origin did not ensure the integrity and effectiveness of the various commercial policy instruments that it may apply consistently with its WTO obligations, it would presumably have introduced changes not only for textiles and clothing products but for all products. The sector-specific nature of the United States' legislation and the fine product distinctions made in that legislation are completely unrelated to the objective of protecting the integrity and effectiveness of the restrictive import measures that the United States may apply under WTO law. The United States has failed to explain this obvious discrepancy between the declared objective and the instrument allegedly used to implement that objective.

For the United States:

73. *With reference to the second sentence of Article 2 (c), if one establishes the existence of "unduly strict requirements" for example, is it then necessary in your view to show that such requirements created actual effects on international trade?*

India's comment:

Answer 73: India considers that the United States has already explained itself clearly on this point. India has presented a prima facie case of violation of the first sentence of Article 2(c) of the *RO Agreement* based on a conduct-oriented interpretation of this provision. India has demonstrated that this interpretation is supported by the text of Article 2(c) and its context and by the object and purpose of the *RO Agreement*. As India noted in its answer 26(e) to the Panel's questions, the second sentence of Article 2(c) is an elaboration of the first sentence. The United States has agreed with this approach in its answers to the panel's questions.³⁵² It thus acknowledged that, according to the second sentence, the imposition of unduly strict requirement and conditions unrelated to manufacturing or processing *as such* is inconsistent with Article 2(c), irrespective of the actual trade impact.

³⁵² Responses of the United States to the questions from the Panel, 6 January 2003, paragraph 16.

ANNEX A-5

ANSWERS OF THE UNITED STATES TO QUESTIONS FROM THE PANEL FOLLOWING
THE SECOND MEETING

For both parties:

46. Could the parties please indicate whether the attached tables accurately reflects the United States rules of origin at issue in this dispute?

1. The United States has made changes to the Panel's tables, indicated in bolded double underline, and has also attached an explanation of its changes.

47. The parties have offered slightly different descriptions of the rules of origin regime applied to textile products before section 334 was enacted. India suggested that that regime, set out in CFR 12.130, was a DP2 regime. The United States, on the other hand, seems to suggest that origin determinations were made based on CFR 12.130, but also case by case. In the light of this, the Panel would appreciate it if the parties could provide clarification with respect to the following two points:

(a) What discretion, if any, did United States Customs officer enjoy in applying the DP2 rule apparently established by CFR 12.130?

2. Before section 334 was effective, 12.130 rules listed manufacturing processes that were considered significant enough to confer origin to a textile product. It also listed certain manufacturing processes that were not sufficient to confer or change the country of origin of a textile product. With respect to fabrics, both DP2 and fabric formation were considered significant enough to confer origin, and provided DP2 was actually performed on a fabric, United States Customs Officers had little discretion in the application of this rule.

3. As the United States indicated at the second meeting with the Panel, United States Customs Officers had some discretion in applying these rules to determine origin. The rules did not directly address every conceivable manufacturing scenario for specific goods and therefore some discretion was a natural consequence of the rules. The United States characterization of origin determinations under 12.130 as "case-by-case," refers primarily to determinations concerning country of origin of apparel and certain flat goods and other made-up products.

4. In the case of most fabrics, flat goods and other made-up products, which normally were not subjected to DP2, the actual manufacturing processes performed in a country were reviewed to determine the proper origin. That is, United States Customs Officers had discretion to determine, on a case-by-case basis, where origin would be conferred.

(b) If there was discretion under CFR 12.130, could it be said that, by the same token, United States Customs officers currently enjoy the same discretion in applying the DP2 rule as provided for section 405?

5. United States Customs Officers have the same level of discretion in applying the DP2 rule now under section 405 as they had under 12.130. However, United States Customs Officers are constrained by section 334 in exercising discretion when determining country of origin for those products that do not meet section 405's guidelines.

48. Article 2(b), (c) and (d) of the RO Agreement refers to "rules of origin" in the plural. Do the parties agree that, notwithstanding the use of the plural, the provisions in question reflect a concern with individual rules of origin as they apply to individual products, rather than with a Member's system of rules of origin?

6. No. As indicated by the use of the plural "rules," Article 2(b), (c) and (d) are concerned with a Member's system (its methods) of rules of origin. Analysis of compliance with this Article requires an examination of a Member's system of rules of origin and its administration. The drafters chose to address the system of rules in these provisions rather than focusing on individual rules.

49. Both parties have argued that the protection of a domestic industry would be a trade objective within the meaning of Article 2(b) of the RO Agreement. On what basis do you reach this conclusion?

7. The United States accepted, for purposes of this dispute and in order to avoid confusion given India's failure to make a prima facie case on its claims, India's contention that protection of a domestic industry would be a trade objective within the meaning of Article 2(b) of the *RO Agreement*. As such, the United States' arguments with respect to whether protectionism could be a trade objective have been responsive only to India's contentions regarding alleged United States motivations and behavior. Moreover, the United States notes that Article 2(b), in its first clause, recognizes that rules of origin may be linked to measures or instruments of commercial policies that may have a protectionist effect, and that the objective and effect of these measures and instruments should not be confused with or attributed to that of the rules themselves. The United States does not support a general proposition that protection of a domestic industry is *ipso facto* an impermissible trade objective within the meaning of Article 2(b).

50. For purposes of the application of Article 2(b), does it make a difference whether rules of origin are adopted by a Member of its own volition or at the request of a trading partner?

8. All rules of origin are adopted by a Member of its own volition, regardless of whether adoption followed consultation with another Member. Either way, the question of whether rules are used as instruments to pursue trade objectives will depend on the particular facts of the case. Further, as the United States has indicated in this dispute, settling a WTO dispute on particular terms as a result of negotiation, pursuant to the goals and objectives of the Dispute Settlement Understanding and the WTO framework, cannot be a prohibited trade objective within the context of Article 2(b).

51. With reference to Article 2(d) of the RO Agreement, please elaborate on the meaning and purpose of the first clause ("the rules of origin that they apply to imports and exports are not more stringent than the rules of origin they apply to determine whether or not a good is domestic"). Please provide an example of a typical situation which the first clause is meant to address.

9. The first clause of Article 2(d) is intended to prohibit Members from using rules of origin to favor domestic production by applying more stringent requirements to imports than to domestic goods. For example, this would preclude a Member that uses an *ad valorem* percentage criterion in its government procurement rules of origin from requiring a higher percentage to determine the country of origin of an imported product than the percentage used to determine the country of origin of a domestic product. However, the first clause recognizes that a determination of domestic origin may involve a more rigorous standard than that applied to imported goods.

52. Why is a provision equivalent to (i) Article 2(b) of the RO Agreement and (ii) to Article 2(c) of the RO Agreement no longer necessary after the transition period? (see Article 3 of the RO Agreement)

10. The construction of Article 3 of the *RO Agreement* further underscores that the analysis in this dispute must focus on the rules of origin *themselves*, and must not involve or be affected by any analysis or assumptions relating to the objectives or effects of the measures to which the rules of origin may be linked. Upon implementation of the results of the harmonization work program, all Members will be using the same rules of origin. The *RO Agreement* recognizes that, at that time, it would simply be implausible to make a determination that a single Member's rules of origin are *themselves* – considered apart from any measure or instrument of commercial policy to which they are linked – either an instrument to pursue a trade objective or otherwise creating restrictive, distorting, or disruptive effects on international trade. Notably, once Article 3 applies, measures or instruments of commercial policy creating restrictive, distorting or disruptive effects on international trade will continue to be introduced and implemented through rules of origin. The absence within Article 3 of the equivalent of Article 2(b) and Article 2(c) underscores that the standard that is to be applied under Article 2 should not confuse either the objectives and effects of a particular measure or instrument of commercial policy with the objectives and effects of the rules of origin themselves.

53. *Why is a provision equivalent to Article 2(d) necessary after the transition period? (see Article 3(c) of the RO Agreement)*

11. The Article 3 provision equivalent to Article 2(d) will remain necessary because, as the *RO Agreement* recognizes, notwithstanding completion and implementation of harmonization, Members will continue to be able to apply more stringent rules for determining whether a good is domestic, than the harmonized rules of origin applied to imports and exports.

54. *With reference to 19 C.F.R. § 102.21, please answer the following questions:*

(a) *What is the legal status and nature of the regulations set forth in 19 C.F.R. § 102.21 in United States law?*

12. Paragraph (a) of section 334 directed the Secretary of Treasury to prescribe rules to implement the principles contained in section 334 of the Uruguay Round Agreements Act (URAA) for determining the origin of textiles and apparel products. The regulations set forth in 19 C.F.R. § 102.21 reflect the exercise of that authority and were promulgated in accordance with the US Administrative Procedures Act and, as such, have the force and effect of law in the United States. The section 102.21 regulations contain amendments, adopted on an interim basis, to align the regulatory text with the statutory amendments to section 334 of the URAA as set forth in section 405 of the Trade and Development Act of 2000. These amendments were the subject of public comment and are in effect pending issuance of final regulations. Therefore, the regulations contained in 19 C.F.R. § 102.21, including the interim amendments, are legally binding.

(b) *Would the Panel have the authority to find that 19 C.F.R. § 102.21, as such, is contrary to the United States' WTO obligations?*

13. The Panel has the authority to find that any claim that properly falls within the terms of reference of this dispute, and for which India has established a prima facie case that the United States has not rebutted, is contrary to the United States' WTO obligations. However, India has failed to establish a prima facie case that section 102.21 breaches United States' obligations, having failed to cite section 102.21 in its first submission, and having provided non-substantive arguments in its second submission.

- (c) *If the Panel were to find that sections 334 and/or 405 are inconsistent with Article 2 of the RO Agreement, would the Panel need to make additional findings in respect of 19 C.F.R. § 102.21?*

14. The Panel could not conclude that section 102.21 is inconsistent with United States' obligations unless India has established a prima facie case with respect to each of the measures at issue in this dispute, and it may not be assumed that one measure is inconsistent with United States' obligations because another has been found to be. A finding that 19 C.F.R. § 102.21 is inconsistent with United States' obligations under Articles 2(b)-(e) would have to be based on a prima facie case of how the regulations contained therein are inconsistent with the obligations found in each of those provisions.

55. *If there were no United States quota regime, could it be said that (i) the fabric formation and (ii) the DP2 rule, in and of themselves, or as such:*

- (a) *create restrictive, distorting or disruptive effects on international trade?*

15. No. As the United States has explained, the fabric formation rule in section 334 and the DP2 rule in section 405 were enacted to best capture where a new product is formed and to facilitate harmonization of rules of origin, in addition to combatting circumvention of quotas through preventing illegal transshipment. The first two of these objectives are valid whether or not a quota regime is in place (and indeed, both section 334 and section 405 will continue in force after the ATC regime expires in 2005). The United States would not agree, and more importantly, India has not shown, that either the fabric formation rule or the DP2 rule in and of themselves have created restrictive, distorting or disruptive effects on international trade. Indeed, the data submitted by the United States in Exhibits US-8 and US-9 would strongly disprove such a conclusion. (The Indian delegation commented at the second meeting with the Panel, in respect of Exhibit US-9, that import data in volume would have been more relevant for assessing trade effects than import data in value. Thus, in Exhibit US-10, attached, the United States presents United States' imports of bed, table and bath (toilet) linen in HTS headings 6302 in volume (kilograms). In volume as well as in value, United States' imports of these products from the world and from India show steady, significant yearly increases, including in the period 1995 to 1997, where the rate of increase in imports from the world and from India in volume is comparable to the rate of increase in value. The import data in volume or value therefore equally refute India's claim of trade restriction, distortion or disruption.)

- (b) *are designed to pursue trade objectives?*

16. No. Both the fabric formation rule and the DP2 rule facilitate the achievement of trade objectives such as transparency and predictability. Having rules of origin which are based on economically rational principles and which are harmonized with trading partners; and settling disputes in a mutually satisfactory manner, furthers rather than detracts from the principles of the RO Agreement.

56. *Could the parties please address whether, and if so, how the following statement by the Appellate Body is relevant to the present dispute:*

The requirement to prevent trade distortion found in Articles 1.2 and 3.2 of the Licensing Agreement refers to any trade distortion that may be caused by the introduction or operation of licensing procedures, and is not necessarily limited to that part of trade to which the licensing procedures themselves apply. There may be situations where the operation of licensing procedures, in fact, have restrictive

*or distortive effects on that part of trade that is not strictly subject to those procedures.*³⁵³

17. The Appellate Body's statement, and the context in which it was made, are relevant in that they underscore that there has to be a causal connection between a measure that is alleged to be trade distortive and any trade distortion.

18. The Licensing Agreement provisions in *EC – Poultry* required an examination of whether Brazil's licensing procedures had trade restrictive or distortive effects in breach of Licensing Agreement Articles 1.2 and 3.2. The Appellate Body agreed with the panel that since Brazil had fully utilized its TRQ and "the absolute volume of Brazilian exports of the relevant product to the European Communities ha[d] been increasing since the opening of the TRQ," Brazil had not shown that the licensing procedures had *caused* a decline in its market share that could be labeled "trade distortive."³⁵⁴ The Appellate Body noted that Brazil needed to establish "a causal relationship between imposition of the European Communities licensing procedure and the claimed trade distortion."³⁵⁵

19. It is also this "essential element of causation"³⁵⁶ that is missing in the present dispute. India has failed to show how its vague allegation of disruption of some exporter's business, shows that the United States' rules of origin are distorting trade, especially when these allegations are considered against the backdrop of concrete evidence presented by the United States that trade with India in the specific products complained of has actually increased since the rules were enacted (exhibits US-8 and US-9), in addition to the fact that India's quotas have increased over this time. Despite India's assertions to the contrary, it is clear that prior WTO panels and the Appellate Body have required a claimant to make a causal connection between the measure it alleges has distorted its trade and trade data.

20. Beyond this, the Appellate Body's statement has little relevance. It stands for the proposition that the Licensing Agreement obligations at issue in *EC – Poultry* apply to more than in-quota trade. The statement was made in the specific context of addressing Brazil's complaint that it was improper for the *EC – Poultry* panel, in assessing the effects of the European Communities' licensing procedures, to have made the broad finding that the Licensing Agreement provisions, "as applied to [that] particular case, only relates to in-quota trade." While the Appellate Body sought through the above statement to counter any mis-impression that the Licensing Agreement somehow limits the examination of trade distortion to in-quota trade, it nevertheless went on, in paragraph 122, to find that, by its terms, the relevant measure applied only to "in quota" trade. Accordingly, the Appellate Body concluded that the panel was merely pointing out "this obvious fact," and upheld the panel's finding. Therefore, it is difficult to draw any relevant conclusion from the Appellate Body's statement other than that there has to be a causal connection between a measure that is alleged to be trade distorting and any trade distortion.

57. *Please recall the following headings and subheadings of the HS96 for bed linen:*

"63.02 (bed linen, table linen, toilet linen and kitchen linen)

6302.10 – bed linen, knitted or crocheted

- other bed linen, printed;

6302.21 - - of cotton

6302.22 - - of man-made fibres

6302.29 - - of other textile materials

³⁵³ Appellate Body Report, *EC- Poultry*, *supra*, para. 121.

³⁵⁴ *Ibid.*, paras. 125-126.

³⁵⁵ *Ibid.*, para. 127.

³⁵⁶ *Ibid.*, para. 127.

- *other bed linen*
- 6302.31 - - *of cotton*
- 6302.32 - - *of man-made fibres*
- 6302.39 - - *of other textile materials"*

Please answer the following questions:

(a) Based on HS96 above, is it correct that the most widely traded bed linen is made of either cotton or man-made fibres?

21. According to United States import data compiled by the US International Trade Commission, cotton is the most widely traded bed linen, followed by manmade fibers and "other." In calendar year 2001, cotton accounted for 85.4% of United States imports by value in these HS96 subheadings. Man-made fibers accounted for 13.4%, and "other" accounted for 1.2%.

(b) Since cotton bed linen is normally bleached or white-dyed, but not dyed and printed, is the DP2 rule appropriate?

22. The United States notes that in addition to being bleached or white-dyed, cotton bed linen may also be printed, but as we have also noted, it is not normally dyed and printed (just as wool is not normally used for bed sheets and pillowcases). Therefore, the DP2 rule would be neither "appropriate" nor meaningful for these products. Because these products are normally cut to length and hemmed, the application of the "fabric formation" rule under section 334 and section 405 results in the same origin as the application of 19 CFR 12.130.

For the United States:

73. With reference to the second sentence of Article 2(c), if one establishes the existence of "unduly strict requirements", for example, is it then necessary, in your view, to show that such requirements created actual effects on international trade?

23. Yes, it would be necessary to show that the existence of the elements of Article 2(c) created actual effects on international trade. The second sentence of Article 2(c) does not stand alone, but operates to articulate the type of rules of origin that "themselves" could meet the requirement of the first sentence— as opposed to a situation where "actual effects on international trade" are created merely by the implementation of a measure through application of a particular rule of origin. Article 2(c) does not bar "requirements," "strict requirements," or "unduly strict requirements." As is discussed in the United States answer to question 74, Article 2(c) bars "unduly strict requirements . . . as a prerequisite for the determination of country of origin." In determining whether such a requirement is "unduly strict," in the United States view, it is necessary to examine the actual effects on international trade. If such a requirement had a significant impact on international trade, it would support a Member's claim that the requirement is "unduly strict." Similarly, if there were no trade impact, it would support a Member's position that such a requirement is not "unduly strict." On the other hand, as is discussed below in the United States' answer to question 74, there are some such requirements that on their face would, in the United States view, be correctly characterized as "unduly strict," even in the absence of a trade effect. However, even if a measure could be characterized as "unduly strict" in the absence of a trade effect, it would only be inconsistent with Article 2(c) if the complaining Member established that the measure created actual effects on international trade in violation of the first sentence of Article 2(c).

24. When applied in the implementation of a particular measure, any rule of origin – and most certainly any change in a rule of origin – could probably be viewed as having an effect on international trade. However, in the context of such a situation, the application of a non-preferential rule of origin that is merely 'strict' (e.g., a 60 percent *ad valorem* criterion) would most likely not be

viewed as a rule of origin that itself creates "restrictive, distorting, or disruptive effects on international trade." By contrast, a nonpreferential rule of origin that, for example, involves an even higher *ad valorem* criterion, combined with mandating a particular technology for manufacture may be viewed as "unduly strict," and, if so, could lead to a conclusion that such a rule of origin itself, creates "restrictive, distorting, or disruptive effects on international trade" – assuming the latter situation has also been established.

74. *With reference to Article 2(c) of the RO Agreement, please elaborate on how the second clause of the second sentence of Article 2(c) could be understood as describing a situation which creates restrictive effects on international trade?*

25. Article 2(c) provides: "Rules of origin shall not themselves create restrictive, distorting, or disruptive effects on international trade. They shall not pose unduly strict requirements or require the fulfilment of a certain condition not related to manufacturing or processing, as a prerequisite for the determination of the country of origin. However, costs not directly related to manufacturing or processing may be included for the purposes of the application of an *ad valorem* percentage criterion consistent with subparagraph (a)". The second sentence demonstrates one manner in which rules of origin can create restrictive, distorting, or disruptive effects on international trade, and the second clause of the second sentence qualifies the first clause. In other words, Article 2(c) does not bar "unduly strict requirements"; it bars "unduly strict requirements ... as a prerequisite for the determination of the country of origin." Similarly, Article 2(c) does not bar "requiring the fulfilment of a certain condition not related to manufacturing or process" except "as a prerequisite for the determination of country of origin."

26. A rule of origin implementing a particular measure that requires the fulfilment of a manufacturing process (e.g., "assembly" as a criterion) may have an effect on international trade, but would not necessarily be seen as a rule of origin that itself creates "restrictive, distorting, or disruptive effects on international trade." By contrast, a rule of origin that requires the fulfilment of a condition not related to manufacturing or processing (e.g., nationality of company ownership, or requiring the use of personnel of a certain religious order to achieve a certain determination of origin) could be viewed as a rule of origin that itself creates "restrictive, distorting, or disruptive effects on international trade" – if the latter situation has also been established.

27. An example of the fulfilment of a certain condition not related to manufacturing or processing as a prerequisite for the determination of the country of origin would be a rule of origin that requires a particular nationality of company ownership, or a requirement that a good be certified by several authorities through a time consuming process in the exporting country in order to be declared as originating in that country. As noted above, such a rule could be viewed as *itself* creating "restrictive, distorting, or disruptive effects on international trade," if the latter situation has also been established.

75. *Could the United States elaborate further on why it thinks that Article 2 of the RO Agreement permits Members to apply rules of origin which are based on narrow product distinctions?*

28. Article 2 sets out certain disciplines on Members during the transition period until the work program leading to the implementation of harmonized product-specific rules of origin is completed. Thus, the United States understands the Panel to be asking whether Article 2 bars Members from applying rules of origin which are based on "narrow" product distinctions. It does not. United States rules of origin are product-specific, and as explained below, operate based on distinctions among products. The United States is not familiar with an *RO Agreement* criterion that would establish whether certain product distinctions (that are captured in a Member's tariff schedule) are deemed "narrow" while other distinctions in a Member's tariff schedule presumably are not.

29. First, rules of origin will necessarily make distinctions between products based on the characteristics of the products and the nature of the industry involved. A single rule for all products would either be so vague as to require case-by-case elaboration (e.g., "substantial transformation") or be administered arbitrarily. This dispute has clearly demonstrated the complexity of determining the origin of certain textile products. The *RO Agreement* clearly envisions that Members could impose product-specific rules, as is demonstrated by Article 2(a)(iii), which authorizes Member to use criterion related to manufacturing or processing to confer origin; as different products undergo different manufacturing/processing, different criterion (and different rules) would be required for different products.

30. If a Member may have different rules for different products, what disciplines does the *RO Agreement* impose on a Member in distinguishing products? Certainly, the *RO Agreement* does not require the same rule for all "like" or "directly competitive" products. Such a requirement is not found in the *RO Agreement* and cannot be inferred from any provision of Article 2, nor has India made a case that it should be so inferred. Moreover, the *RO Agreement* does not require the same rules for all products that are similar in some other sense. Again, such a requirement is not spelled out in the *RO Agreement* and cannot be inferred from any provision of the *RO Agreement*. Thus, it would be incorrect to interpret the *RO Agreement* as barring Members from distinguishing in their rules between products – regardless of whether these products are "like," "directly competitive" or similar in some other manner, and even if such product-specific rules are perceived to be based on distinctions deemed in some sense "narrow."

76. *Did meeting the European Communities requests and the consequent enactment of section 405 compromise the objectives stated in the SAA for the adoption of section 334?*

31. No. The objectives stated in the SAA for section 334 were not compromised by section 405. It should first be noted that while section 405 emerged from consultations with the European Communities, not all of the "European Communities requests" are reflected in the rules which the United States adopted in section 405. Moreover, those which are reflected in section 405 were adopted in a manner that the United States considered appropriate so as not to undermine the core principles of section 334. The objectives of 334 were to reflect the important role assembly plays in the manufacture of an apparel product; to prevent circumvention by illegal transshipment, to harmonize United States practice with that of our major trading partners and to advance the goals of the *RO Agreement*. Two of these objectives were unaffected by the changes in section 405. First, harmonization referred primarily to eliminating the conference of origin by cutting, and this was unchanged by section 405. Second, advancing the goals of the *RO Agreement* is accomplished by having clear, concise predictable rules, and this too remained unchanged. Similarly, it was felt that having clear guidance for importers and United States Customs Service officers would make it more difficult to circumvent the rules and easier to detect circumvention. This was unchanged because section 405, like section 334, provides concise direction regarding origin determination.

32. In addition, as the United States has indicated before, one reason for the changes in section 405 was that we were persuaded that, for the products at issue, such as silk scarves, the most important manufacturing process would be better reflected by a change in the rule of origin back to DP2. Also, as the United States has previously noted, a primary goal of section 334 was to address assembly of apparel products, whereas section 405 addresses fabric formation and flat goods. *See also* United States answers to panel questions 14 and 19.

77. *Why does the United States apply the fabric formation rule to wool fabric, when all other fabrics appear to be subject to DP2?*

33. In section 405, the United States amended section 334 to reflect the terms of our settlement agreement with the European Communities. In all other respects, we retained the section 334 rules. For 95% of the trade, all non-wool fabrics are treated the same as wool fabrics. The European

Communities, which is one of the world's leading manufacturers and exporters of wool fabric, found the solution to its dispute with the United States satisfactory, even though it excluded wool.

78. *With reference to para. 73 of India's Second Submission, does the United States agree that "the exemptions provided for in section 405 do not bear any relation to the criteria for determining origin as set out in Article 2(a)?"*

34. No. We would first note that India did not make an allegation in its panel request that section 405 is inconsistent with any part of Article 2(a). As the United States has made clear during its submissions and answers to questions, the exemptions in section 405 are in accordance with all relevant provisions of the *RO Agreement*. The relevant provision in Article 2(a) is subparagraph (iii). To the extent that the United States understands India's argument in paragraph 73 with respect to "end products" and Article 2(a)(iii), these arguments seem to be based on India's desire to return to a pre-section 334 world. The issue in this dispute is not about end products, it is about India's desire to have specific rules or no rules or vague rules which would produce an origin determination that India favours for certain end products. Article 2(a)(iii) prescribes that where manufacturing or processing operations determine origin, they should be precisely specified. The determinations of fabric or product origin in section 405 could not be more precisely specified. Indeed, it is those precise specifications which India does not appreciate.

79. *On the one hand, the United States says that the purpose of section 405 was to settle a WTO dispute with the European Communities. On the other hand, the United States says that, "as a result of extensive consultations with the European Communities, as well as representatives of its textile industry, the United States agreed that, at least with respect to goods of silk, certain cotton blends, and fabrics made of man-made and vegetable fibers (specifically silk scarves and flat products such as linens), dyeing and printing along with two or more finishing operations were significant enough to confer origin". Could the United States please explain the relationship of these two statements?*

35. These statements form the basis for section 405 and there is no conflict between the two. The purpose of section 405 was to settle the European Communities dispute. The terms upon which the settlement was arrived at, and which ultimately formed the basis of the text of section 405, resulted from the consultations with the European Communities, during which, for example, the United States was persuaded that it would be appropriate to amend section 334 and return to DP2 for the cited products.

ORIGIN OF FABRICS

| ORIGIN-CONFERRING PROCESS | FABRIC-MAKING (KNITTING, WEAVING, ETC.) | PRINTING & <u>DYEING</u> OF FABRIC & 2 OR MORE SPECIFIED FINISHING OPERATIONS |
|--|---|--|
| Wool fabrics | YES (section 334(b)(2)) | |
| Other fabrics (silk, cotton, man-made fibres and vegetable fibres) | <u>YES</u> <u>(Section 334 (b)(2), unless</u> <u>subsequently subjected to DP2</u> <u>under Section 405)</u> | YES (section 405(a)(3)(B)) |

~~Note: Empty cells should be understood as saying “no”. That is to say, the relevant processes do not confer origin for the articles in question.~~

ORIGIN OF MADE-UP ARTICLES ASSEMBLED IN SINGLE COUNTRY FROM SINGLE COUNTRY FABRIC(S)

| ORIGIN-CONFERRING PROCESS | | FABRIC-MAKING (KNITTING, WEAVING, ETC.) | PRINTING & <u>DYEING</u> OF FABRIC & 2 OR MORE SPECIFIED FINISHING OPERATIONS | "WHOLLY OF ASSEMBLED" |
|---|---|--|--|----------------------------------|
| Articles (scarves, bed linen, etc.) specified in section 334(b)(2)(A) and section 405(a)(3)(C) and made of: | | | | |
| | - Wool | YES (Section 405(a)(3)(C)) <u>Section 334(b)(2)(A)</u> | <u>NO</u> | <u>NO</u> |
| | - Cotton | YES (section 405(a)(3)(C)) <u>Section 334(b)(2)(A)</u> | <u>NO</u> | <u>NO</u> |
| | - Cotton blends (more than 16% cotton by weight) | YES (section 405(a)(3)(C)) <u>Section 334(b)(2)(A)</u> | <u>NO</u> | <u>NO</u> |
| | - Other (silk, man-made fibres, vegetable fibres) | <u>YES</u> <u>(Section 334(b)(2)(A), unless DP2)</u> | YES (section 334(b)(2)(A) and section 405(a)(3)(C)) | |

| | | | |
|--|---|-----------|----------------------------|
| Articles which are "knit to shape" (e.g., stockings) | YES (section 334(b)(2)(B)) <u>(Not considered fabric making, considered component or article formation)</u> | <u>NO</u> | <u>NO</u> |
| Other articles (including apparels) | <u>NO</u> | <u>NO</u> | YES (section 334(b)(1)(D)) |

Summary of United States changes to the Panel's chart:

- Inserted "no" in the applicable blocks to be clear.

Origin of Fabrics:

- On other fabrics (silk, etc)... indicated "yes," unless subsequently subjected to DP2 pursuant to Section 405

Origin of Made-up Articles Assembled in a Single Country from Single Country Fabric(s)

- In the title added "from single country fabric(s)" to better reflect conclusions
- For other articles (silk, etc.), specified in 334(b)(2)(A), we indicated "yes," the origin would be conferred by fabric making.
- For articles which are "knit-to-shape", we clarified the fact that the process of "knitting to shape" is not a fabric making process. The process of "knitting-to-shape" involves making a component or an article directly without the formation of a fabric.

ANNEX A-6

ANSWERS OF INDIA TO QUESTIONS FROM THE UNITED STATES FOLLOWING THE
SECOND MEETING

Could India clarify what "comparative advantage," other than the lack of a quota, would drive Indian exports of greige fabrics to Sri Lanka, where they are "converted" into bed linen? (India answer to panel question 17(c)). Can India clarify exactly what activities are being performed in Sri Lanka to "convert" the fabric into bed linens?

Answer: Sri Lanka has emerged as a major conversion centre for producing made-up articles and garments. Unlike India, Sri Lanka has a low fabric base and mainly depends on imports of fabrics from various fabric producing countries including India for producing value added cotton made-ups like bed sheets/pillow cases, shop towels etc. Studies benchmarking costs of production between competing countries like India, Sri Lanka, China, Indonesia, Pakistan show that Sri Lanka has the following advantages giving it an edge over other supplying countries in Asia.

- (i) Cost of Power
- (ii) Cost of Steam
- (iii) Wage Costs.

In view of the above advantages, rather than lack of quota Sri Lanka has emerged as a major manufacturing centre for made-up articles and garments and an important market for export of greige fabrics from India.

As regards "lack of quota", India notes that it needs to be clarified that the United States imposes "quotas" on imports of "pillow cases" (Cat. 360) from Sri Lanka which were debited to India's quota levels under the "fabric forward" rule by the United States.

With reference to India's statement in paragraph 52 of its second submission that the "very adoption" of changes has an immediate impact on producers, could India please explain how this standard is different from a per se rule that changes are inconsistent with Article 2(c)?

Answer: The "very adoption" of changes to rules of origin differs from the *per se* rule in the following way. The "very adoption" of the rule connotes a temporal aspect, whereby as soon as the rule of origin is made effective, it can impact on business plans. India has explained this approach as the "conduct-oriented approach." For example, in paragraph 52 of its second submission, India has clarified the impact of a "conduct oriented" approach could be seen in terms of "the incentives and disincentives for producers and traders and as a result also on their investment and other business plans". The *per se* rule requires an examination of the rules themselves. The common element with the *per se* rule is that there is no requirement to demonstrate the actual adverse effects through trade statistics.

In the present situation, India notes that the United States' rules of origin have restrictive, distorting or disruptive effects on international trade for the following reasons:

- (i) Section 334 had the dual effect of moving the origin of dyed, printed and finished fabrics back to the country where the fabric was woven and making products such as bed sheets/duvet covers subject to DP2 operations cut and sewn in Sri Lanka from India greige fabrics subjected to quotas whereas they had never previously been subject to quotas.

- (ii) Importers have to switch to new suppliers as traditional suppliers lost their access to the United States' market because of the new rules, thereby distorting historical trade patterns.
- (iii) The new rules undermine informed compliance by foreign producers thereby exacerbating the disruptive effects as the same product undergoing the same production operations in Sri Lanka may be a product of Sri Lanka or India depending on the product's fibre content.
- (iv) As China argued in its reply to *question No. 41(d)* "If the patterns of trade – the "shape" of the trading relationship among the subject countries for the products in question – have been "twisted" as a consequence of the changes in the origin rules themselves", the very adoption of a rule of origin can be an example of the serious restrictive or distorting effects on international trade.

Can India clarify if in India's second submission, paragraph 43, it is saying that it is an "unduly strict requirement" to conform to Harmonized Tariff Schedule (HTS) classifications for cotton, wool or silk?

Answer: In paragraph 43, India is not implying that it is an "unduly strict requirement" to conform to Harmonized Tariff Schedule (HTS) classifications for cotton, wool, silk. India is claiming that it is completely arbitrary and burdensome for producers and traders if the criteria for determining origin vary with these HTS classifications.

With respect to the situation described in India's answer to Panel question No. 5, does India have any documentary evidence, such as contracts, invoices, bills of lading, etc. indicating that a) India exported greige fabric to Portugal, or b) that the fabric was subjected to "DP2" in Portugal?

Answer: India considers that it is not required to provide such information. Nevertheless, India has provided the attached bills of lading (INDIA-EXHIBIT 21). Furthermore, India notes the following. Portugal is an important market for export of greige fabric from India. India's exports of greige fabrics to Portugal are as follows:

| Year | Qty. (in Tonnes) | Value (in Million US \$) |
|------|---------------------|-----------------------------|
| 1994 | 773 | 4.07 |
| 1995 | 726 | 4.27 |
| 1996 | 504 | 2.52 |
| 1997 | 667 | 3.81 |
| 1998 | 850 | 3.97 |
| 1999 | 982 | 3.55 |
| 2000 | 998 | 3.38 |
| 2001 | 1159 | 3.58 |
| 2002 | 1022 | 3.34 |

With respect to the question as to whether these fabrics were subjected to DP2 in Portugal, it is a well known principle in the manufacture of textiles that greige fabrics imported into any country including Portugal are meant to be further processed including subject to DP2 as mere re-routing of the fabric to a third country is infrequently done.

Can India provide a general estimate of the percentage of world trade in fabrics that are actually

subject to "DP2?" An estimate of world trade in bed sheets that are actually subject to "DP2?"

Answer: The harmonized system of classification provides separate tariff headings for bleached, dyed, printed fabrics. An estimated 70% of the fabrics in the world are traded in the form of DP2. As regards world trade in bed sheets, it is estimated that in the year 1999 world trade in bed wear was approximately US \$ 3.2 billion. Out of this trade around 70% is subject to DP2. Nevertheless, India notes that these trade statistics are not relevant in the determination of whether the United States' rules of origin are WTO-inconsistent.

Could India give examples of wool products that are actually subject to DP2? Could they also estimate the amount of trade in those items?

Answer: India notes that wool is spun into yarn and woven into a greige fabric which is subsequently subjected to DP2 operations. Woollen scarves, shawls, mufflers, mantillas, veils and the like are made from greige fabrics after DP2 operations. India notes that with respect to woollen products, while generally yarn dyeing takes place, piece dyeing (e.g., dyeing after the fabric is woven) also takes place. In very rare cases, printing takes place in woollen products.

Besides silk scarves and cotton/man-made fibre bed linens, can India give examples of other flat goods subject to DP2?

Answer: There are many examples of DP2 flat goods besides silk scarves and cotton/manmade fibre bed linens. These include, table linen, toilet linen, curtains/interior blinds, other furnishing articles like cushion covers, quilt covers etc.

ANNEX A-7

COMMENTS OF INDIA ON ANSWERS OF THE UNITED STATES TO QUESTIONS
FROM THE PANEL FOLLOWING THE SECOND MEETING

46. *Could the parties please indicate whether the attached tables accurately reflects the United States' rules of origin at issue in this dispute?*

1. The United States has made changes to the Panel's tables, indicated in bolded double underline, and has also attached an explanation of its changes.

COMMENT: India has attached a table which sets out its understanding of the scope and coverage of both Section 334 and Section 405. We have not included the customs regulations 102.21 as they are only subordinate to the statutory provisions. India has also commented in redline on the U.S. comments on the panel's tables.

48. *Article 2(b), (c) and (d) of the RO Agreement refers to "rules of origin" in the plural. Do the parties agree that, notwithstanding the use of the plural, the provisions in question reflect a concern with individual rules of origin as they apply to individual products, rather than with a Member's system of rules of origin?*

No. As indicated by the use of the plural "rules," Article 2(b), (c) and (d) are concerned with a Member's system (its methods) of rules of origin. Analysis of compliance with this Article requires an examination of a Member's system of rules of origin and its administration. The drafters chose to address the system of rules in these provisions rather than focusing on individual rules.

COMMENT: India does not agree with this interpretation, which is not borne out by the text of Article 2. In this particular case, the United States' rules of origin apply to textile and apparel products (which are individual products.) A panel must be able to examine the WTO-consistency of rules of origin as they apply to individual products. Otherwise, a large body of rules of origin that only apply to individual products could escape examination by a panel. This would be especially true if a Member's overall system of rules of origin were WTO-consistent, but the rules of origin it applied to individual products, such as textiles and apparel products were WTO-inconsistent. This cannot be what the drafters of the *RO Agreement* intended.

Indeed, in Answer 28, the United States has itself recognised that Article 2 sets out "certain disciplines on Members during the transition period until the work program leading to the implementation of harmonized product-specific rules of origin is completed." This is an acknowledgement that the HWP will lead to product-specific rules of origin. India notes that Article 3 also refers to "rules of origin" in the plural. Therefore, the interpretation proffered by the United States cannot be correct.

53. *Why is a provision equivalent to Article 2(d) necessary after the transition period? (see Article 3(c) of the RO Agreement)*

The Article 3 provision equivalent to Article 2(d) will remain necessary because, as the *RO Agreement* recognizes, notwithstanding completion and implementation of harmonization, Members will continue to be able to apply more stringent rules for determining whether a good is domestic, than the harmonized rules of origin applied to imports and exports.

COMMENT: As previously noted by India in its answer to this question, a provision equivalent to Article 2(d) is also necessary after the transition period because a Member can still discriminate in favour of another Member.

54. *With reference to 19 C.F.R. § 102.21, please answer the following questions:*

- (a) *What is the legal status and nature of the regulations set forth in 19 C.F.R. § 102.21 in United States law?*

Paragraph (a) of Section 334 directed the Secretary of Treasury to prescribe rules to implement the principles contained in Section 334 of the Uruguay Round Agreements Act (URAA) for determining the origin of textiles and apparel products. The regulations set forth in 19 C.F.R. § 102.21 reflect the exercise of that authority and were promulgated in accordance with the US Administrative Procedures Act and, as such, have the force and effect of law in the United States. The Section 102.21 regulations contain amendments, adopted on an interim basis, to align the regulatory text with the statutory amendments to Section 334 of the URAA as set forth in Section 405 of the Trade and Development Act of 2000. These amendments were the subject of public comment and are in effect pending issuance of final regulations. Therefore, the regulations contained in 19 C.F.R. § 102.21, including the interim amendments, are legally binding.

- (b) *Would the Panel have the authority to find that 19 C.F.R. § 102.21, as such, is contrary to the United States' WTO obligations?*

The Panel has the authority to find that any claim that properly falls within the terms of reference of this dispute, and for which India has established a prima facie case that the United States has not rebutted, is contrary to the United States' WTO obligations. However, India has failed to establish a prima facie case that Section 102.21 breaches United States' obligations, having failed to cite Section 102.21 in its first submission, and having provided non-substantive arguments in its second submission.

COMMENT: India has cited the customs regulations in its request for the establishment of a panel. India has referred to the customs regulations in its first submission (para. 7, *inter alia*). In footnote 12 of the first submission, India noted that "we will use Section 334 and 405 to refer to the rules as set out in both the statutes and the customs implementing regulations." Therefore, all the claims and arguments that India made in its submissions and other documents submitted to the Panel have covered the customs regulations as well.

- (c) *If the Panel were to find that sections 334 and/or 405 are inconsistent with Article 2 of the RO Agreement, would the Panel need to make additional findings in respect of 19 C.F.R. § 102.21?*

The Panel could not conclude that Section 102.21 is inconsistent with United States' obligations unless India has established a prima facie case with respect to each of the measures at issue in this dispute, and it may not be assumed that one measure is inconsistent with United States' obligations because another has been found to be. A finding that 19 C.F.R. § 102.21 is inconsistent with United States' obligations under Articles 2(b)-(e) would have to be based on a prima facie case of how the regulations contained therein are inconsistent with the obligations found in each of those provisions.

COMMENT: India considers that if the panel were to find that Section 334 and Section 405 are WTO-inconsistent then it follows that 19 C.F.R. § 102.21 (which are the implementing for these sections) would have to be found WTO-inconsistent as well.

55. *If there were no United States quota regime, could it be said that (i) the fabric formation and (ii) the DP2 rule, in and of themselves, or as such:*

- (a) *create restrictive, distorting or disruptive effects on international trade?*

No. As the United States has explained, the fabric formation rule in Section 334 and the DP2 rule in Section 405 were enacted to best capture where a new product is formed and to facilitate harmonization of rules of origin, in addition to combatting circumvention of quotas through preventing illegal transshipment. The first two of these objectives are valid whether or not a quota regime is in place (and indeed, both Section 334 and Section 405 will continue in force after the ATC regime expires in 2005). The United States would not agree, and more importantly, India has not shown, that either the fabric formation rule or the DP2 rule in and of themselves have created restrictive, distorting or disruptive effects on international trade. Indeed, the data submitted by the United States in Exhibits US-8 and US-9 would strongly disprove such a conclusion. (The Indian delegation commented at the second meeting with the Panel, in respect of Exhibit US-9, that import data in volume would have been more relevant for assessing trade effects than import data in value. Thus, in Exhibit US-10, attached, the United States presents United States' imports of bed, table and bath (toilet) linen in HTS headings 6302 in volume (kilograms). In volume as well as in value, United States' imports of these products from the world and from India show steady, significant yearly increases, including in the period 1995 to 1997, where the rate of increase in imports from the world and from India in volume is comparable to the rate of increase in value. The import data in volume or value therefore equally refute India's claim of trade restriction, distortion or disruption.)

COMMENT: In India's view, these trade statistics are not germane. These trade statistics could be interpreted in different ways. As noted in paragraph 17 of India's oral statement at the second meeting, India would argue that this result is precisely what Section 334 was designed to achieve, namely to bring more finished products under the quota of the country where the greige fabric was woven.

(b) *are designed to pursue trade objectives?*

No. Both the fabric formation rule and the DP2 rule facilitate the achievement of trade objectives such as transparency and predictability. Having rules of origin which are based on economically rational principles and which are harmonized with trading partners; and settling disputes in a mutually satisfactory manner, furthers rather than detracts from the principles of the *RO Agreement*.

COMMENT: In India's view, transparency and predictability are not trade objectives, but rather public policy objectives.

57. *Please recall the following headings and subheadings of the HS96 for bed linen:*

*"63.02 (bed linen, table linen, toilet linen and kitchen linen)
6302.10 – bed linen, knitted or crocheted
- other bed linen, printed;
6302.21 - - of cotton
6302.22 - - of man-made fibres
6302.29 - - of other textile materials
- other bed linen
6302.31 - - of cotton
6302.32 - - of man-made fibres
6302.39 - - of other textile materials"*

Please answer the following questions:

(a) *Based on HS96 above, is it correct that the most widely traded bed linen is made of either cotton or man-made fibres?*

According to United States import data compiled by the US International Trade Commission, cotton is the most widely traded bed linen, followed by manmade fibers and "other." In calendar year 2001, cotton accounted for 85.4% of United States imports by value in these HS96 subheadings. Man-made fibers accounted for 13.4%, and "other" accounted for 1.2%.

(b) Since cotton bed linen is normally bleached or white-dyed, but not dyed and printed, is the DP2 rule appropriate?

The United States notes that in addition to being bleached or white-dyed, cotton bed linen may also be printed, but as we have also noted, it is not normally dyed and printed (just as wool is not normally used for bed sheets and pillowcases). Therefore, the DP2 rule would be neither "appropriate" nor meaningful for these products. Because these products are normally cut to length and hemmed, the application of the "fabric formation" rule under Section 334 and Section 405 results in the same origin as the application of 19 CFR 12.130.

COMMENT: India does not agree with this view. Insofar as there are some cotton bed linen that are both dyed and printed, then the DP2 rule would be appropriate.

For the United States:

73. *With reference to the second sentence of Article 2(c), if one establishes the existence of "unduly strict requirements", for example, is it then necessary, in your view, to show that such requirements created actual effects on international trade?*

Yes, it would be necessary to show that the existence of the elements of Article 2(c) created actual effects on international trade. The second sentence of Article 2(c) does not stand alone, but operates to articulate the type of rules of origin that "themselves" could meet the requirement of the first sentence— as opposed to a situation where "actual effects on international trade" are created merely by the implementation of a measure through application of a particular rule of origin. Article 2(c) does not bar "requirements," "strict requirements," or "unduly strict requirements." As is discussed in the United States answer to question 74, Article 2(c) bars "unduly strict requirements . . . as a prerequisite for the determination of country of origin." In determining whether such a requirement is "unduly strict," in the United States view, it is necessary to examine the actual effects on international trade. If such a requirement had a significant impact on international trade, it would support a Member's claim that the requirement is "unduly strict." Similarly, if there were no trade impact, it would support a Member's position that such a requirement is not "unduly strict." On the other hand, as is discussed below in the United States' answer to question 74, there are some such requirements that on their face would, in the United States view, be correctly characterized as "unduly strict," even in the absence of a trade effect. However, even if a measure could be characterized as "unduly strict" in the absence of a trade effect, it would only be inconsistent with Article 2(c) if the complaining Member established that the measure created actual effects on international trade in violation of the first sentence of Article 2(c).

When applied in the implementation of a particular measure, any rule of origin – and most certainly any change in a rule of origin – could probably be viewed as having an effect on international trade. However, in the context of such a situation, the application of a nonpreferential rule of origin that is merely 'strict' (e.g., a 60 percent *ad valorem* criterion) would most likely not be viewed as a rule of origin that itself creates "restrictive, distorting, or disruptive effects on international trade." By contrast, a nonpreferential rule of origin that, for example, involves an even higher *ad valorem* criterion, combined with mandating a particular technology for manufacture may be viewed as "unduly strict," and, if so, could lead to a conclusion that such a rule of origin itself, creates "restrictive, distorting, or disruptive effects on international trade" – assuming the latter situation has also been established.

COMMENT: Please see India's comments on Panel question No. 73 to the United States. It is reproduced below for ease of reference.

Answer 73: India considers that the United States has already explained itself clearly on this point. India has presented a *prima facie* case of violation of the first sentence of Article 2(c) of the *RO Agreement* based on a conduct-oriented interpretation of this provision. India has demonstrated that this interpretation is supported by the text of Article 2(c) and its context and by the object and purpose of the *RO Agreement*. As India noted in its answer 26(e) to the Panel's questions, the second sentence of Article 2(c) is an elaboration of the first sentence. The United States has agreed with this approach in its answers to the panel's questions.³⁵⁷ It thus acknowledged that, according to the second sentence, the imposition of unduly strict requirement and conditions unrelated to manufacturing or processing *as such* is inconsistent with Article 2(c), irrespective of the actual trade impact.

78. With reference to para. 73 of India's Second Submission, does the United States agree that "the exemptions provided for in Section 405 do not bear any relation to the criteria for determining origin as set out in Article 2(a)?"

No. We would first note that India did not make an allegation in its panel request that Section 405 is inconsistent with any part of Article 2(a). As the United States has made clear during its submissions and answers to questions, the exemptions in Section 405 are in accordance with all relevant provisions of the *RO Agreement*. The relevant provision in Article 2(a) is subparagraph (iii). To the extent that the United States understands India's argument in paragraph 73 with respect to "end products" and Article 2(a)(iii), these arguments seem to be based on India's desire to return to a pre-Section 334 world. The issue in this dispute is not about end products, it is about India's desire to have specific rules or no rules or vague rules which would produce an origin determination that India favors for certain end products. Article 2(a)(iii) prescribes that where manufacturing or processing operations determine origin, they should be precisely specified. The determinations of fabric or product origin in Section 405 could not be more precisely specified. Indeed, it is those precise specifications which India does not appreciate.

COMMENT: India made this point - that Section 405 did not bear any relation to the criteria for determining origin as set out in Article 2(a) - in response to the United States' argument in its first submission that its rules of origin were promulgated in accordance with the criteria set out in Article 2(a). That is why this claim was not included in the panel request.

79. On the one hand, the United States says that the purpose of section 405 was to settle a WTO dispute with the European Communities. On the other hand, the United States says that, "as a result of extensive consultations with the European Communities, as well as representatives of its textile industry, the United States agreed that, at least with respect to goods of silk, certain cotton blends, and fabrics made of man-made and vegetable fibers (specifically silk scarves and flat products such as linens), dyeing and printing along with two or more finishing operations were significant enough to confer origin". Could the United States please explain the relationship of these two statements?

14. These statements form the basis for Section 405 and there is no conflict between the two. The purpose of Section 405 was to settle the European Communities dispute. The terms upon which the settlement was arrived at, and which ultimately formed the basis of the text of Section 405, resulted from the consultations with the European Communities, during which, for example, the United States was persuaded that it would be appropriate to amend Section 334 and return to DP2 for the cited products.

³⁵⁷ Responses of the United States to the questions from the Panel, 6 January 2003, paragraph 16.

General comment: India notes that in the United States consolidated exhibit list (circulated at the second meeting of the parties), the United States referred to US-7 *bis* as the USITC Pub. No. 1695 (1985). However, the United States attached the 1987 USITC Report as US -7 *bis*. It did not indicate that it was circulating the 1987 report as an update to the 1985 report it had circulated earlier as US Exhibit-7. (India notes that the United States did attach the 1985 USITC report as Exhibit - 7 in its second submission.) It is unclear whether the omission of the correct document in the United States' consolidated exhibit list would mean that the 1985 report is not properly before the panel. In order to avoid any question in this respect, India has filed the 1985 report as India Exhibit - 20.

ORIGIN OF FABRICS

| ORIGIN-CONFERRING PROCESS | FABRIC-MAKING (KNITTING, WEAVING, ETC.) | PRINTING & <u>DYEING</u> OF FABRIC & 2 OR MORE SPECIFIED FINISHING OPERATIONS |
|--|--|--|
| Wool fabrics | YES (section 334(b)(2)) YES, but Section 334 (b) (1) (C) as it is fabric | <u>NO</u> |
| Other fabrics (silk, cotton, man-made fibres and vegetable fibres) | <u>YES</u> <u>(Section 334 (b)(2), unless</u> <u>subsequently subjected to</u> <u>DP2 under Section 405)</u> We agree with the Panel's original classification. In any event, it is not Section 334 (b) (2) which only deals with finished products not fabrics. | YES (section 405(a)(3)(B)) |

~~Note: Empty cells should be understood as saying "no". That is to say, the relevant processes do not confer origin for the articles in question.~~

ORIGIN OF MADE-UP ARTICLES ASSEMBLED IN SINGLE COUNTRY FROM SINGLE COUNTRY FABRIC(S)

| ORIGIN-CONFERRING PROCESS | | FABRIC-MAKING (KNITTING, WEAVING, ETC.) | PRINTING & <u>DYEING</u> OF FABRIC & 2 OR MORE SPECIFIED FINISHING OPERATIONS | "WHOLLY ASSEMBLED" |
|---|---|---|---|--------------------|
| Articles (scarves, bed linen, etc.) specified in section 334(b)(2)(A) and section 405(a)(3)(C) and made of: | | | | |
| | - Wool | YES (Section 405(a)(3)(C)) <u>Section 334(b)(2)(A)</u> <u>India considers that the Panel's original classification was correct. The origin for wool, cotton and fibre blends with 16%+ cotton is determined by virtue of Section 405 (a) (3)(C)</u> | <u>NO</u> | <u>NO</u> |
| | - Cotton | YES (section 405(a)(3)(C)) <u>Section 334(b)(2)(A)</u> <u>See India's comment above</u> | <u>NO</u> | <u>NO</u> |
| | - Cotton blends (more than 16% cotton by weight) | YES (section 405(a)(3)(C)) <u>Section 334(b)(2)(A)</u> <u>See India's comment above</u> | <u>NO</u> | <u>NO</u> |
| | - Other (silk, man-made fibres, vegetable fibres) | <u>YES</u> (<u>Section 334(b)(2)(A), unless DP2</u>) | YES (section 334(b)(2)(A) and section 405(a)(3)(C)) | <u>NO</u> |

| | | | |
|---|--|------------------|-------------------------------|
| Articles which are "knit to shape" (e.g., stockings) | YES (section 334(b)(2)(B) <u>(Not considered fabric making, considered component or article formation)</u>) | <u>NO</u> | <u>NO</u> |
| Other articles (including apparels) | <u>NO</u> | <u>NO</u> | YES (section 334(b)(1)(D)) |

Summary of United States changes to the Panel's chart:

- Inserted "no" in the applicable blocks to be clear.

Origin of Fabrics:

- On other fabrics (silk, etc) indicated "yes," unless subsequently subjected to DP2 pursuant to Section 405

Origin of Made-up Articles Assembled in a Single Country from Single Country Fabric(s)

- In the title added "from single country fabric(s)" to better reflect conclusions
- For other articles (silk, etc.), specified in 334(b)(2)(A), we indicated "yes," the origin would be conferred by fabric making.
- For articles which are "knit-to-shape", we clarified the fact that the process of "knitting to shape" is not a fabric making process. The process of "knitting-to-shape" involves making a component or an article directly without the formation of a fabric.

Section 334

(b)(1)(A) single country

(b)(1)(B) yarn forward

(b)(1)(C) fabric forward

(b)(1)(D) "wholly assembled"
where product is wholly
assembled, that is its country
of origin

Section 405(a)(3)(B)
fabric of silk, cotton,
MMF, or vegetable fibre
conferred origin where DP2
(not wool)

(b)(2) Special rules

(A) For 16 HTS, they
will be classified not where they
are assembled, but under single
country yarn forward or fabric
forward rules.

(B) Knit to shape products
determined where knit

Section 405(a)(3)(C)
For products classified under
7 HTS (out of 16 HTS
4 digit) origin is conferred
where fabric is subject to DP2,
(not where greige fabric is
formed).

405(a)(3)(C)
BUT:
If products under
7 HTS made of:
- cotton
- wool
- fibre blend 16%
or more cotton,
then origin is
determined
where the greige
fabric is woven

(b)(3) "multicountry"

(A) most important assembly

(B) last country

See also supporting customs regulations in 19 C.F.R. 102.21

ANNEX A-8

**COMMENTS OF THE UNITED STATES ON ANSWERS OF INDIA TO QUESTIONS
FROM THE PANEL AND TO QUESTIONS FROM THE UNITED STATES FOLLOWING
THE SECOND MEETING**

Answer to Panel question No. 57(b)

1. The United States notes that India's response is somewhat misleading. The harmonized system provides for a separate classification of printed bed linen, but that does not necessarily mean that the linens are also dyed and subject to 2 or more finishing operations. Therefore, not everything that would be classified under this printed bed linen subheading would qualify for DP2.

Answer to Panel question No. 61

2. India's statement that "Prior to the adoption of the Section 334 rules, only products in (1) would have been recognised as being products of Country A," is misleading. For example, towels could fall within the description of (3), but towels generally were deemed to originate in the country in which the towels were woven unless subjected to dyeing and printing plus 2 finishing operations. Prior to Section 334, since most towels are not dyed and printed, towels normally originated in the country in which they were formed. This is also true of fabrics.

Answer to Panel question No. 71

3. The United States is puzzled by India's representations in this response. First, the United States submitted the 1985 document (exhibit India-20) that the Panel requested on January 15, 2003 as exhibit US-7. India was forwarded a copy of the document, despite its notice to the United States mission in Geneva that it already had a copy of this document. At the second meeting with the Panel on January 23rd, the United States presented exhibit US-7bis, the 1987 document, and noted that both the 1985 and 1987 documents should be considered exhibit US-7bis. As to India's more specific comments, the *EC-Poultry* dispute, at the very least, makes it clear that it is possible for a claimant to present, and a panel to evaluate, economic data to assess trade effects.

Answer to United States' question No. 4

4. India has supplied (Exhibit India -21) an invoice from 2002 which indicates a single shipment of "drill" fabric to Portugal, which responds to the first part of the United States' question, but India has provided no documentary evidence in response to the second part of the United States' question (which was could India support its assertion that Indian greige fabric was subject to DP2 in Portugal).

5. Furthermore, the type of fabric on India's invoice, is, according to industry experts, one of the very last fabrics anyone would try to dye and print, and a far cry from the Hermes-type silk scarves that were the subject of the EU settlement agreement. Fairchild's Dictionary of Textiles defines "drill" fabric as:

A strong, warp-faced, twilled, cotton fabric, medium to heavy weight generally made with coarse carded yarns in a two up, one down left-hand twill, in a dense construction. Resembles denim. ... A variety of uses, e.g., work clothes, pocketings,

*shoe linings, uniforms, book bindings, corsets, backing for coated fabric, industrial fabric, ticking, etc.*³⁵⁸

6. Printing (alone) is usually not done on "drill" fabric because it is heavy and the twill design will make a uniform pattern or design very difficult to achieve. In addition, if such a fabric had been subject to DP2 in Portugal and then exported to the United States, it would have been classified in HTS heading 5209.52.0020. According to statistics available on the Department of Commerce's Office of Textiles and Apparel website, there were no United States imports of fabrics in HTS heading 5209.52.0020 from Portugal in 2002.

7. Thus, India's example in its answer to Panel question 5 of January 6, 2003 remains unsupported, and India has still not introduced any evidence to show that either Section 334 or Section 405 actually resulted in goods being charged to India's quotas or that India's trade was restricted, distorted or disrupted by the introduction of Section 334 or 405.

Answer to United States' question No. 5

8. India's statement that the Harmonized System provides separate classifications for bleached, dyed and printed fabrics is partially correct, but India's estimates of the amount of world trade in fabric and bed sheets that are subject to DP2 are grossly exaggerated. Under the Harmonized System, fabric and bed linen which are DP2'd would fall in the classifications for printed fabric and printed bed linen, respectively.

9. Using official statistics for United States imports as a proxy, since the United States is the world's largest import market, we found that 5.3 percent of our imports of fabric were printed and 41.2 percent of our imports of bed linen were printed (in quantity). These percentages would include all imports of woven fabric and woven bed linen that were either printed or DP2'd, and are not even remotely close to the estimate of 70 percent (for each) offered by India. DP2 is expensive and rarely done. While we can show that DP2'd fabric and bed linen could not have been more than 5.3 percent and 41.2 percent of total United States imports of fabric and bed linen, customs experts strongly believe that the actual shares of fabric and bed linen that had actually been DP2'd are substantially lower.

³⁵⁸ Wingate, Dr. Isabel B. (ed), *Fairchild's Dictionary of Textiles*, Fairchild Publications, Inc., New York, 1970, Page 197 (emphasis added).

ANNEX B

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| Annex B | Answers of third parties to questions |
| | B-1 Answers of China to questions from the Panel following the first meeting |
| | B-2 Answers of the European Communities to questions from the Panel following the first meeting |
| | B-3 Answers of the Philippines to questions from the Panel following the first meeting |

ANNEX B-1

ANSWERS OF CHINA TO QUESTIONS FROM THE PANEL

For all third parties:

39. Do the parties consider that Article 2(b)-(e) of the RO Agreement could be relied on to challenge a change in rules of origin per se, as opposed to the specific rules of origin in force at the time a challenge is brought? In other words, could a panel uphold claims under Article 2(b)-(e) that a change in rules of origin of itself is contrary to these provisions?

REPLY: China believes that Members' obligations as specified in Article 2(b)-(e) of the *RO Agreement* encompass both the substantive content of particular rules of origin as well as the *circumstances and purposes* that underlie any changes that Members might choose to make in such rules. Thus, Article 2(b) prohibits Members from "using" their rules of origin as instruments "to pursue" trade objectives. This language expressly imposes obligations on Members with respect to the *purpose and use* of their rules of origin, obligations that necessarily encompass the *circumstances and purposes* of any changes to such rules in addition to the particular substantive content of the revised rules.

A Member, therefore, may change its rules of origin and then attempt to defend such change on the basis that the specific substantive provisions of the new rules are not inconsistent with its obligations under the *RO Agreement*. Notwithstanding the merits of that Member's argument as to the consistency of specific substantive provisions, however, the circumstances and purposes that underlie that Member's revision to its origin rules may establish that the Member has used the change to its rules as an instrument to pursue trade objectives. To this extent, therefore, a change in rules of origin may be challenged under Article 2(b) of the *RO Agreement*, apart from a challenge to the consistency of specific substantive provisions of such rules under other provisions of the *RO Agreement*.

In this case it has been established that the history, design and structure of section 334 show that it was used by the United States as an instrument to pursue trade objectives, in contravention of the United States' obligations under Article 2(b) of the *RO Agreement*. The Complainant and the Third Parties in support of the Complainant have demonstrated that the circumstances and purposes that underlay the United States changes to its textiles origin rules in section 334 amounted to an impermissible pursuit of trade policy objectives: the United States changed the definition of a product's origin by applying *per se* rules that no longer took into account the nature and degree of subsequent processing in a third country, thereby increasing the quantities of textile imports that would be subject to China's limited quota and thus protecting the United States domestic textiles and apparel industry.

40. With reference to Article 2(b) of the RO Agreement, do the parties consider that the term "used" should be interpreted to mean that a panel should assess whether rules of origin are used as instruments to pursue trade objectives as of the time they were adopted or as of the time of establishment of the panel?

REPLY: China believes that the proper focus of this Panel is the issue as framed by Complainant India in its Request for the Establishment of a Panel: "The structure of the [US] rules of origin, their implementation and administration, the circumstances under which they were adopted and their effect on the conditions of competition for textiles and apparel products demonstrate that they are used as instruments to pursue trade objectives."³⁵⁹ The request of India specifically refers to

³⁵⁹ WT/DS243/5/Rev. 1.

"the changes introduced by legislation adopted in 1994 and 2000."³⁶⁰ This Panel's Terms of Reference are "[t]o examine, in the light of the relevant provisions of the covered agreements cited by India in document WT/DS243/5/Rev.1, the matter referred to the DSB by India in that document . . ."³⁶¹

Therefore, it is appropriate for this Panel to interpret the term "used," as contained in Article 2(b) of the *RO Agreement*, with reference to circumstances and purposes that underlay the enactment by the United States of changes to its rules of origin in 1994 and 2000, as well as the implementation and administration of such revised rules since that time, up until the initiation of this Panel proceeding by Complainant India.

41. With reference to Article 2(c) of the RO Agreement, could the third parties answer the following questions:

(a) Does Article 2(c) prohibit rules of origin which create the specified effects even in cases where those effects are entirely unintentional?

REPLY: China believes that Article 2(c) of the *RO Agreement*, by its plain language, does not provide for a determination of whether the prohibited effects were "intended" by the Member. Rather, the prefatory language in Article 2 provides that "Members shall ensure that" their rules of origin do not create the prohibited effects specified in Article 2(c). If a Member's rules of origin are found to create such prohibited effects, it must be concluded that the Member has failed to ensure that this does not happen and that this failure constitutes a violation of that Member's obligation under Article 2.

(b) Does the phrase "restrictive [...] effects on international trade" mean that a complaining Member must show a net restrictive effect on international trade? Or would it be sufficient to show that the trade of one Member has adversely affected, even if the trade of another Member has been favourably affected? In the latter case, could that one Member be a Member other than the complaining Member?

REPLY: China submits that the plain language of Article 2(c) of the *RO Agreement* does not impose any condition that the "net" effect on *all* multilateral trade be restrictive. Trade between any two sovereign Nations is necessarily "international trade"; it is sufficient, therefore, to show that trade between two individual Members has been adversely affected in order to demonstrate the creation of "restrictive effects" on "international trade," the circumstance prohibited by Article 2(c).

Further, China notes that Article 2(c) of the *RO Agreement* refers to "restrictive, distorting, or disruptive effects on international trade." China believes that, while the terms "restrictive," "distorting" and "disruptive" are listed in the disjunctive -- suggesting that any one of these effects is sufficient to constitute a violation -- these three terms should be read together as connoting a comprehensive concern by Members over the effects of origin rules on *multilateral* trade. The term "distortion," for example, denotes a *multidimensional* change, one that "twist[s] out of shape" the pre-existing condition.³⁶² A "distorting" effect on international trade, therefore, must reasonably encompass a scenario in which trade between two particular Members is "restricted" or "disrupted" while trade between one of those Members and a third Member is *correspondingly* enhanced and liberalized.

³⁶⁰ Id.

³⁶¹ WT/DS243/6.

³⁶² *The New Shorter Oxford English Dictionary*, L. Brown (ed.)(Clarendon Press 1993), Vol. 1, p. 707.

(c) *Could it be said that rules of origin inherently create "restrictive" effects on international trade, inasmuch as they may require traders to fulfill certain requirements (e.g., the preparation of certificates of origin, etc.)? If so, would this suggest that Article 2(c) implies some sort of a de minimis exception? If so, what would constitute a de minimis restrictive effect? In answering this question, please address the relevance of the second sentence of Article 2(c) ("unduly strict requirements") and the fourth preambular paragraph of the RO Agreement ("unnecessary obstacles to trade").*

REPLY: China believes that Article 2(c), taken together with the fourth preambular paragraph of the *RO Agreement*, addresses the overarching concern of Members that rules of origin themselves do not create distorting effects on international trade or otherwise create unnecessary obstacles to the free flow of international trade. One may distinguish between the "restrictive, distorting or disruptive" effects that may flow from the *specific substantive provisions* of a given set of rules, and the more general administrative obstacles that may flow from the *procedural requirements* of a given set of origin rules. In the former case, there is no *de minimis* threshold; the first sentence of Article 2(c) does not speak of "unnecessarily" restrictive effects or "unduly" distorting effects. If rules of origin themselves create restrictive, distorting or disruptive effects on international trade, they do so as a result of their specific *substantive* provisions, and no degree of such effects are acceptable under a "*de minimis* exemption."

The second sentence of Article 2(c), on the other hand, may be read to refer to the administrative obstacles that naturally flow from any system in which exporters and importers are asked to document the origin of goods. It is reasonable to conclude that Members accepted a certain level of administrative burden (e.g., filing certificates of origin) as the natural consequence of trade with any Member that imposes a rules of origin regime (as most if not all Members did at the time of adoption of the *RO Agreement*). Such burdens are recognized as acceptable if they are not "unduly strict" and do not require the fulfillment of conditions not related to manufacturing or processing. A Member that imposes "unduly strict" requirements, however, has violated its obligations by failing to ensure that the rules of origin themselves do not create "unnecessary obstacles to trade."

(d) *How should the Panel assess whether particular rules of origin create "distorting" effects on international trade? What do you compare the existing rules of origin with?*

REPLY: As noted in China's response to question No. 41(b) above, the term "distortion" denotes a *multidimensional* change, one that "twist[s] out of shape" the pre-existing condition. A "distorting" effect on international trade, therefore, must reasonably encompass a scenario in which trade between two particular Members is "restricted" or "disrupted" while trade between one of those Members and a third Member is *correspondingly* enhanced and liberalized. The Panel should assess, therefore, the patterns of trade that existed prior to the changes to the rules of origin in question and compare that to the "shape" of the trade patterns that followed from the rules changes. If the patterns of trade -- the "shape" of the trading relationship among the subject countries for the products in question -- have been "twisted" as a *consequence* of the changes in the origin rules themselves, this must be found to be a distorting effect prohibited by Article 2(c).

(e) *How should the phrase "create [...] disruptive effects on international trade" be interpreted? Could the third parties give examples of cases where rules of origin might create such effects?*

REPLY: China believes that the Panel should interpret the phrase "create . . . disruptive effects on international trade" in the context of the entire first sentence of Article 2(c). As noted in China's answer to question No. 41(b) above, Article 2(c) of the *RO Agreement* refers to "restrictive, distorting, or disruptive effects on international trade." China believes that, while the

terms "restrictive," "distorting" and "disruptive" are listed in the disjunctive -- suggesting that any one of these effects is sufficient to constitute a violation -- these three terms should be read together as connoting a comprehensive concern by Members over the effects of origin rules on *multilateral* trade.

Literally, an effect that "disrupts" is one that "break[s] apart, burst[s], shatter[s]; separate[s] forcibly."³⁶³ In that sense, there is some overlap with the notion of "restrictive" and "distorting" effects on international trade, since origin rules that "break apart" pre-existing patterns of trade can be said also to "restrict" trade as to a given bilateral trade relationship or to "twist out of shape" the interlocking patterns of a multilateral trade relationship.

In this case, the Complainant and certain Third Parties have provided the Panel with specific examples in which the United States changes to its origin rules, *of themselves*, have created disruptive effects (and, to a certain degree, restrictive and distorting effects) on international trade. As discussed in China's Third-Party Submission at 3-4, the result of the enactment of section 334, with its subsequent modifications in section 405, is a patchwork of United States origin rules for textile and apparel products that arbitrarily give no consideration -- except for certain fabrics of particular interest to the European Communities -- to the value added or changes in the nature and characteristics of the product that are incurred and conferred in subsequent assembly and manufacturing operations outside the initial country in which the fabric was first woven, knitted or otherwise formed in the "greige" state. For example, certain types of fabrics have their origin determined on the basis of where the greige fabric was first woven or knitted, without regard to any subsequent processing, assembly or other manufacturing; but there is an exception to this rule for fabrics classified as silk, cotton, man-made fibres or vegetable fibres -- the particular fibres of interest to the European Communities -- which *will* have origin determined by consideration of the subsequent processing operations (such as dyeing, printing, bleaching, napping, etc.). A web of other exceptions and modifications results in a situation in which some non-apparel textile products are conferred origin based on the country in which the fabric was created in its greige state, while other non-apparel textile products will be conferred origin based on the location of certain subsequent processes and finishing operations; yet other exceptions and modifications result in different origin determinations depending upon whether a fibre blend contains less than or more than 16% cotton.³⁶⁴

(f) What is the relationship between the first and second sentences of Article 2(c)? Do they provide for distinct and independent obligations, such that the second sentence adds an obligation which is not already covered by the first sentence? Or does the second sentence simply spell out one aspect, or consequence, of the obligation set out in the first sentence?

REPLY: As noted in China's answer to question No. 41(c) above, China believes that the second sentence of Article 2(c) provides for a distinct and independent obligation on the part of Members, which relates to the Members' concerns over the administrative obstacles that naturally flow from any system in which exporters and importers are required to document the origin of goods. This reflects a distinction between the "restrictive, distorting or disruptive" effects that may flow from the *specific substantive provisions* of a given set of rules, and the more general administrative obstacles that may flow from the *procedural requirements* of a given set of origin rules. In the former case, there is no relative notion of "unnecessarily" restrictive effects or "unduly" distorting effects. If rules of origin themselves create restrictive, distorting or disruptive effects on international trade, they do so as a result of their specific *substantive* provisions, and *no* degree of such effects are acceptable.

The use of the relative concept of "unduly strict" in the second sentence of Article 2(c), on the other hand, suggests that Members accepted a certain level of administrative burden (e.g., filing

³⁶³ *The New Shorter Oxford English Dictionary*, L. Brown (ed.)(Clarendon Press 1993), Vol. 1, p. 703.

³⁶⁴ See *United States -- Rules of Origin for Textiles and Apparel Products*, WT/DS243, First Submission of India (30 October 2002), at 9-16.

certificates of origin) as the natural consequence of trade with any Member that imposes a rules of origin regime (as most if not all Members did at the time of adoption of the *RO Agreement*). Such burdens are recognized as acceptable if they are not "unduly strict" and do not require the fulfillment of conditions not related to manufacturing or processing. A Member that imposes "unduly strict" requirements, however, has violated its obligations by failing to ensure that the rules of origin themselves do not create "unnecessary obstacles to trade," as referred to in the fourth preambular paragraph of the *RO Agreement*.

42. Assume that in the framework of multilateral tariff negotiations Member X requests Member Y to grant a tariff concession with respect to product Z (of which Member X is the principal supplier) and Member X obtains that concession on an MFN basis. Assume further that Member Y refuses to grant a tariff concession with respect to product Q (of which Member R is the principal supplier). In those circumstances, could it be said that Member X has obtained from Member Y a de facto advantage contrary to Article I of the GATT 1994? Why (not)? Is this different from the United States providing, at the request of the European Communities, for exceptions from the fabric formation rule with respect to specified products and regardless of the "origin" of those products?

REPLY: China believes that concessions granted (or withheld) in the context of multilateral tariff negotiations are quite distinct from unilateral action by one Member to change its rules of origin in a way that disadvantages particular Members with respect to particular products. Multilateral negotiations over concessions in tariff levels span -- virtually by definition -- all Members and (potentially) all products. The results of such multilateral negotiations, which involve the give and take of all Members, are made final and enforceable only after the agreement of all Members. It is well within the prerogative of a given Member to endorse a multilateral tariff concession agreement that may put that Member at a disadvantage *vis-à-vis* other Members with respect to certain products, if that Member has concluded that other provisions in the multilateral agreement provide advantages to the Member that equal or outweigh the disadvantages.

It is quite a different matter when, as in this case, the United States has unilaterally changed its rules of origin -- not once, but twice -- such that the modified rules of origin themselves restrict, distort and disrupt trade to the disadvantage of particular Members. The actions by the United States in 1994 and 2000 were not the result of any multilateral tariff concession negotiations. As demonstrated in the Third-Party Submission of China and in the First Submission of India to this Panel, the changes wrought by the United States to its rules of origin in section 334 were not the result of any multilateral agreement on particular changes to textile and apparel origin rules; likewise, the changes enacted by the United States in section 405 were not the result of multilateral negotiations. Rather, section 405 was a unilateral action taken by the United States, to the detriment of China and other Members, in order to appease one particular Member -- the EU -- and to avoid the difficulty of defending the provisions of section 334 before the WTO. In this respect, it can be said that the United States has granted the EU a *de facto* advantage over certain other Members, contrary to the requirements of Article 1 of GATT 1994, and contrary to the obligation under Article 2(d) that rules of origin not discriminate between other Members.

43. With reference to Article 5.1 of the Agreement on Textiles and Clothing, could the parties please answer the following questions:

(a) What is the meaning of the term "circumvention" as that term is used in Article 5.1? Please provide documentary support if available (e.g., WTO documents, negotiating documents, view of experts, etc.)?

REPLY: China believes that a textual analysis of Article 5.1 makes clear that "circumvention" as defined therein is limited to a specified set of activities that involves either the

evasive movement of goods, false documentation, or both. Specifically, Article 5.1 refers to "circumvention *by* transshipment, re-routing, false declaration concerning country or place of origin, and falsification of official documents." Article 5.1 further provides that Members should take necessary action against "*such* circumvention." Thus, even if "circumvention" in a general sense can be considered to encompass circumstances or activities other than the ones expressly listed in Article 5.1, the text and structure of Article 5.1 clearly show that only the four specified activities constitute "circumvention" within the meaning of that Article.³⁶⁵

China notes, furthermore, that none of the four specified activities that constitute "circumvention" under Article 5.1 involves any activity related to *manufacturing* or *processing*. Each of the four specified activities relates either to the evasive *movement* of goods from the original country of manufacture to other locations prior to import ("transshipment," "re-routing"), or to the *falsification* of documents that are relevant to the determination of origin ("false declarations concerning country or place of origin," "falsification of official documents"). In either case, the condition and characteristics of the goods after leaving the original place of manufacture have not physically changed through any subsequent *manufacturing* or *processing* activity. Therefore, to the extent that any Member takes the position that physical alteration of the condition and characteristics of the goods, as a result of subsequent manufacturing or processing activity, constitutes "circumvention," that Member has exceeded its authority under Article 5.1 to address "*such* circumvention."

(b) Does "circumvention" as that term is used in Article 5.1 cover both quota "evasion" (i.e., illegal action such as fraud, etc.) as well as quota "avoidance" (i.e., legal action intended to minimise the impact of a quota, etc.)?

REPLY: As noted in China's answer to question No. 43(a), "circumvention" as defined in Article 5.1 is limited to a specified set of activities that involves either the evasive movement of goods, false documentation, or both. In either case, false representations and/or false documentation (*i.e.*, illegal action) must be present to frustrate the purposes of the Agreement. Any other interpretation would render the references in Article 5.1 to "transshipment" and "re-routing" overly broad and essentially meaningless.

For example, a producer may wish, for whatever reason, to ship his products from the original country of manufacture to a third country, where the products will be stored and then re-shipped to the ultimate country of end-use. So long as the parties to the transactions accurately report the true (original) country of manufacture, there would be no difference in duty assessment, application of quotas, statistical reporting or other aspects of the importing Member's treatment of those products. This type of "transshipment," therefore, cannot be considered the type of activity that Members believed would frustrate the implementation of the Agreement. Thus, the type of "transshipments" envisioned as "circumvention" in Article 5.1 must contain an element of misrepresentation, deception, or other falsification that would enable the parties involved to obtain some advantage in the importing Member's treatment of the products for duty assessment, quota application or other aspects.³⁶⁶

In this regard, quota "avoidance" - *legal* action intended to minimize the impact of a quota - is not within the ambit of "circumvention" as defined in Article 5.1. At the same time, the options available for *legal* "avoidance" of quotas by way of "transshipment" or "re-routing" are limited, if they indeed exist at all. So long as a quota is defined with reference to a given product's original country of manufacture, it would seem that no amount of "transshipment" or "re-routing" of the

³⁶⁵ If Members had wished the definition of "circumvention" to encompass more than the four specified activities, it would have been a simple matter to insert the words "for example," "*inter alia*" or other such terms to indicate that the list of activities was not exhaustive. Furthermore, Members could have agreed to remove the limiter "such" when referring to "circumvention" later in the Article.

³⁶⁶ The same can be said for circumvention by "re-routing."

product would result in avoidance of the quota, *unless* an element of misrepresentation, deception or other falsification were included. At that point, of course, the activity no longer qualifies as "legal avoidance" and instead must be considered "circumvention" within the meaning of Article 5.1.

Again, China wishes to stress that the definition of "circumvention" in Article 5.1 nowhere refers to any activity related to *manufacturing* or *processing*. Each of the four specified activities in Article 5.1 relates either to the evasive *movement* of goods from the original country of manufacture to other locations prior to import, or to the *falsification* of documents that are relevant to the determination of origin. In either case, the condition and characteristics of the goods after leaving the original place of manufacture have not physically changed through any subsequent *manufacturing* or *processing* activity.

(c) Does outward processing involving no fraud, false declaration, etc. constitute quota "circumvention" within the meaning of Article 5.1?

REPLY: China submits that, in light of the conclusions that follow from the discussion in its answers to questions 43(a) and (b) above, the answer here is clearly "No."

As noted in China's answer to question No. 43(a), none of the four specified activities that constitute "circumvention" under Article 5.1 involves any activity related to *manufacturing* or *processing*. Each of the four specified activities relates either to the evasive *movement* of goods from the original country of manufacture to other locations prior to import ("transshipment," "re-routing"), or to the *falsification* of documents that are relevant to the determination of origin ("false declarations concerning country or place of origin," "falsification of official documents"). In either case, the condition and characteristics of the goods after leaving the original place of manufacture have not physically changed through any subsequent *manufacturing* or *processing* activity. Therefore, to the extent that any Member takes the position that physical alteration of the condition and characteristics of the goods, as a result of subsequent manufacturing or processing activity, constitutes "circumvention," that Member has exceeded its authority under Article 5.1 to address "*such* circumvention."

In the case before the Panel, the United States has rested the justification for its substantive changes to origin rules on its concerns over "circumvention." As noted in the Third-Party Submission of China, the United States argues that changes to its rules of origin were necessary "to reduce circumvention of quota limits through illegal transshipment."³⁶⁷ As China has shown, however, this argument ultimately amounts to a concession that the origin rules were in fact used to pursue trade objectives. The textile quota limits enforced by the United States depend entirely on an accurate determination, based on true and correct information, of the actual country of origin of the product. As shown, however, the substantive revisions to the origin rules enacted in section 334 *changed* the country of origin outcome for particular textile and apparel products, as compared with United States origin determinations prior to section 334, *under the same set of facts*. These substantive revisions changed the nature and degree of the subsequent *manufacturing* and *processing* activity that the United States would consider sufficient to confer origin on particular products. Yet, as noted above, none of the four specified activities that constitute "circumvention" under Article 5.1 involves any activity related to *manufacturing* or *processing*.

(d) What is "circumvention by transshipment"? Would this necessarily involve some illegal actions such as fraud, false declaration, etc., or could the mere fact that shipments are transiting through third countries with or without alterations made to the goods concerned be considered "circumvention"?

³⁶⁷ *United States -- Rules of Origin for Textile and Apparel Products, first written submission* of the United States (November 27, 2002), at 7.

REPLY: As noted in China's answer to question No. 43(b) above, China believes that the type of "transshipments" envisioned as "circumvention" in Article 5.1 must contain an element of misrepresentation, deception, or other falsification that would enable the parties involved to obtain some advantage in the importing Member's treatment of the products for duty assessment, quota application or other aspects. For example, a producer may wish, for whatever reason, to ship his products from the original country of manufacture to a third country, where the products will be stored and then re-shipped to the ultimate country of end-use. So long as the parties to the transactions accurately report the true (original) country of manufacture, there would be no difference in duty assessment, application of quotas, statistical reporting or other aspects of the importing Member's treatment of those products. This type of "transshipment," therefore, cannot be considered the type of activity that Members believed would frustrate the implementation of the Agreement.³⁶⁸

For China:

44. What could the United States have done "to improve the collection of true and correct information regarding the actual source and location of the materials and particular production processes" rather than "simply change the substantive origin rules"? (China's written submission, para. 17)

REPLY: In China's view, the concern of the United States regarding "circumvention" could have been addressed, in a manner consistent with its obligations under the *RO Agreement*, by implementing measures intended to ensure more accurate information regarding the location of manufacturing and production processes, so that the substantive rules of origin already being applied by the United States would lead to more uniform and correct results and reduce the instances in which imports were not correctly allocated to the appropriate quotas.

Such measures could have included a wide variety of pre-emptive and punitive measures, such as: (1) more resources (funds and manpower) devoted to coordination with the customs agencies of third countries that are thought to be the source of major "circumvention" efforts; (2) increased penalties (criminal and civil) for falsification of documentation relevant to determining the true country of origin of imported goods; (3) more resources (funds and manpower) devoted to United States Customs' inspection and verification of imported goods and accompanying documentation; and (4) gathering of more complete information regarding the nature and extent of foreign industries of particular concern to the United States, so that this intelligence could assist in the inspection and verification of the origin of imported goods.

Each of these measures would have enhanced the United States' enforcement of its textile quota limits, for example. Such quotas depend entirely on an accurate determination, based on true and correct information, of the actual country of origin of the product. At the same time, as noted in China's response to question No. 43(a) above, the notion of "circumvention," as defined in Article 5.1 of the Agreement on Textiles, involves either the evasive movement of goods, false documentation, or both. In either case, false representations and/or false documentation (*i.e.*, illegal action) must be present to frustrate the purposes of the Agreement. Thus, actions to combat circumvention that are

³⁶⁸ It is conceivable, although highly unlikely, that a Member could define the country of origin of a good for quota purposes as being the last country in which the good was physically present prior to importation into the Member country, regardless of the location of any original or subsequent manufacturing or processing of the good. In that case, a producer or importer could obtain an advantage by simply "transshipping" the good from the country subject to the quota to another country prior to importation into the Member country. It is questionable whether the Member, having chosen to define country of origin in this manner, would consider such a transshipment as "circumvention." In any event, China believes that the *RO Agreement* -- and indeed the origin rules of virtually every Member -- depends upon the notion of where the good is *produced* or *processed*, not where it happens to be shipped after completion of the manufacturing or processing. See Article 9(1)(b) of the *RO Agreement*.

consistent with the United States' multilateral obligations would focus on mechanisms to prevent the evasive movement of goods and false documentation. In contrast, actions that change the substantive rules on the nature and degree of *manufacturing* or *processing* that a Member deems sufficient to confer origin, as the United States has done in this case, have nothing to do with preventing circumvention; they are, rather, a veiled use of origin rules as an instrument to pursue trade objectives, in violation of Article 2(b) of the *RO Agreement*.

ANNEX B-2

ANSWERS OF THE EUROPEAN COMMUNITIES TO QUESTIONS FROM THE PANEL

Question 39: Do the third parties consider that Article 2(b)-(e) of the RO Agreement could be relied on to challenge a change in rules of origin per se, as opposed to the specific rules of origin in force at the time a challenge is brought? In other words, could a panel uphold claims under Article 2(b)-(e) that a change in rules of origin of itself is contrary to these provisions?

In the European Communities' view the answer to this question is yes. While it is clear that Members are not prevented from changing their rules of origin during the transitional period (otherwise Article 2(i) would not make sense), it is equally obvious that they cannot do so if that change, for example, is made to pursue trade objectives within the meaning of Article 2(b). Such a change in the rules of origin would be open to challenge under that provision.

Question 40: *With reference to Article 2(b) of the RO Agreement, do the third parties consider that the term "used" should be interpreted to mean that a panel should assess whether rules of origin are used as instruments to pursue trade objectives as of the time they were adopted or as of the time of establishment of the panel?*

Whether the panel is to assess rules of origin as of the time they were adopted or as of the time of establishment of the panel, depends on what is challenged. If the rules themselves are challenged, the relevant point in time is the adoption of the rules. If the application of the rules is challenged, the relevant point in time is the establishment of the panel.

Question 41: *With reference to Article 2(c) of the RO Agreement, could the third parties answer the following questions:*

Question 41 (a): *Does Article 2(c) prohibit rules of origin which create the specified effects even in cases where those effects are entirely unintentional?*

In the European Communities' view the answer to this question is yes. Intent is not relevant in Article 2(c) for three reasons. First, there is no mention whatsoever of intentional elements in the text itself. Second, such elements, at the same time, are amply present in Article 2(b), so that a contextual analysis points to the conclusion that intent was not meant to be in Article 2(c), but in Article 2(b). And third, reading intent into Article 2(c) would make a distinction between Article 2(b) and Article 2(c) impossible, which is contrary to the principle of effective treaty interpretation.

Question 41 (b): *Does the phrase "restrictive [...] effects on international trade" mean that a complaining Member must show a net restrictive effect on international trade? Or would it be sufficient to show that the trade of one Member has adversely affected, even if the trade of another Member has been favourably affected? In the latter case, could that one Member be a Member other than the complaining Member?*

In the European Communities' view it is not necessary to show a *net* effect on international trade. In principle, it is enough to show the effect on just one Member. This may be the complaining Member itself or another Member. The latter point, in the European Communities' view is supported, on the one hand, by the text of Article 2(c) itself ("international trade" instead of "trade of a given Member") and, on the other hand, by the findings of the Appellate Body in the case *European Communities - Bananas* regarding the issue of *locus standi* requirements.³⁶⁹

³⁶⁹ Appellate Body Report, *EC – Bananas III*, *supra*, para. 132 ff.

Question 41 (c): *Could it be said that rules of origin inherently create "restrictive" effects on international trade, inasmuch as they may require traders to fulfil certain requirements (e.g., the preparation of certificates of origin, etc.)? If so, would this suggest that Article 2(c) implies some sort of a de minimis exception? If so, what would constitute a de minimis restrictive effect? In answering this question, please address the relevance of the second sentence of Article 2(c) ("unduly strict requirements") and the fourth preambular paragraph of the RO Agreement ("unnecessary obstacles to trade").*

In order to reply to these questions, it is, in the European Communities' view necessary to make a number of clarifications. First, it is important to keep in mind that the concept of "rules of origin" refers to requirements both on a substantive and on a formal level. On a substantive level rules of origin establish origin-conferring criteria, on a formal level they set conditions necessary to proceed with an origin determination in a given case. On both levels international trade has faced and is facing restrictive effects, which is the very reason why the Agreement on Rules of Origin has been negotiated. If that agreement provides for different stages, it is because time and further negotiation is required to address some of the problems related to origin rules, and in particular to achieve a harmonisation of the origin-conferring criteria relied upon by the Members.

Against this background, the European Communities would agree with the proposition that rules of origin inherently create "restrictive" effects on international trade, inasmuch as they may require traders to fulfil certain requirements such as the preparation of certificates etc. It would suggest, however, that such "inherent" effects are not the ones meant by Article 2(c) first sentence. For that reason, also, it does not believe, that there exists a *de minimis* requirement in Article 2 (c). As the European Communities has already stated in its submission,³⁷⁰ *de minimis* requirements are usually spelled out in the specific areements, if and where they are intended.

The European Communities would also note that the concepts of unduly strict requirements in the second sentence of Article 2(c) and unnecessary obstacles in the Preamble, to which the Panel points, suggest that the Agreement is concerned with non-inherent effects and those that are disproportionate to the objective pursued and is not intended to prevent origin rules from being applied at all.

Question 41 (d): *How should the Panel assess whether particular rules of origin create "distorting" effects on international trade? What do you compare the existing rules of origin with?*

The European Communities agrees that it is necessary to compare rules with an appropriate benchmark. Given that Article 2(c) covers a number of different cases, that benchmark may vary and, therefore, may have to be established on a case by case basis. In the European Communities' view, where changes of origin rules are addressed, effects can be shown in a comparison with the *status quo ante* of a given country.

Question 41 (e): *How should the phrase "create [...] disruptive effects on international trade" be interpreted? Could the third parties give examples of cases where rules of origin might create such effects?*

An example for disruptive effects on international trade would be if an export activity would have to be stopped because of the change in origin rules.

Question 41 (f): *What is the relationship between the first and second sentences of Article 2(c)? Do they provide for distinct and independent obligations, such that the second sentence adds an*

³⁷⁰ See, submission of the European Communities, para. 30 (*supra*, para. 4.284).

obligation which is not already covered by the first sentence? Or does the second sentence simply spell out one aspect, or consequence, of the obligation set out in the first sentence?

In the European Communities' view, Article 2(c) first sentence and Article 2(c) second sentence have to be read as two distinct and independent obligations. First, a textual analysis does not point to there being a relationship between the two sentences. If, the second sentence were meant to be an "aspect" or a "consequence" of the first, there would have been an element of linkage in the text such as for example "in particular" or "therefore." Second, the second sentence is clearly not about effect, but rather about the structure of the origin rules as such. Therefore, from a point of view of logic, the two sentences do not belong together.

Question 42: *Assume that in the framework of multilateral tariff negotiations Member X requests Member Y to grant a tariff concession with respect to product Z (of which Member X is the principal supplier) and Member X obtains that concession on an MFN basis. Assume further that Member Y refuses to grant a tariff concession with respect to product Q (of which Member R is the principal supplier). In those circumstances, could it be said that Member X has obtained from Member Y a de facto advantage contrary to Article I of the GATT 1994? Why (not)? Is this different from the United States providing, at the request of the European Communities, for exceptions from the fabric formation rule with respect to specified products and regardless of the "origin" of those products?*

In the European Communities' view the example given by the Panel is not a case of MFN violation. The MFN principle requires Members to treat all other Members equally in the application of tariffs, custom duties and other measures related to the importation or exportation of a good. The MFN principle does not, however, require Members to treat equally products that are not like. Indeed, Members are free to apply individual policies to individual products even if these policies affect other Members in unequal ways. WTO law does not prescribe a substantive standard on what tariff (and other measures) should apply to what products.³⁷¹

The same logic applies to rules of origin. As long as there is no harmonisation, Members may apply individual origin-conferring criteria for individual products even if other Members are affected differently by the individual choices. Discrimination (as prohibited by Article 2(d)) only exists where Members are treated differently with regard to the same product.

Question 43: *With reference to Article 5.1 of the Agreement on Textiles and Clothing, could the third parties please answer the following questions:*

³⁷¹ The concept of *de facto* discrimination as developed by the Appellate Body in the case Canada Automotive follows the above logic that MFN is about discrimination between countries and not between products. Indeed, in that case the *de facto* discrimination was found to reside in the fact that one and the same product – cars – was being treated differently with regard to different countries as a tariff advantage was granted *de facto* only to cars from certain countries (and brands) and not to cars from other countries. Appellate Body Report, *Canada – Autos*, *supra*, in particular para. 81.

The European Communities would like to point out that the issue of circumvention, in the present case, is of relevance because the United States has used it as a justification for changing its rules of origin in 1996. It has done so without referring to the ATC. In light of this, the European Communities questions the relevance of the questions below. In its view the exact interpretation of Article 5.1. of the ATC is not particularly relevant here. Neither does the *RO Agreement* itself use that notion, nor is it obligatory that whatever meaning is to be given to "circumvention" in the context of Article 5.1. of the ATC necessarily has to be employed in the context of the application of the *RO Agreement*. The ATC and the *RO Agreement* do not pursue the same objective and may provide for different means of addressing a given situation.

Question 43 (a): *What is the meaning of the term "circumvention" as that term is used in Article 5.1? Please provide documentary support if available (e.g., WTO documents, negotiating documents, views of experts, etc.)?*

The dictionary defines the act of "circumventing" as "deceiving, outwitting, overreaching; finding a way round, evading (a difficulty)"³⁷² thus leaving open the question whether a fraudulent behaviour is necessarily involved or not. Whether Article 5.1. of the ATC presupposes such behaviour is not expressly stated in the text as that provision does not offer a definition of circumvention, but merely refers to certain ways of achieving it (see Raffaelli and Jenkins, "The Drafting History of the Agreement on Textiles and Clothing", ITCB Geneva, at p. 101). In any event, in the European Communities' view the question as to what specific meaning "circumvention" might have in the context of Article 5.1. ATC can be left open. It is by no means obligatory that the meaning of that word in Article 5.1. ATC is automatically relevant for the assessment of what may be a legitimate objective in the context of Article 2(b) of the *RO Agreement*.

Question 43 (b): *Does "circumvention" as that term is used in Article 5.1 cover both quota "evasion" (i.e., illegal action such as fraud, etc.) as well as quota "avoidance" (i.e., legal action intended to minimise the impact of a quota, etc.)?*

In light of what has been said above, for the European Communities the question of the legal or illegal character of "circumvention" has to be addressed in the specific context of the Agreement on the Rules of Origin. Article 2(b), in the view of the European Communities is about preventing that origin rules are used to manipulate trade patterns that would have legitimately arisen under the existing set of rules. Therefore, for the purposes of the application of Article 2(b) it is clear that such trade patterns that do not violate any (so far) existing provisions, must be protected from being manipulated (disrupted/distorted/restricted) through a change in origin rules.

Question 43(c): *Does outward processing involving no fraud, false declaration, etc. constitute quota "circumvention" within the meaning of Article 5.1?*

Outward processing involves an origin conferring activity. From a point of view of origin rules, therefore, it cannot be considered a circumvention.

³⁷² The New Shorter Oxford English Dictionary, L. Brown (ed.) (Clarendon Press, 1993), Vol. I, p. 406.

Question 43 (d): *What is "circumvention by transshipment"? Would this necessarily involve some illegal action such as fraud, false declaration, etc., or could the mere fact that shipments are transiting through third countries with or without alterations made to the goods concerned be considered "circumvention"?*

To "transship" is defined in the dictionary as meaning to "transfer (cargo etc.) from one ship or form of transport to another."³⁷³ On the basis of that definition, transshipment in itself does not constitute circumvention, neither in a "legal" nor in an "illegal" sense. The mere fact that a product is being transferred from one means of transport to another does not change its origin; the same is true if the transfer takes place in another country through which the product transits. If the original declaration of origin is sent along, the authorities in the country of the final destination would be able to determine origin correctly and apply quota restrictions if there are any.

Question 45: *The European Communities suggests that Article 2(c) of the RO Agreement requires a showing of actual restrictive or distorting effects and that such actual effects would need to be demonstrated through trade statistics (European Communities' written submission, paras. 28 and 32). At the same time, the European Communities argues that protectionist intent would be indicated if what the European Communities calls a "quota-effect" could be demonstrated, i.e., if it could be demonstrated, for instance, that certain products which used to be quota-free before certain rules of origin entered into force are subject to a quota after the entry into force of those rules (European Communities' written submission, paras. 23-24). Would a clear demonstration of such a (potential) "quota-effect", when there is no demonstration of actual adverse impact on the trade of a Member, be sufficient to establish restrictive or distorting effects under Article 2(c)?*

No. Such a clear demonstration of a "quota-effect", however, would play its role in establishing protectionist intent in Article 2(b) in that it would indicate that the "design and architecture" of the measure at hand shows this intent.

³⁷³ The New Shorter Oxford English Dictionary, L. Brown (ed.) (Clarendon Press, 1993), Vol. II, p. 3374.

ANNEX B-3

ANSWERS OF THE PHILIPPINES TO QUESTIONS FROM THE PANEL

Question 39. Do the parties consider that Article 2(b)-(e) of the RO Agreement could be relied on to challenge a change in rules of origin per se, as opposed to the specific rules of origin in force at the time a challenge is brought? In other words, could a panel uphold claims under Article 2(b)-(e) that a change in rules of origin of itself is contrary to these provisions?

Article 2(b)-(e) can be relied upon to challenge a change in the rules of origin *per se* insofar as, among others, it results in the consequences proscribed by Article 2(b)-(e) of the *RO Agreement*. In addition, where the changes themselves are meant to or inevitably result in the implementation of policy which discriminates between WTO Members, then such changes themselves may be said to be in derogation of the principles established under Article 2(b)-(e).

Question 40. With reference to Article 2(b) of the RO Agreement, do the parties consider that the term "used" should be interpreted to mean that a panel should assess whether rules of origin are used as instruments to pursue trade objectives as of the time they were adopted or as of the time of establishment of the panel?

The term "used" should be construed in the context of the time in which the rules of origin themselves were adopted. In this particular case, the change in the rules of origin especially section 405 of the Trade and Development Act had the patent objective at the time they were adopted of providing preferential treatment in favor of the European Communities for the purpose of dissuading the latter from pursuing the dispute proceedings it had filed against the United States. While it may be the case that the existing rules under section 405 continue to serve the objective of providing preferential treatment even as of the time of the establishment of the panel, this "use" was especially true and particularly of more import at the time section 405 was adopted.

Question 41. With reference to Article 2(c) of the RO Agreement, could the third parties answer the following questions:

(a) Does Article 2(c) prohibit rules of origin which create the specified effects even in cases where those effects are entirely unintentional?

Yes, Article 2(c) prohibits such rules of origin even where their effects are entirely unintentional. The issue of intent is very difficult to ascertain, especially where it would incriminate the Member implementing the rules of origin. In such a situation, documentary evidence proving the intent sought to be established, if any existed, would obviously be difficult to access. Subsidiarily, to the extent that intent is a "state of mind" of the government or at least certain officials of the Member in question, one would have to divine or ascertain such "state of mind" existing at the time the rules of origin were adopted.

Furthermore, if intent were deemed to be a necessary element which needs to be proved under Article 2(c), any Member whose rules of origin are being challenged may conveniently assert the defense that the effects specified under Article 2(c) are "entirely unintentional" and thereafter avoid culpability under the WTO. Certainly, this could not have been the intention of the negotiators when they drafted the final text of the *RO Agreement*.

(b) Does the phrase "restrictive [...] effects on international trade" mean that a complaining Member must show a net restrictive effect on international trade? Or would it be sufficient to show that the trade of one Member has been adversely affected, even if the trade of another Member has

been favorably affected? In the latter case, could that one Member be a Member other than the complaining Member?

No, a complaining Member need not show a *net* restrictive effect, it being sufficient that the trade of that Member or any other Member has been adversely affected. A contrary interpretation would mean that a complaining Member would have to conduct a thorough, comprehensive investigation of how the rules of origin of the Member complained against have affected the trade of each and every Member and then evaluate how these trade effects sum up on each side of the equation. It is our sense that such a mode of evaluation of the restrictive effects on international trade of a particular set of rules of origin is too encompassing and unduly comprehensive as to have been intended by the negotiators of the *RO Agreement*.

Furthermore, a contrary interpretation would mean that a Member may impose a measure which benefits a major trading partner to the detriment of trade with other less major trading partners, and justify such preferential or discriminatory practice on the basis that the net effect of such a measure does not or will not result in a reduction in the level of international trade.

(c) Could it be said that rules of origin inherently create "restrictive" effects on international trade, inasmuch as they may require traders to fulfill certain requirements (e.g., the preparation of certificates of origin, etc.)? If so, would this suggest that Article 2(c) implies some sort of a de minimis exception? If so, what would constitute a de minimis restrictive effect? In answering this question, please address the relevance of the second sentence of Article 2(c) ("unduly strict requirement") and the fourth preambular paragraph of the RO Agreement ("unnecessary obstacle to trade").

The concept of "restrictive effects" on international trade generally speaking must be understood to relate to how a certain measure impedes or diminishes a Member's ability to effectively trade or export its products to another Member. Such "restrictive effects" must be distinguished from reasonable, necessary, and oftentimes procedural, requirements which may be imposed upon products imported by a Member. For instance, in the ordinary course of trade, the preparation of certificates of origin are presumably reasonable and necessary requirements, the fulfillment of which would not result in a diminution or impediment to the ability of a Member to effectively export its products to the imposing Member. Where the criteria and substantive modality for ascertaining the origin to be marked upon the certificate however has the effect of impeding or diminishing a Member's ability to effectively export its product(s) of interest to the imposing Member, as is the case in the present dispute, then such criteria and substantive modalities have "restrictive effects" on international trade.

In this sense, it may be admitted that Article 2(c) implies some sort of a *de minimis* exception. More properly, however Article 2(c) implies a "reasonableness" exception, such that a reasonable and necessary requirement may be deemed as not necessarily having "restrictive effect." In this regard, the imposition by an importing Member of "unduly strict requirements" forming "unnecessary obstacles to trade" fall outside the ambit of "reasonable" exceptions insofar as they have the effect of impeding or diminishing a Member's ability to effectively export its products.

(d) How should the panel assess whether particular rules of origin create "distorting" effects on international trade? What do you compare the existing rules of origin with?

(e) How should the phrase "create [...] disruptive effects on international trade" be interpreted? Could the third parties give examples of cases where rules of origin might create such effects?

The Philippines prefers to provide a consolidated answer to these two questions.

As indicated by India in its submission, which the Philippines fully subscribes with, rules of origin create "distorting" effects on international trade if they modify the pattern of international trade

by changing either the type of product traded in international trade or the direction of international trade flows. In concrete terms, the change in the United States rules of origin created distorting effects because they shifted origin from a third country, such as the Philippines, where the fabric was dyed and printed and subjected to two further finishing operations to the country, e.g., India, where the greige fabric was formed. For purposes of calculating quota usage, India as a restrained Member is constrained to account for the export of fabrics to the United States even if these were otherwise substantially transformed in the Philippines. To the extent that these otherwise substantially transformed fabrics and apparel are counted against India's export quotas to the United States, which are empirically proved to be almost always fully utilized, if not exceeded, then the Philippines' ability to export its products made up of greige fabrics 'originating' from India is substantially impaired. Moreover, since the amended rules favored products of export interest to the European Communities over products of export interest to other, mostly developing, countries, the rules consequently distorted the flow of trade away from developing countries in favor of the European Communities.

Likewise, as articulated by the Philippines in support of the Indian argument, the sheer complexity and arbitrary nature of the criteria used in determining origin under the United States' amended rules of origin create trade-disruptive effects. The challenged measures allow more favorable access to certain products vis-à-vis other products. For instance, the rule on substantial transformation is applied differently depending on fiber composition, i.e., wool, silk, cotton and even the blend of cotton. There is no cogent reason for this other than to obviously favor the products of export interest to the European Communities over products of export interest to developing countries.

(f) What is the relationship between the first and second sentences of Article 2(c)? Do they provide for distinct and independent obligations, such that the second sentence adds an obligation which is not already covered by the first sentence? Or does the second sentence simply spell out one aspect, or consequence, of the obligation set out in the first sentence?

The first and second sentences of Article 2(c) provide for distinct and independent obligations, such that the second sentence adds an obligation which is not already covered by the first sentence. The first sentence more properly relates to the effects on international trade that ought to be avoided by a Member's rules of origin. As earlier indicated in certain responses, the restrictive, distorting and disruptive effects may be assessed even from a particular country's perspective and experience. In the sense that a particular requirement imposed by an importing Member may impede or diminish an exporting Member's ability to effectively export a product of export interest to it, such requirement may be said to have a "restrictive effect." This however does not preclude a more specific examination under the test established under the second sentence of how a particular requirement imposed by an importing Member's may in fact pose an unduly strict requirement or obligation on the part of the exporting Member such that while it may or may not have a "restrictive effect" it, for instance, increases the cost or the burden, be it in actual, administrative or other terms, of exporting the product.

7.1 Question 42. Assume that in the framework of multilateral tariff negotiations Member X requests Member Y to grant a tariff concession with respect to product Z (of which Member X is the principal supplier) and Member X obtains that concession on an MFN basis. Assume further that Member Y refuses to grant a tariff concession with respect to product Q (of which Member R is the principal supplier). In those circumstances, could it be said that Member X has obtained from Member Y a de facto advantage contrary to Article I of the GATT 1994? Why (not)? Is this different from the United States providing, at the request of the European Communities, for exceptions from the fabric formation rule with respect to specified products and regardless of the "origin" of those products?

7.2 In the first place, it may not be appropriate to compare the situation in which the European Communities was able to obtain exceptions from the fabric formation rule with respect to specific products with the situation of multilateral tariff negotiations. In the former situation, only the European Communities given its inherently stronger negotiating leverage, was in a position to obtain

the concessions it got. Other Members were not similarly situated, i.e., not every other Member was in a position to file dispute settlement proceedings and use the advantage of their large and diverse trading interest and ability to use, for instance, retaliatory measures to compel the United States to come to a settlement. In contrast, in the on-going multilateral tariff negotiations, each Member has at least an equal opportunity to request from another Member a concession with respect to a particular product of export interest to it.

Question 43. *With reference to Article 5.1 of the Agreement on Textiles and Clothing, could the third parties please answer the following questions:*

- (a) *What is the meaning of the term "circumvention" as that term is used in Article 5.1? Please provide documentary support if available (e.g., WTO documents, negotiating documents, views of experts, etc.)?*
- (b) *Does "circumvention" as that term is used in Article 5.1 cover both quota "evasion" (i.e., illegal action such as fraud, etc.) as well as quota "avoidance" (i.e., legal action intended to minimise the impact of a quota, etc.)?*
- (c) *Does outward processing involving no fraud, false declaration, etc. constitute quota "circumvention" within the meaning of Article 5.1?*
- (d) *What is "circumvention by transshipment"? Would this necessarily involve some illegal action such as fraud, false declaration, etc., or could the mere fact that shipments are transiting through third countries with or without alterations made to the goods concerned be considered "circumvention"?*

The Philippines declines the opportunity to respond to these questions.

ANNEX C

19 CFR

§ 102.21 Textile and apparel products.

(a) *Applicability.* Except for purposes of determining whether goods originate in Israel or are the growth, product, or manufacture of Israel, and except as otherwise provided for by statute, the provisions of this section shall control the determination of the country of origin of imported textile and apparel products for purposes of the Customs laws and the administration of quantitative restrictions. The provisions of this section shall apply to goods entered, or withdrawn from warehouse, for consumption on or after 1 July 1996.

(b) *Definitions.* The following terms shall have the meanings indicated when used in this section: (1) *Country of origin.* The term country of origin means the country, territory, or insular possession in which a good originates or of which a good is the growth, product, or manufacture. (2) *Fabric-making process.* A *fabricmaking process* is any manufacturing operation that begins with polymers, fibers, filaments (including strips), yarns, twine, cordage, rope, or fabric strips and results in a textile fabric.

(3) *Knit to shape.* The term *knit to shape* applies to any good of which 50 percent or more of the exterior surface area is formed by major parts that have been knitted or crocheted directly to the shape used in the good, with no consideration being given to patch pockets, appliques, or the like. Minor cutting, trimming, or sewing of those major parts will not affect the determination of whether a good is “knit to shape.” (4) *Major parts.* The term *major parts* means integral components of a good but does not include collars, cuffs, waistbands, plackets, pockets, linings, paddings, trim, accessories, or similar parts. (5) *Textile or apparel product.* A *textile or apparel product* is any good classifiable in Chapters 50 through 63, Harmonized Tariff Schedule of the United States (HTSUS), and any good classifiable under one of the following HTSUS headings or subheadings:

3005.90; 3921.12.15; 3921.13.15; 3921.90.2550; 4202.12.40–80; 4202.22.40–80; 4202.32.40–95; 4202.92.15–30; 4202.92.60–90; 6405.20.60; 6406.10.77; 6406.10.90; 6406.99.15; 6501; 6502; 6503; 6504; 6505.90; 6601.10–99; 7019.19.15; 7019.19.28; 7019.40–59; 8708.21; 8804; 9113.90.40; 9404.90.10; 9404.90.80–95; 9502.91; 9612.10.9010

(6) *Wholly assembled.* The term “wholly assembled” when used with reference to a good means that all components, of which there must be at least two, pre-existed in essentially the same condition as found in the finished good and were combined to form the finished good in a single country, territory, or insular possession. Minor attachments and minor embellishments (for example, appliques, beads, spangles, embroidery, buttons) not appreciably affecting the identity of the good, and minor subassemblies (for example, collars, cuffs, plackets, pockets), will not affect the status of a good as “wholly assembled” in a single country, territory, or insular possession.

(c) *General rules.* Subject to paragraph (d) of this section, the country of origin of a textile or apparel product shall be determined by sequential application of paragraphs (c)(1) through (5) of this section and, in each case where appropriate to the specific context, by application of the additional requirements or conditions of §§ 102.12 through 102.19 of this part.

(1) The country of origin of a textile or apparel product is the single country, territory, or insular possession in which the good was wholly obtained or produced.

(2) Where the country of origin of a textile or apparel product cannot be determined under paragraph (c)(1) of this section, the country of origin of the good is the single country, territory, or insular possession in which each foreign material incorporated in that good underwent an applicable change in tariff classification, and/or met any other requirement, specified for the good in paragraph (e) of this section.

(3) Where the country of origin of a textile or apparel product cannot be determined under paragraph (c) (1) or (2) of this section:

- (i) If the good was knit to shape, the country of origin of the good is the single country, territory, or insular possession in which the good was knit; or
- (ii) except for goods of heading 5609, 5807, 5811, 6213, 6214, 6301 through 6306, and 6308, and subheadings 6209.20.5040, 6307.10, 6307.90, and 9404.90, if the good was not knit to shape and the good was wholly assembled in a single country, territory, or insular possession, the country of origin of the good is the country, territory, or insular possession in which the good was wholly assembled.

(4) Where the country of origin of a textile or apparel product cannot be determined under paragraph (c)(1), (2) or (3) of this section, the country of origin of the good is the single country, territory, or insular possession in which the most important assembly or manufacturing process occurred.

(5) Where the country of origin of a textile or apparel product cannot be determined under paragraph (c)(1), (2), (3) or (4) of this section, the country of origin of the good is the last country, territory, or insular possession in which an important assembly or manufacturing process occurred.

(d) *Treatment of sets.* Where a good classifiable in the HTSUS as a set includes one or more components that are textile or apparel products and a single country of origin for all of the components of the set cannot be determined under paragraph (c) of this section, the country of origin of each component of the set that is a textile or apparel product shall be determined separately under paragraph (c) of this section. (e) *Specific rules by tariff classification.* (1) The following rules will apply for purposes of determining the country of origin of a textile or apparel product under paragraph (c)(2) of this section:

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| 3005.90 | If the good contains pharmaceutical substances, a change to subheading 3005.90 from any other heading; or If the good does not contain pharmaceutical substances, a change to subheading 3005.90 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5601 through 5603, 5801 through 5804, 5806, 5809, 5903, 5906 through 5907, and 6001 through 6002. |
| 3921.12.15 | A change to subheading 3921.12.15 from any other heading. |
| 3921.13.15 | A change to subheading 3921.13.15 from any other heading. |
| 3921.90.2550 | A change to subheading 3921.90.2550 from any other heading. |
| 4202.12.40– 4202.12.80 | A change to subheading 4202.12.40 through 4202.12.80 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. |
| 4202.22.40– 4202.22.80 | A change to subheading 4202.22.40 through 4202.22.80 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. |
| 4202.32.40– 4202.32.95 | A change to subheading 4202.32.40 through 4202.32.95 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. |
| 4202.92.15– 4202.92.30 | A change to subheading 4202.92.15 through 4202.92.30 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. |
| 4202.92.60– 4202.92.90 | A change to subheading 4202.92.60 through 4202.92.90 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. |
| 5001–5002 | A change to heading 5001 through 5002 from any other chapter. |
| 5003 | A change to heading 5003 from any other heading, provided that the change is the result of garnetting. If the change to heading 5003 is not the result of garnetting, the country of origin of the good is the country of origin of the good prior to its becoming waste. |
| 5004–5006 | (1) If the good is of staple fibers, a change to heading 5004 through 5006 from any heading outside that group, provided that the change is the result of a spinning process. (2) If the good is of filaments, a change to heading 5004 through 5006 from any heading outside that group, provided that the change is the result of an extrusion process. |

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| 5007 | (1) A change from greige fabric of heading 5007 to finished fabric of heading 5007 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or, (2) If the country of origin cannot be determined under (1) above, a change to heading 5007 from any other heading, provided that the change is the result of a fabric-making process. |
| 5101–5103 | A change to heading 5101 through 5103 from any other chapter. |
| 5104 | A change to heading 5104 from any other heading. |
| 5105 | A change to heading 5105 from any other chapter. |
| 5106–5110 | A change to heading 5106 through 5110 from any heading outside that group, provided that the change is the result of a spinning process. |
| 5111–5113 | A change to heading 5111 through 5113 from any heading outside that group, provided that the change is the result of a fabric-making process. |
| 5201 | A change to heading 5201 from any other chapter. |
| 5202 | A change to heading 5202 from any other heading, provided that the change is the result of garnetting. If the change to heading 5202 is not the result of garnetting, the country of origin of the good is the country of origin of the good prior to its becoming waste. |
| 5203 | A change to heading 5203 from any other chapter. |
| 5204–5207 | A change to heading 5204 through 5207 from any heading outside that group, provided that the change is the result of a spinning process. |
| 5208–5212 | (1) A change from greige fabric of heading 5208 through 5212 to finished fabric of heading 5208 through 5212 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or (2) If the country of origin cannot be determined under (1) above, a change to heading 5208 through 5212 from any heading outside that group, provided that the change is the result of a fabric-making process. |
| 5301–5305 | (1) Except for waste, a change to heading 5301 through 5305 from any other chapter. (2) For waste, a change to heading 5301 through 5305 from any heading outside that group, provided that the change is the result of garnetting. If the change is not the result of garnetting, the country of origin of the good is the country of origin of the good prior to its becoming waste. |
| 5306–5307 | A change to heading 5306 through 5307 from any heading outside that group, provided that the change is the result of a spinning process. |
| 5308 | (1) Except for paper yarns, a change to heading 5308 from any other heading, provided that the change is the result of a spinning process. (2) For paper yarns, a change to heading 5308 from any other heading, except from heading 4707, 4801 through 4806, 4811, and 4818. |
| 5309–5311 | (1) A change from greige fabric of heading 5309 through 5311 to finished fabric of heading 5309 through 5311 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or (2) If the country of origin cannot be determined under (1) above, a change to heading 5309 through 5311 from any heading outside that group, provided that the change is the result of a fabric-making process. |
| 5401–5406 | A change to heading 5401 through 5406 from any other heading, provided that the change is the result of an extrusion process. |
| 5407–5408 | (1) A change from greige fabric of heading 5407 through 5408 to finished fabric of heading 5407 through 5408 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or (2) If the country of origin cannot be determined under (1) above, a change to heading 5407 through 5408 from any heading outside that group, provided that the change is the result of a fabric-making process. |
| 5501–5502 | A change to heading 5501 through 5502 from any other chapter, provided that the change is the result of an extrusion process. |

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| 5503–5504 | A change to heading 5503 through 5504 from any other chapter, except from Chapter 54. |
| 5505 | A change to heading 5505 from any other heading, provided that the change is the result of garnetting. If the change is not the result of garnetting, the country of origin of the good is the country of origin of the good prior to its becoming waste. |
| 5506–5507 | A change to heading 5506 through 5507 from any other chapter, except from Chapter 54. |
| 5508–5511 | A change to heading 5508 through 5511 from any heading outside that group, provided that the change is the result of a spinning process. |
| 5512–5516 | (1) A change from greige fabric of heading 5512 through 5516 to finished fabric of heading 5512 through 5516 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or (2) If the country of origin cannot be determined under (1) above, a change to heading 5512 through 5516 from any heading outside that group, provided that the change is the result of a fabric-making process. |
| 5601 | (1) A change to wadding of heading 5601 from any other heading, except from heading 5105, 5203, and 5501 through 5507. (2) A change to flock, textile dust, mill neps, or articles of wadding, of heading 5601 from any other heading or from wadding of heading 5601. |
| 5602–5603 | (1) Except for fabric of wool or of fine animal hair, a change from greige fabric of heading 5602 through 5603 to finished fabric of heading 5602 through 5603 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or (2) If the country of origin cannot be determined under (1) above, a change to heading 5602 through 5603 from any heading outside that group, provided that the change is the result of a fabric-making process. |
| 5604 | (1) If the textile component is of continuous filaments, including strips, a change of those filaments, including strips, to heading 5604 from any other heading, except from heading 5001 through 5007, 5401 through 5408, and 5501 through 5502, and provided that the change is the result of an extrusion process. (2) If the textile component is of staple fibers, a change of those fibers to heading 5604 from any other heading, except from heading 5004 through 5006, 5106 through 5110, 5204 through 5207, 5306 through 5308, and 5508 through 5511, and provided that the change is the result of a spinning process. |
| 5605–5606 | If the good is of continuous filaments, including strips, a change of those filaments, including strips, to heading 5605 through 5606 from any other heading, except from heading 5001 through 5007, 5401 through 5408, and 5501 through 5502, and provided that the change is the result of an extrusion process; or If the good is of staple fibers, a change of those fibers to heading 5605 through 5606 from any other heading, except from heading 5106 through 5110, 5204 through 5207, 5306 through 5308, and 5508 through 5511, and provided that the change is the result of a spinning process. |
| 5607 | If the good is of continuous filaments, including strips, a change of those filaments, including strips, to heading 5607 from any other heading, except from heading 5001 through 5007, 5401 through 5406, and 5501 through 5511, and provided that the change is the result of an extrusion process; or If the good is of staple fibers, a change of those fibers to heading 5607 from any other heading, except from heading 5106 through 5110, 5204 through 5207, 5306 through 5308, and 5508 through 5511, and provided that the change is the result of a spinning process. |
| 5608 | (1)(a) Except for netting of wool or of fine animal hair, a change from greige netting of heading 5608 to finished netting of heading 5608 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or (1)(b) If the country of origin cannot be determined under (1)(a) above, a change to |

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| | <p>netting of heading 5608 from any other heading, except from heading 5804, and provided that the change is the result of a fabric-making process.</p> <p>(2) A change to fishing nets or other made up nets of heading 5608:</p> <p>(a) If the good does not contain non-textile attachments, from any other heading, except from heading 5804 and 6002, and provided that the change is the result of a fabric-making process; or</p> <p>(b) If the good contains non-textile attachments, from any heading, including a change from another good of heading 5608, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession.</p> |
| 5609 | <p>(1) If of continuous filaments, including strips, the country of origin of a good classifiable under heading 5609 is the country, territory, or insular possession in which those filaments, including strips, were extruded.</p> <p>(2) If of staple fibers, the country of origin of a good classifiable under heading 5609 is the country, territory, or insular possession in which those fibers were spun into yarns.</p> |
| 5701–5705 | A change to heading 5701 through 5705 from any other chapter. |
| 5801–5803 | <p>(1) Except for fabric of wool or of fine animal hair, a change from greige fabric of heading 5801 through 5803 to finished fabric of heading 5801 through 5803 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decatizing, permanent stiffening, weighting, permanent embossing, or moireing; or</p> <p>(2) If the country of origin cannot be determined under (1) above, a change to heading 5801 through 5803 from any other heading, including a heading within that group, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, and 6002, and provided that the change is the result of a fabric-making process.</p> |
| 5804.10 | <p>(1) Except for fabric of wool or of fine animal hair, a change from greige fabric of subheading 5804.10 to finished fabric of subheading 5804.10 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decatizing, permanent stiffening, weighting, permanent embossing, or moireing; or</p> <p>(2) If the country of origin cannot be determined under (1) above, a change to subheading 5804.10 from any other heading, except from heading 5608, and provided that the change is the result of a fabric-making process.</p> |
| 5804.21–5804.30 | <p>(1) Except for lace of wool or of fine animal hair, a change from greige lace of subheading 5804.21 through 5804.30 to finished lace of subheading 5804.21 through 5804.30 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decatizing, permanent stiffening, weighting, permanent embossing, or moireing; or (2) If the country of origin cannot be determined under (1) above, a change to subheading 5804.21 through 5804.30 from any other heading, provided that the change is the result of a fabric-making process.</p> |
| 5805 | A change to heading 5805 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, and 5512 through 5516, and provided that the change is the result of a fabric-making process. |
| 5806 | <p>(1) Except for fabric of wool or of fine animal hair, a change from greige fabric of heading 5806 to finished fabric of heading 5806 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decatizing, permanent stiffening, weighting, permanent embossing, or moireing; or (2) If the country of origin cannot be determined under (1) above, a change to heading 5806 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, and 5801 through 5803, and provided that the change is the result of a fabric-making process.</p> |
| 5807 | The country of origin of a good classifiable under heading 5807 is the country, territory, or insular possession in which the fabric comprising the good was formed by a fabric-making process. |
| 5808.10 | (1) If the good is of continuous filaments, including strips, a change of those filaments, |

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| | <p>including strips, to subheading 5808.10 from any other heading, except from heading 5001 through 5007, 5401 through 5406, 5501 through 5502, and 5604 through 5607, and provided that the change is the result of an extrusion process.</p> <p>2) If the good is of staple fibers, a change of those fibers to heading 5808.10 from any other heading, except from heading 5106 through 5113, 5204 through 5212, 5306 through 5311, 5401 through 5408, 5508 through 5516, and 5604 through 5607, and provided that the change is the result of a spinning process.</p> |
| 5808.90 | <p>(1) For ornamental fabric trimmings: (a) A change from a greige good of subheading 5808.90 to a finished good of subheading 5808.90 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decatizing, permanent stiffening, weighting, permanent embossing, or moireing; or,</p> <p>(b) If the country of origin cannot be determined under (a) above, a change to subheading 5808.90 from any other chapter, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, and 5512 through 5516, and provided that the change is the result of a fabric-making process.</p> <p>(2) For non-fabric ornamental trimmings: (a) If the trimming is of continuous filaments, including strips, a change to subheading 5808.90 from any other heading, except from heading 5001 through 5007, 5401 through 5408, 5501 through 5502, and 5604 through 5607, and provided that the change is the result of an extrusion process; or</p> <p>(b) If the trimming is of staple fibers, a change to subheading 5808.90 from any other heading, except from heading 5106 through 5113, 5204 through 5212, 5306 through 5311, 5401 through 5408, 5508 through 5516, and 5604 through 5607, and provided that the change is the result of a spinning process.</p> <p>(3) For tassels, pompons and similar articles: (a) If the good has been wholly assembled in a single country, territory, or insular possession, a change to subheading 5808.90 from any other heading;</p> <p>b) If the good has not been wholly assembled in a single country, territory, or insular possession and the good is of staple fibers, a change to subheading 5808.90 from any other heading, except from heading 5004 through 5006, 5106 through 5110, 5204 through 5207, 5306 through 5308, and 5508 through 5511, and 5604 through 5607, and provided that the change is the result of a spinning process; or</p> <p>c) If the good has not been wholly assembled in a single country, territory, or insular possession and the good is of filaments, including strips, a change to subheading 5808.90 from any other heading, except from heading 5001 through 5007, 5401 through 5406, and 5501 through 5502, and provided that the change is the result of an extrusion process.</p> |
| 5809 | A change to heading 5809 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5801 through 5802, 5804, and 5806, and provided that the change is the result of a fabric-making process. |
| 5810.10 | The country of origin of goods of subheading 5810.10 is the single country, territory, or insular possession in which the embroidery was performed. |
| 5810.91–5810.99 | <p>(1) For embroidered fabric, the country of origin is the country, territory, or insular possession in which the fabric was produced by a fabric-making process.</p> <p>(2) For embroidered badges, emblems, insignia, and the like, comprised of multiple components, the country of origin is the place of assembly, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession.</p> <p>(3) For embroidered badges, emblems, insignia, and the like, not comprised of multiple components, a change to subheading 5810.91 through 5810.99 from any other chapter, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5608, 5903, 5907, 6001 through 6002, and provided that the change is the result of a fabric-making process.</p> |
| 5811 | The country of origin of a good classifiable under heading 5811 is the country, territory, or insular possession in which the fabric comprising the good was formed by a fabric-making process. |
| 5901–5903 | (1) Except for fabric of wool or of fine animal hair, a change from greige fabric of |

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| | <p>heading 5901 through 5903 to finished fabric of heading 5901 through 5903 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or,</p> <p>(2) If the country of origin cannot be determined under (1) above, a change to heading 5901 through 5903 from any other heading, including a heading within that group, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5803, 5806, 5808, and 6002, and provided that the change is the result of a fabric-making process.</p> |
| 5904 | <p>(1) For goods that have been wholly assembled by means of a lamination process, a change to heading 5904 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) For all other goods, the country of origin of the good will be determined by application of § 102.21(c)(4) or, if the country of origin cannot be determined under that section, by application of § 102.21(c)(5).</p> |
| 5905 | <p>(1) Except for wall coverings consisting of textile fabric of wool or of fine animal hair treated on the back or affixed by any means to a backing of any material, a change from wall coverings of greige fabric of heading 5905 to wall coverings of finished fabric of heading 5905 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or,</p> <p>(2) If the country of origin cannot be determined under (1) above, a change to heading 5905 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5603, 5803, 5806, 5808, and 6002, and provided that the change is the result of a fabric-making process.</p> |
| 5906–5907 | <p>(1) Except for fabric of wool or of fine animal hair, a change from greige fabric of heading 5906 through 5907 to finished fabric of heading 5906 through 5907 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or,</p> <p>(2) If the country of origin cannot be determined under (1) above, a change to heading 5906 through 5907 from any other chapter, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5803, 5806, 5808, and 6002, and provided that the change is the result of a fabric-making process.</p> |
| 5908 | <p>(1) Except for yarns, twine, cord, and braid, a change to heading 5908 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5801 through 5802, 5806, 5808, and 6001 through 6002.</p> <p>(2) For yarns, twine, cord, and braid:</p> <p>(a) If the good is of continuous filaments, including strips, a change to heading 5908 from any other heading, except from heading 5001 through 5007, 5401 through 5406, and 5501 through 5502, and provided that the change is the result of an extrusion process; or</p> <p>(b) If the good is of staple fibers, a change to heading 5908 from any other heading, except from heading 5106 through 5110, 5204 through 5207, 5306 through 5308, and 5508 through 5511, and 5605 through 5607, and provided that the change is the result of a spinning process.</p> |
| 5909 | <p>A change to heading 5909 from any other chapter, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5603, 5801 through 5804, 5806, 5808, and 6001 through 6002, and provided that the good does not contain armor or accessories of non-textile material and provided that the change is the result of a fabricmaking process; or</p> <p>A change to textile hosepiping with armor or accessories of non-textile material, of heading 5909, from any heading, including a change from another good of heading 5909, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession.</p> |

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| 5910 | <p>(1) For belts and belting of braid, rope, or cord:</p> <p>(a) If the good is of continuous filaments, including strips, a change of those filaments, including strips, to heading 5910 from any other heading, except from heading 5001 through 5006, 5401 through 5406, and 5501 through 5502, and provided that the change is the result of an extrusion process; or</p> <p>(b) If the good is of staple fibers, a change of those fibers to heading 5910 from any other heading, except from heading 5106 through 5110, 5204 through 5207, 5306 through 5308, and 5508 through 5511, and provided that the change is the result of a spinning process.</p> <p>(2) For fabric belting and belts, not braids and not combined with non-textile components, whether or not reinforced with metal or other material, a change to heading 5910 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5804, 5806, 5808 through 5809, and 6001 through 6002, and provided the change is the result of a fabric-making process.</p> <p>(3) For fabric belts, including belts of braided materials, combined with non-textile components, whether or not reinforced with metal or other material, a change to heading 5910 from any heading, including a change from another good of heading 5910, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession.</p> |
| 5911.10– 5911.20 | <p>(1) Except for fabric of wool or of fine animal hair, a change from greige fabric of subheading 5911.10 through 5911.20 to finished fabric of subheading 5911.10 through 5911.20 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or,</p> <p>(2) If the country of origin cannot be determined under (1) above, a change to subheading 5911.10 through 5911.20 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5804, 5806, and 6001 through 6002, and provided that the change is the result of a fabric-making process.</p> |
| 5911.31– 5911.32 | <p>(1)(a) Except for fabric of wool or of fine animal hair, a change from greige fabric of subheading 5911.31 through 5911.32 to finished fabric of subheading 5911.31 through 5911.32 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or,</p> <p>(1)(b) If the country of origin cannot be determined under (1)(a) above, for goods not combined with non-textile components, a change to subheading 5911.31 through 5911.32 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5804, 5806, and 6001 through 6002, and provided that the change is the result of a fabric-making process.</p> <p>(2) For goods combined with non-textile components, a change to subheading 5911.31 through 5911.32 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession.</p> |
| 5911.40 | <p>(1) Except for fabric of wool or of fine animal hair, a change from greige fabric of subheading 5911.40 to finished fabric of subheading 5911.40 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or,</p> <p>(2) If the country of origin cannot be determined under (1) above, a change to subheading 5911.40 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5804, 5806, and 6001 through 6002, and provided that the change is the result of a fabric-making process.</p> |
| 5911.90 | <p>(1) For goods of yarn, rope, cord, or braid:</p> <p>a) If the good is of continuous filaments, including strips, a change of those filaments, including strips, to subheading 5911.90 from any other heading, except from heading 5001 through 5006, 5401 through 5406, and 5501 through 5502, and provided that the</p> |

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| | <p>change is the result of an extrusion process; or</p> <p>b) If the good is of staple fibers, a change of those fibers to subheading 5911.90 from any other heading, except from heading 5106 through 5110, 5204 through 5207, 5306 through 5308, and 5508 through 5511, and provided that the change is the result of a spinning process.</p> <p>(2)(a) If the good is a fabric, except for fabric of wool or of fine animal hair, a change from greige fabric of subheading 5911.90 to finished fabric of subheading 5911.90 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or,</p> <p>(2)(b) If the country of origin cannot be determined under (2)(a) above, if the good is a fabric, a change to subheading 5911.90 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5804, 5806, 5809, and 6001 through 6002, and provided that the change is the result of a fabric-making process.</p> <p>(3) If the good is a made up article other than a good of yarn, rope, cord, or braid, a change to subheading 5911.90 from any heading, including a change from another good of heading 5911, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession.</p> |
| 6001–6002 | <p>(1) Except for fabric of wool or of fine animal hair, a change from greige fabric of heading 6001 through 6002 to finished fabric of heading 6001 through 6002 by both dyeing and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing; or,</p> <p>(2) If the country of origin cannot be determined under (1) above, a change to heading 6001 through 6002 from any heading outside that group, provided that the change is the result of a fabric-making process.</p> |
| 6101–6117 | <p>(1) If the good is not knit to shape and consists of two or more component parts, except for goods of subheading 6117.10 provided for in paragraph (e)(2) of this section, a change to an assembled good of heading 6101 through 6117 from unassembled components, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession.</p> <p>(2) If the good is not knit to shape and does not consist of two or more component parts, except for goods of subheading 6117.10 provided for in paragraph (e)(2) of this section, a change to heading 6101 through 6117 from any heading outside that group, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5806, 5809 through 5811, 5903, 5906 through 5907, and 6001 through 6002, and subheading 6307.90, and provided that the change is the result of a fabric-making process.</p> <p>(3) If the good is knit to shape, except for goods of subheading 6117.10 provided for in paragraph (e)(2) of this section, a change to 6101 through 6117 from any heading outside that group, provided that the knit to shape components are knit in a single country, territory, or insular possession.</p> |
| 6201–6208 | <p>(1) If the good consists of two or more component parts, a change to an assembled good of heading 6201 through 6208 from unassembled components, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more component parts, a change to heading 6201 through 6208 from any heading outside that group, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5806, 5809 through 5811, 5903, 5906 through 5907, and 6217, and subheading 6307.90, and provided that the change is the result of a fabric-making process.</p> |
| 6209.10.0000–6209.20.5035 | <p>(1) If the good consists of two or more component parts, a change to an assembled good of subheading 6209.10.0000 through 6209.20.5035 from unassembled components, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession.</p> <p>2) If the good does not consist of two or more component parts, a change to subheading 6209.10.0000 through 6209.20.5035 from any other heading, except from heading 5007,</p> |

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| | 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5806, 5809 through 5811, 5903, 5906 through 5907, and 6217, and subheading 6307.90, and provided that the change is the result of a fabric-making process. |
| 6209.20.5040 | The country of origin of a good classifiable in subheading 6209.20.5040 is the country, territory, or insular possession in which the fabric comprising the good was formed by a fabric-making process. |
| 6209.20.5045– 6209.90.9000 | (1) If the good consists of two or more component parts, a change to an assembled good of subheading 6209.20.5045 through 6209.90.9000 from unassembled components, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more component parts, a change to subheading 6209.20.5045 through 6209.90.9000 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5806, 5809 through 5811, 5903, 5906 through 5907, and 6217, and subheading 6307.90, and provided that the change is the result of a fabric-making process. |
| 6210–6212 | (1) If the good consists of two or more component parts, a change to an assembled good of heading 6210 through 6212 from unassembled components, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more component parts, a change to heading 6210 through 6212 from any heading outside that group, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5806, 5809 through 5811, 5903, 5906 through 5907, 6001 through 6002, and 6217, and subheading 6307.90, and provided that the change is the result of a fabric-making process. |
| 6213–6214 | Except for goods of heading 6213 through 6214 provided for in paragraph (e)(2) of this section, the country of origin of a good classifiable under heading 6213 through 6214 is the country, territory, or insular possession in which the fabric comprising the good was formed by a fabric-making process. |
| 6215–6217 | (1) If the good consists of two or more component parts, a change to an assembled good of heading 6215 through 6217 from unassembled components, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more component parts, a change to heading 6215 through 6217 from any heading outside that group, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5801 through 5806, 5809 through 5811, 5903, 5906 through 5907, and 6217, and subheading 6307.90, and provided that the change is the result of a fabric-making process. |
| 6301–6306 | Except for goods of heading 6302 through 6304 provided for in paragraph (e)(2) of this section, the country of origin of a good classifiable under heading 6301 through 6306 is the country, territory, or insular possession in which the fabric comprising the good was formed by a fabric-making process. |
| 6307.10 | The country of origin of a good classifiable under subheading 6307.10 is the country, territory, or insular possession in which the fabric comprising the good was formed by a fabric-making process. |
| 6307.20 | A change to subheading 6307.20 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. |
| 6307.90 | The country of origin of a good classifiable under subheading 6307.90 is the country, territory, or insular possession in which the fabric comprising the good was formed by a fabric-making process. |
| 6308 | The country of origin of a good classifiable under heading 6308 is the country, territory, or insular possession in which the woven fabric component of the good was formed by a fabric-making process. |

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| 6309–6310 | The country of origin of a good classifiable under heading 6309 through 6310 is the country, territory, or insular possession in which the good was last collected and packaged for shipment. |
| 6405.20.60 | A change to subheading 6405.20.60 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. |
| 6406.10.77 | (1) If the good consists of two or more components, a change to subheading 6406.10.77 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more components, a change to subheading 6406.10.77 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5608, 5801 through 5804, 5806, 5808 through 5810, 5903, 5906 through 5907, and 6001 through 6002, and provided that the change is the result of a fabric-making process. |
| 6406.10.90 | (1) If the good consists of two or more components, a change to subheading 6406.10.90 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more components, a change to subheading 6406.10.90 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5608, 5801 through 5804, 5806, 5808 through 5810, 5903, 5906 through 5907, and 6001 through 6002, and provided that the change is the result of a fabric-making process. |
| 6406.99.15 | (1) If the good consists of two or more components, a change to subheading 6406.99.15 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more components, a change to subheading 6406.99.15 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5608, 5801 through 5804, 5806, 5808 through 5810, 5903, 5906 through 5907, and 6001 through 6002, and provided that the change is the result of a fabric-making process. |
| 6501 | (1) If the good consists of two or more components, a change to heading 6501 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more components, a change to heading 6501 from any other heading, except from heading 5602, and provided that the change is the result of a fabricmaking process |
| 6502 | (1) If the good consists of two or more components, a change to heading 6502 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more components, a change to heading 6502 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5608, 5801 through 5804, 5806, 5808 through 5810, 5903, 5906 through 5907, and 6001 through 6002, and provided that the change is the result of a fabric-making process. |
| 6503 | (1) If the good consists of two or more components, a change to heading 6503 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more components, a change to heading 6503 from any other heading, except from heading 5602, and provided that the change is the result of a fabricmaking process. |
| 6504 | (1) If the good consists of two or more components, a change to heading 6504 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more components, a change to heading 6504 |

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| | from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5608, 5801 through 5804, 5806, 5808 through 5810, 5903, 5906 through 5907, and 6001 through 6002, and provided that the change is the result of a fabric-making process. |
| 6505.90 | (1) If the good consists of two or more components, a change to subheading 6505.90 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more components, a change to subheading 6505.90 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5407 through 5408, 5512 through 5516, 5602 through 5603, 5608, 5801 through 5804, 5806, 5808 through 5811, 5903, 5906 through 5907, and 6001 through 6002, and provided that the change is the result of a fabric-making process. |
| 6601.10– 6601.91 | A change to subheading 6601.10 through 6601.91 from any other heading, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. |
| 7019.19.15 | (1) If the good is of filaments, a change to subheading 7019.19.15 from any other heading, provided that the change is the result of an extrusion process. (2) If the good is of staple fibers, a change to subheading 7019.19.15 from any other subheading, except from subheading 7019.19.30 through 7019.19.90, 7019.31.00 through 7019.39.50, and 7019.90, and provided that the change is the result of a spinning process. |
| 7019.19.28 | (1) If the good is of filaments, a change to subheading 7019.19.28 from any other heading, provided that the change is the result of an extrusion process. (2) If the good is of staple fibers, a change to subheading 7019.19.28 from any other subheading, except from subheading 7019.19.30 through 7019.19.90, 7019.31.00 through 7019.39.50, and 7019.90, and provided that the change is the result of a spinning process. |
| 7019.40– 7019.59 | A change to subheading 7019.40 through 7019.59 from any other subheading, provided that the change is the result of a fabric-making process. |
| 8708.21 | (1) For seat belts not combined with non-textile components, a change to subheading 8708.21 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, and 5512 through 5516, and provided that the change is the result of a fabric-making process. (2) For seat belts combined with non-textile components, a change to an assembled good of subheading 8708.21 from unassembled components, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. |
| 8804 | (1) If the good consists of two or more component parts, a change to an assembled good of heading 8804 from unassembled components, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. 2) If the good does not consist of two or more component parts, a change to heading 8804 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5603, 5801 through 5804, 5806, 5809 through 5811, 5903, 5906 through 5907, and 6001 through 6002, and subheading 6307.90, and provided that the change is the result of a fabric-making process. |
| 9113.90.40 | (1) If the good consists of two or more component parts, a change to an assembled good of subheading 9113.90.40 from unassembled components, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. (2) If the good does not consist of two or more component parts, a change to subheading 9113.90.40 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5603, 5801 through 5802, 5806, 5809, 5903, 5906 through 5907, and 6001 through 6002, and subheading 6307.90, and provided that the change is the result of a fabric-making process. |
| 9404.90 | Except for goods of subheading 9404.90 provided for in paragraph (e)(2) of this section, |

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| | the country of origin of a good classifiable under subheading 9404.90 is the country, territory, or insular possession in which the fabric comprising the good was formed by a fabric-making process. |
| 9502.91 | A change to an assembled good of subheading 9502.91 from unassembled components, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. |
| 9612.10.9010 | A change to subheading 9612.10.9010 from any other heading, except from heading 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, 5512 through 5516, 5603, 5806, 5903, 5906 through 5907, and 6002, and provided that the change is the result of a fabric-making process. |

(2) For goods of HTSUS headings 6213 and 6214 and HTSUS subheadings 6117.10, 6302.22, 6302.29, 6302.52, 6302.53, 6302.59, 6302.92, 6302.93, 6302.99, 6303.92, 6303.99, 6304.19, 6304.93, 6304.99, 9404.90.85 and 9404.90.95, except for goods classified under those headings or subheadings as of cotton or of wool or consisting of fibre blends containing 16 percent or more by weight of cotton: (i) The country of origin of the good is the country, territory, or insular possession in which the fabric comprising the good was both dyed and printed when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decatizing, permanent stiffening, weighting, permanent embossing, or moireing; (ii) If the country of origin cannot be determined under (i) above, except for goods of HTSUS subheading 6117.10 that are knit to shape or consist of two or more component parts, the country of origin is the country, territory, or insular possession in which the fabric comprising the good was formed by a fabric-making process; or (iii) For goods of HTSUS subheading 6117.10 that are knit to shape or consist of two or more component parts: (A) If the good is knit to shape, the country of origin of the good is the country, territory, or insular possession in which a change to HTSUS subheading 6117.10 from yarn occurs, provided that the knit to shape components are knit in a single country, territory, or insular possession; or (B) If the good is not knit to shape and consists of two or more component parts, the country of origin of the good is the country, territory, or insular possession in which a change to an assembled good of HTSUS subheading 6117.10 from unassembled components occurs, provided that the change is the result of the good being wholly assembled in a single country, territory, or insular possession. [T.D. 95-69, 60 FR 46197, Sept. 5, 1995, as amended by T.D. 96-56, 61 FR 37818, July 22, 1996; T.D. 99-64, 64 FR 43266, Aug. 10, 1999; T.D. 01-36, 66 FR 21661, May 1, 2001; 66 FR 23981, May 10, 2001]