

**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.<sup>1</sup>

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 requested<sup>2</sup> 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)<sup>3</sup> of Article 2 of the *RO Agreement*.<sup>4</sup>

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."<sup>5</sup>

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

Chairperson: Mr Lars Anell

Members: Ms Mary Elizabeth Chelliah  
Mr Donald McRae<sup>6</sup>

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.

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<sup>1</sup> WT/DS243/1.

<sup>2</sup> 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.

<sup>3</sup> 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.

<sup>4</sup> WT/DS243/5/Rev.1.

<sup>5</sup> WT/DS243/6.

<sup>6</sup> *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 Act 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).

**[Parties' arguments in Sections III and IV and Annexes deleted from this version.]**

## 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 Act<sup>133</sup> (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 Act<sup>134</sup> (hereafter "section 405"), which entered into force on 18 May 2000, and
- (c) the customs regulations contained in 19 C.F.R. § 102.21<sup>135</sup>, 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 headings<sup>136</sup> – 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.<sup>137</sup> 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.

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<sup>133</sup> 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.

<sup>134</sup> 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.

<sup>135</sup> Reproduced, in relevant part, in Annex C.

<sup>136</sup> 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.

<sup>137</sup> United States' reply to Panel question No. 7.

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.

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 334<sup>138</sup> 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.<sup>139</sup>

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

<b><u>ORIGIN OF FABRICS</u></b>		
<b>ORIGIN-CONFERRING PROCESS</b>	<b>FABRIC-FORMATION (KNITTING, WEAVING, ETC.)</b>	<b>DYEING &amp; PRINTING OF FABRIC &amp; TWO OR MORE SPECIFIED FINISHING OPERATIONS ("DP2")</b>
<b>Wool fabrics</b>	YES (section 334(b)(1)(C))	NO
<b>Other fabrics</b> (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))

<sup>138</sup> For a list of the goods concerned, see *supra*, para. 2.7.

<sup>139</sup> 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)

<b><u>ORIGIN OF MADE-UP ARTICLES ASSEMBLED IN SINGLE COUNTRY FROM SINGLE COUNTRY FABRIC(S)</u></b>			
<b>ORIGIN-CONFERRING PROCESS</b>	<b>FABRIC-FORMATION (KNITTING, WEAVING, ETC.)</b>	<b>DYEING &amp; PRINTING OF FABRIC &amp; 2 OR MORE SPECIFIED FINISHING OPERATIONS ("DP2")</b>	<b>"WHOLLY ASSEMBLED"</b>
<b>Articles (scarves, bed linen, etc.) specified in section 334(b)(2)(A) and section 405(a)(3)(C) and made of:</b>			
- 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
<b>Articles which are "knit to shape" (e.g., stockings)</b>	YES (section 334(b)(2)(B), although "knitting-to- shape" is not considered fabric making, but component or article formation)	NO	NO
<b>Other articles (including apparels)</b>	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".<sup>140</sup> 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.<sup>141</sup> 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*.<sup>142</sup> 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*]"<sup>143</sup>.

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

<sup>140</sup> Section 334(b)(1).

<sup>141</sup> United States' reply to Panel question No. 34.

<sup>142</sup> India's first oral statement, paras. 8 and 11.

<sup>143</sup> 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.<sup>144</sup>

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:<sup>145</sup>

- (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*.<sup>146</sup>

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*.<sup>147</sup>

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*.

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

<sup>145</sup> India's first written submission, para. 8; India's second written submission, para. 75.

<sup>146</sup> India's second oral statement, para. 18.

<sup>147</sup> 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.<sup>148</sup> 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.<sup>149</sup>

## 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."<sup>150</sup>

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.<sup>151</sup> It is clear from Appellate Body jurisprudence that Articles 31 and 32 of the Vienna Convention on the Law of Treaties (the "Vienna Convention")<sup>152</sup> are part of the customary rules of interpretation of public international

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<sup>148</sup> India's reply to Panel questions Nos. 15 and 18.

<sup>149</sup> *Ibid.*

<sup>150</sup> 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.

<sup>151</sup> Appendix 1 of the DSU.

<sup>152</sup> 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.<sup>153</sup> 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".<sup>154</sup> After this "transition period"<sup>155</sup>, *i.e.*, "upon implementation of the results of the harmonization work programme"<sup>156</sup>, 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 indirectly<sup>157</sup>; they should not themselves create restrictive, distorting or disruptive effects on international trade<sup>158</sup>; they should not pose unduly strict requirements or require the fulfilment of a condition unrelated to manufacturing or processing<sup>159</sup>; and they should not discriminate between other Members<sup>160</sup>. 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 origin<sup>161</sup>, changing those criteria over time<sup>162</sup>, or applying different criteria to different goods<sup>163</sup>.

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<sup>153</sup> 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.

<sup>154</sup> Chapeau of Article 2 of the *RO Agreement*.

<sup>155</sup> Title of Article 2 of the *RO Agreement*.

<sup>156</sup> Article 3 of the *RO Agreement*.

<sup>157</sup> Article 2(b) of the *RO Agreement*.

<sup>158</sup> Article 2(c), first sentence, of the *RO Agreement*.

<sup>159</sup> Article 2(c), second sentence, of the *RO Agreement*.

<sup>160</sup> Article 2(d) of the *RO Agreement*.

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

<sup>162</sup> India's first oral statement, para. 6; United States' first oral statement, para. 3

<sup>163</sup> 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".<sup>164</sup>

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".<sup>165</sup> 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".<sup>166</sup>

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

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<sup>164</sup>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 120 (emphasis added by India).

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

<sup>166</sup>United 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)<sup>167</sup>

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).<sup>168</sup> 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.<sup>169</sup>

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

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<sup>167</sup> 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).

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

<sup>169</sup> *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.<sup>170</sup> 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 Act<sup>171</sup>, 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.<sup>172</sup>

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.<sup>173</sup>

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<sup>170</sup> 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.

<sup>171</sup> 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.

<sup>172</sup> SAA, *supra*, pp. 118-119.

<sup>173</sup> 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 URAA<sup>174</sup>, 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*.<sup>175</sup> 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 [...]".<sup>176</sup> 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".<sup>177</sup> 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.<sup>178</sup> 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

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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?

<sup>174</sup> Exhibit INDIA-5.

<sup>175</sup> 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.

<sup>176</sup> India refers to United States' first written submission, para. 29.

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

<sup>178</sup> India refers to *ibid.*

unilateral changes of origin rules for certain textiles and apparel by the United States.<sup>179</sup> 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".<sup>180</sup>

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.<sup>181</sup> 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.<sup>182</sup>

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

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

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

<sup>182</sup> 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."<sup>183</sup> 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.<sup>184</sup> The United States notes that the SAA stated that section 334 would combat circumvention<sup>185</sup> 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.

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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

<sup>183</sup> The United States refers to exhibit INDIA-12.

<sup>184</sup> 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.

<sup>185</sup> 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.<sup>186</sup>

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.<sup>187</sup> 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,

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

<sup>187</sup> 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 determinations<sup>188</sup>, 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.<sup>189</sup> 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 earlier<sup>190</sup>, Article 2 simply provides broad parameters for the use of rules of origin.

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<sup>188</sup> 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.

<sup>189</sup> Document G/RO/52, p. 69.

<sup>190</sup> *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.<sup>191</sup> 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.<sup>192</sup> 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.<sup>193</sup> 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".<sup>194</sup> 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.<sup>195</sup> India argues that this "strengthens the impact"<sup>196</sup> of the United States' quota regime and renders it "more restrictive"<sup>197</sup>.

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

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<sup>191</sup> 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.

<sup>192</sup> United States' reply to Panel question No. 14.

<sup>193</sup> 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.

<sup>194</sup> India's first oral statement, para. 22.

<sup>195</sup> India's second oral statement, para. 8.

<sup>196</sup> *Ibid.*

<sup>197</sup> 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.<sup>198</sup>

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 States<sup>199</sup>; 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.<sup>200</sup> In the

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<sup>198</sup> 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.

<sup>199</sup> 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.

<sup>200</sup> 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.<sup>201</sup> 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".<sup>202</sup> 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.<sup>203</sup>

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

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<sup>201</sup> 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.

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

<sup>203</sup> 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.<sup>204</sup> *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.<sup>205</sup> 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.<sup>206</sup>

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.<sup>207</sup> 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".<sup>208</sup> 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*.<sup>209</sup> 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

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<sup>204</sup> United States' replies to Panel questions Nos. 2, 14 and 19.

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

<sup>206</sup> 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.

<sup>207</sup> United States' first written submission, para. 32.

<sup>208</sup> India's reply to Panel question No. 2.

<sup>209</sup> 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.<sup>210</sup>

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.<sup>211</sup> 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.<sup>212</sup> 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 reports<sup>213</sup>; post-enactment statements by two United States senators<sup>214</sup>; a statement by a United States textile importer association<sup>215</sup>; and publications by academics and a practising lawyer<sup>216</sup>. It should be noted that these elements are not part of section 334 itself, nor can they be said to "objectively manifest"<sup>217</sup> the objective of the fabric formation rule. Under the test established by the Appellate Body in *Chile - Alcoholic Beverages*<sup>218</sup>, we are not to base our inquiry into the objective of the fabric formation rule on such elements.<sup>219</sup> 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.<sup>220</sup> With respect to the post-enactment statements by two United States senators, India states that the senators

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<sup>210</sup> 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.

<sup>211</sup> India's reply to Panel question No. 72.

<sup>212</sup> *Ibid.*

<sup>213</sup> India's first written submission, para. 57.

<sup>214</sup> *Ibid.*, paras. 66-68.

<sup>215</sup> *Ibid.*, para. 64.

<sup>216</sup> *Ibid.*, para. 65.

<sup>217</sup> Appellate Body Report, *Chile - Alcoholic Beverages*, *supra*, para. 71.

<sup>218</sup> *Supra*, para. 6.37.

<sup>219</sup> 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.

<sup>220</sup> India's first written submission, para. 57.

in question referred to section 334 as a "very significant change in rules of origin".<sup>221</sup> However, such a characterization would not demonstrate that section 334 is "protectionist"<sup>222</sup>. 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.<sup>223</sup> 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.<sup>224</sup> However, neither in its written submissions nor in its oral statements has India offered specific legal arguments with respect to fabrics.<sup>225</sup> At any rate, *mutatis mutandis*,<sup>226</sup> 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.<sup>226</sup> 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).

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

<sup>222</sup> India's first written submission, para. 66.

<sup>223</sup> 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.

<sup>224</sup> India's replies to Panel questions Nos. 19 and 61.

<sup>225</sup> 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.

<sup>226</sup> 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.<sup>227</sup> 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

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<sup>227</sup> 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".<sup>228</sup> 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.<sup>229</sup> 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*.<sup>230</sup> 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.<sup>231</sup>

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.<sup>232</sup> 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

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<sup>228</sup> India refers to document WT/DS85/1.

<sup>229</sup> India refers to document WT/DS85/9.

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

<sup>231</sup> India refers to document WT/DS151/1.

<sup>232</sup> 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.<sup>233</sup>

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.<sup>234</sup> 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).<sup>235</sup> In any event, since section 405 applies equally to qualifying goods from all Members<sup>236</sup>, we do not see how it could be said that

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

<sup>234</sup> India's first written submission, paras. 69 and 84.

<sup>235</sup> India's reply to Panel question No. 58(a).

<sup>236</sup> 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.<sup>237</sup>

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.<sup>238</sup> 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.<sup>239</sup> 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 itself<sup>240</sup>, 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.<sup>241</sup> 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' complaint<sup>242</sup>, but because, *inter alia*, it was "*persuaded* that it would be appropriate to amend Section 334 and return to DP2 for the [relevant] products".<sup>243</sup> 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.

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<sup>237</sup> 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.

<sup>238</sup> United States' second oral statement, para. 23.

<sup>239</sup> India's first written submission, para. 71.

<sup>240</sup> *Ibid.*, para. 74.

<sup>241</sup> 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.

<sup>242</sup> United States' first written submission, para. 37; United States' first oral statement, para. 16.

<sup>243</sup> 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*<sup>244</sup>, 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.<sup>245</sup> 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.<sup>246</sup> 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".<sup>247</sup>

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.<sup>248</sup>

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

<sup>245</sup> *Ibid.*, p. 113.

<sup>246</sup> Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances* ("*US – Superfund*"), adopted 17 June 1987, BISD 34S/136, 160.

<sup>247</sup> 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.

<sup>248</sup> 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

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[...]

- (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.<sup>249</sup> 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".<sup>250</sup> 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

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<sup>249</sup> 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).

<sup>250</sup> *The New Shorter Oxford English Dictionary*, L. Brown, ed., Clarendon Press, 1993, Vol. I, p. 198.

specified in the first sentence.<sup>251</sup> In our view, the term "create" does not imply, however, that the creation of the prohibited effects necessarily needs to be deliberate.<sup>252</sup>

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".<sup>253</sup> 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)?<sup>254</sup> *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)?<sup>255</sup> 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 below<sup>256</sup>, 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).

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<sup>251</sup> 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.

<sup>252</sup> The parties share this view. India's reply to Panel question No. 11(a); United States' reply to Panel question No. 11(a).

<sup>253</sup> *The New Shorter Oxford English Dictionary*, L. Brown, ed., Clarendon Press, 1993, Vol. II, p. 2569; Vol. I, pp. 707 and 702, respectively.

<sup>254</sup> 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.

<sup>255</sup> India considers this to be an example of distorting effects inconsistent with Article 2(c), first sentence. India's first written submission, para. 91.

<sup>256</sup> *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".<sup>257</sup> We consider that the same could be said of Article 2(c), first sentence.<sup>258</sup>

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.<sup>259</sup> 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"<sup>260</sup>, *i.e.*, that "the incentives and disincentives

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<sup>257</sup> 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.

<sup>258</sup> 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.

<sup>259</sup> India's reply to Panel question No. 11(b).

<sup>260</sup> 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".<sup>261</sup>

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.<sup>262</sup> 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.<sup>263</sup> As the relationship between these two sets of arguments is not clear, the Panel will address them separately.<sup>264</sup> 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 WTO<sup>265</sup>, 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

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<sup>261</sup> India's first oral statement, para. 38.

<sup>262</sup> India's first written submission, paras. 91-96.

<sup>263</sup> India's first oral statement, para. 25; India's second written submission, para. 61; India's reply to Panel question No. 66.

<sup>264</sup> We note that India has not said that the second set of arguments was somehow intended to supersede the first set.

<sup>265</sup> 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.<sup>266</sup> 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.<sup>267</sup> 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.<sup>268</sup> 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.<sup>269</sup>

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.<sup>270</sup>

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"<sup>271</sup> 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),

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<sup>266</sup> The United States refers to exhibits US-8 and US-9.

<sup>267</sup> *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.

<sup>268</sup> India uses the term "chilling effect". India's second oral statement, para. 17.

<sup>269</sup> 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.

<sup>270</sup> Exhibit INDIA-15, p. 1.

<sup>271</sup> *Ibid.*, p. 2.

first sentence. As we have previously pointed out<sup>272</sup>, 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.<sup>273</sup> 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

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<sup>272</sup> *Supra*, para. 6.78.

<sup>273</sup> 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.<sup>274</sup>

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.<sup>275</sup>

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.<sup>276</sup> 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.<sup>277</sup>

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).<sup>278</sup> 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).

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<sup>274</sup> India refers to *Pac Fung Leather Co. v. The United States*, 111 F.3d. 114 (Fed. Cir 1997) (exhibit INDIA-16).

<sup>275</sup> The United States refers to exhibits US-8 and US-9.

<sup>276</sup> India's first written submission, para. 96.

<sup>277</sup> United States' reply to Panel question No. 11(f).

<sup>278</sup> 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).<sup>279</sup> 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.<sup>280</sup> 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.<sup>281</sup> 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.<sup>282</sup> 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 countries<sup>283</sup>, we do not think that these measures could, for that reason

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<sup>279</sup> India's reply to Panel question No. 66.

<sup>280</sup> 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).

<sup>281</sup> India's reply to Panel question No. 58(b).

<sup>282</sup> India's reply to United States' question No. 2.

<sup>283</sup> 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.<sup>284</sup>

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

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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.

<sup>284</sup> 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".<sup>285</sup> 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.<sup>286</sup> 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).<sup>287</sup> 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.<sup>288</sup>

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.<sup>289</sup> At any rate, India has provided no information regarding the steps producers must take in order to comply

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<sup>285</sup> India's first written submission, para. 100.

<sup>286</sup> 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).

<sup>287</sup> India's first written submission, paras. 78, 82-83.

<sup>288</sup> 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.

<sup>289</sup> 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.<sup>290</sup> 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.<sup>291</sup>

(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

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<sup>290</sup> India has not identified the legal basis for such a requirement. India's first written submission, para. 95.

<sup>291</sup> 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.<sup>292</sup> 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).

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<sup>292</sup> *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)".<sup>293</sup> 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.<sup>294</sup> Nevertheless, the clause "as a prerequisite for the

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<sup>293</sup> United States' reply to Panel question No. 73.

<sup>294</sup> 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 requirements<sup>295</sup> that must be met for a good to obtain origin status.<sup>296</sup>

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"<sup>297</sup> and "rigorous"<sup>298</sup>. 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.<sup>299</sup>

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".<sup>300</sup> 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

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"[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."

<sup>295</sup> 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).

<sup>296</sup> 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.*

<sup>297</sup> *Black's Law Dictionary*, B. A. Garner (ed.), West Group, 1999, p. 1434.

<sup>298</sup> *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".

<sup>299</sup> 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.

<sup>300</sup> *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.<sup>301</sup> 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").<sup>302</sup> 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.<sup>303</sup> *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.<sup>304</sup> *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

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<sup>301</sup> 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.

<sup>302</sup> India's second written submission, para. 43.

<sup>303</sup> India refers to section 405(a)(3)(B).

<sup>304</sup> 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.<sup>305</sup> 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

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<sup>305</sup> 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.<sup>306</sup> 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*.<sup>307</sup> 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.

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<sup>306</sup> 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.

<sup>307</sup> 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.<sup>308</sup> 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.<sup>309</sup> 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.<sup>310</sup> 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".<sup>311</sup> 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

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<sup>308</sup> *Supra*, para. 6.207.

<sup>309</sup> India's second written submission, para. 46.

<sup>310</sup> 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.

<sup>311</sup> India's second written submission, para. 46.

link.<sup>312</sup> 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.<sup>313</sup> 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 concerned<sup>2</sup>[.]"

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<sup>2</sup> 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

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<sup>312</sup> *Ibid.*, paras. 45-46.

<sup>313</sup> *Supra*, paras. 6.207.

differentially disadvantageous consequences on certain parties, and because those differential effects are found to be wrong or unjustifiable."<sup>314</sup>

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 GATT<sup>315</sup> and the GATS<sup>316</sup>, 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.

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<sup>314</sup> 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.

<sup>315</sup> 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.

<sup>316</sup> 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".<sup>317</sup> 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.<sup>318</sup> *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.

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<sup>317</sup> India's reply to Panel question No. 60; India's second written submission, para. 68.

<sup>318</sup> 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(d) 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.<sup>319</sup>

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.).<sup>320</sup>

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.<sup>321</sup>

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

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<sup>319</sup> For instance, Article I of the GATT 1994 prohibits discrimination as between "like" products only.

<sup>320</sup> 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.

<sup>321</sup> 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.<sup>322</sup>

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,

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<sup>322</sup> 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.<sup>323</sup>

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.<sup>324</sup> 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.<sup>325</sup> 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.<sup>326</sup>

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<sup>323</sup> India's second written submission, paras. 70-74; India's reply to Panel question No. 60.

<sup>324</sup> *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.

<sup>325</sup> India's first oral statement, paras. 28-29.

<sup>326</sup> 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.<sup>327</sup> 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.<sup>328</sup> 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.<sup>329</sup> 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.<sup>330</sup> To that extent, *mutatis mutandis*, our observations in the preceding paragraph with respect to scarves apply equally here.<sup>331</sup> 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.<sup>332</sup> 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.<sup>333</sup> 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.<sup>334</sup> 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

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<sup>327</sup> 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.

<sup>328</sup> India's second written submission, para. 40.

<sup>329</sup> India's reply to Panel question No. 60.

<sup>330</sup> India's second oral statement, para. 20.

<sup>331</sup> We note that India has not provided any information regarding the manufacturing processes for silk and cotton bed linen.

<sup>332</sup> India's second oral statement, para. 20.

<sup>333</sup> India's second written submission, footnote 33.

<sup>334</sup> *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"<sup>335</sup> 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%.<sup>336</sup> 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.<sup>337</sup> 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.<sup>338</sup>

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.<sup>339</sup> Thus, setting a relatively low percentage threshold is consistent with the fact that cotton goods which

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<sup>335</sup> India's second written submission, para. 72.

<sup>336</sup> India's second oral statement, para. 20.

<sup>337</sup> India's reply to Panel question No. 60; India's second oral statement, para. 19.

<sup>338</sup> United States' reply to Panel question No. 9.

<sup>339</sup> 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.<sup>340</sup>

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.<sup>341</sup>

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*.<sup>342</sup> 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

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<sup>340</sup> 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.

<sup>341</sup> *E.g.*, India's reply to Panel question No. 21; India's second written submission, paras. 9-10, 14, 17 and 20.

<sup>342</sup> India's first written submission, para. 102.

in those measures.<sup>343</sup> 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.

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<sup>343</sup> 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.