

***CHINA – MEASURES RELATED TO THE EXPORTATION OF  
RARE EARTHS, TUNGSTEN AND MOLYBDENUM***

**(DS431)**

**OPENING ORAL STATEMENT OF THE UNITED STATES  
AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL  
WITH THE PARTIES**

**February 26, 2013**

1. Good morning, Mr. Chairman and members of the Panel. On behalf of the United States, we would like to begin by thanking the Panel and the Secretariat staff for taking on this task. We look forward to working with you, and with the delegations of China, the European Union and Japan, as you carry out your work.

## **I. INTRODUCTION**

2. We are here today because China, notwithstanding the plain language of the WTO Agreement, the clear-cut application of those provisions in *China – Raw Materials I* (or *Raw Materials I*),<sup>1</sup> and years of engagement by the complaining parties, imposes duties and quotas on the exportation of key industrial raw materials. In particular, this dispute involves export restraints on rare earths, tungsten and molybdenum – for all of which China is the world’s leading producer.

3. Rare earths, tungsten and molybdenum are used to produce a wide variety of products, including electronics, automobiles, steel and highly sophisticated products such as wind turbines. These are materials that China considers so economically strategic that it has imposed on them both export duties and export quotas to maximize its leverage as the globally dominant producer and supplier of these materials.

4. Over time, China has increased the severity of export restrictions on these products by, for example, expanding the scope of coverage of the quotas while decreasing the corresponding quota volumes, sometimes dramatically – as in the case of the rare earth quota in the second half of 2010. These restrictions have and continue to severely distort the global marketplace for these materials and their downstream products. Recent and current data reflect the profound havoc that these export policies have wrought on trade, production and behavioral patterns for actors in the market for these materials. For example, China’s production and export of the downstream products that

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<sup>1</sup> Panel Report, *China – Measures Related to the Exportation of Various Raw Materials* (“*China – Raw Materials I (Panel)*”), WT/DS394/R, WT/DS395/R, WT/DS398/R, (adopted 22 February 2012), as modified by the Appellate Body Report, WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R; Appellate Body Report, *China – Measures Related to the Exportation of Various Raw Materials* (“*China – Raw Materials I (AB)*”), WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R (adopted 22 February 2012).

use rare earths, tungsten and molybdenum as inputs have increased dramatically. Manufacturing plants, jobs and technology in the industries that use these materials as inputs have moved into China from other countries around the world. Further, consumers have faced a lack of predictability in supply and price volatility, particularly after the cut in the rare earth quota in 2010.

5. In addition to its overall restrictions, China's export quota allocation requirements further restrict the market by limiting the number of entities that can export rare earths and molybdenum through the imposition of unjustifiable minimum capital and prior export performance requirements.

6. And despite all the disruption that its policies have caused, China has not been conserving these materials. Rather, China's domestic consumption has increased, fueled by the fact that materials that otherwise would have been exported are now consumed domestically.

7. As such, China's measures undermine core principles of the multilateral trading system – they discriminate against foreign users of these materials and provide substantial and unfair advantages to Chinese users when they compete with foreign industries and workers.

8. In response to the co-complainants' first written submissions establishing *prima facie* breaches of Paragraph 11.3 of the Accession Protocol by China's export duties, Article XI:1 of the GATT 1994 by China's export quotas, and Paragraph 5.1 of the Accession Protocol by China's export quota administration requirements, China has not contested these *prima facie* showings. Instead, China seeks only to invoke affirmative defenses to excuse its deviations from its WTO obligations. Accordingly, the issues are limited to whether China can avail itself of these excuses in the case of China's export duties, and whether China has met its burden of demonstrating that its measures satisfy the requirements of the exceptions that permit deviation from WTO rules for conservation or the protection of human health.

**II. ARTICLE XX OF THE GATT 1994 IS NOT AVAILABLE AS A DEFENSE FOR CHINA’S EXPORT DUTIES AND WOULD NOT IN ANY EVENT JUSTIFY CHINA’S MEASURES**

9. As noted already, China imposes export duties simultaneously with quotas on the various rare earths, tungsten and molybdenum products at issue. In Paragraph 11.3 of its Accession Protocol, China committed to eliminate taxes and charges applied to exports. Yet China imposes duties of up to 25 percent *ad valorem* on the exportation of various forms of rare earths, tungsten and molybdenum for which China did not reserve a right to impose export duties. The challenged export duties are, therefore, inconsistent with China’s commitments.

10. The United States maintains that this is the end of the analysis. As the panel and the Appellate Body concluded in *Raw Materials I*, China cannot avail itself of the Article XX exceptions of the GATT 1994.<sup>2</sup>

11. Even China appears to recognize that there is a serious question as to whether the Article XX exceptions of the GATT 1994 are available to excuse breaches of Paragraph 11.3 of its Accession Protocol. After first unsuccessfully seeking advance findings from the Panel prior to this first panel meeting, China has now belatedly made what appears to be only a superficial defense for these duties.

12. However, even aside from the fact that Article XX is not available as a matter of law, China’s asserted Article XX defense for its export duties would fail on the merits. China has not presented any compelling arguments or evidence to distinguish its export duties on rare earths, tungsten and molybdenum from the export duties challenged in *Raw Materials I*. And the DSB recommendations and rulings in that dispute provide a persuasive rationale to reject China’s arguments in this dispute. Accordingly, as the *Raw Materials I* panel concluded in assuming *arguendo* that Article XX of the GATT 1994 was available as a defense to a breach of China’s export duty commitments contained in Paragraph 11.3 of the Accession Protocol,<sup>3</sup> China’s

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<sup>2</sup> *China – Raw Materials I (Panel)*, para. 7.159; *China – Raw Materials I (AB)*, para. 307.

<sup>3</sup> *China – Raw Materials I (Panel)*, paras. 7.591, 7.162.

assertion in this dispute that the exceptions under Article XX excuse China’s breach of those commitments must be rejected.

13. With respect to the particulars of the Article XX(b) defense that China presented for the first time only a week and a half ago, and putting aside for the moment that this defense is not available to excuse a breach of Paragraph 11.3, the United States provides the following preliminary observations. The United States notes first that China maintains both export duties and quotas on a number of the products at issue. However, China has provided no explanation as to why it needs export duties to protect human, animal, or plant life or health under Article XX(b), and export quotas on the same products as conservation measures under Article XX(g).

14. China’s attempt to justify its export duties under Article XX(b) suffers from a number of shortcomings. In particular, similar to its failed attempt to justify its export quotas under Article XX(g), China ignores the fact that it is the production of the products at issue, not their export, that produces pollution.<sup>4</sup>

15. In addition, China has not demonstrated that its export duties fall within the range of policies designed to protect human, animal or plant life or health. While the United States will elaborate on this point in our second written submission, it is important to point out now that there is no link between China’s export duties and any comprehensive policy to reduce pollution. As the panel found in rejecting China’s Article XX(b) defense with respect to export duties in *Raw Materials I*, “a Member must do more than simply produce a list of measures referring, *inter alia*, to environmental protection and polluting products”; there must be “persuasive evidence of a connection between environmental protection standards and export restrictions.”<sup>5</sup> China has provided no such evidence.

16. Moreover, China’s attempted substantiation of an Article XX(b) defense with respect to its export duties indicates that those duties are in no way “necessary” for the protection of health but

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<sup>4</sup> *China – Raw Materials I (Panel)*, para. 7.586.

<sup>5</sup> *China – Raw Materials I (Panel)*, paras. 7.511, 7.507.

instead promote China’s economic goals. China’s claim that its export duties are “apt to make a material contribution” to the achievement of the objectives of reducing pollution and protecting health is based on its assertion that the export duties increase the price of exported rare earths, tungsten and molybdenum.<sup>6</sup> However, this increase simply reduces access to these products by consuming industries in the rest of the world vis-a-vis consumers in China.

17. China again completely ignores the fact that the export duties *decrease* the price of those products when consumed domestically and thereby encourage the production of downstream products, which can also produce pollution. Indeed, the panel in *Raw Materials I* found that China’s export duties on certain raw materials were not “necessary” within the meaning of Article XX(b) because China had similarly failed to account for the pollution generated by the downstream sector.<sup>7</sup> China’s repeated failure to acknowledge that it is the production – not the export – of rare earths, tungsten, and molybdenum that might lead to environmental or pollution concerns belies China’s assertion that its restrictions on those exports are designed to address those concerns.

### **III. CHINA’S ATTEMPT TO EXCUSE ITS EXPORT QUOTAS ON RARE EARTHS, TUNGSTEN AND MOLYBDENUM FAILS**

18. Turning to China’s imposition of export quotas on rare earths, tungsten and molybdenum, China does not dispute that these measures breach its obligations under Article XI:1 of the GATT 1994. Instead, China seeks to excuse these export quotas – imposed on nearly 100 rare earth, tungsten, and molybdenum ores and materials at various stages of processing – as a conservation measure. As the United States will outline in this statement, and will explain more fully in our second written submission, China has not met its burden of establishing a justification under Article XX(g) of the GATT 1994.

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<sup>6</sup> China’s Substantive Defense of Export Duties, para. 36.

<sup>7</sup> *China – Raw Materials I (Panel)*, paras. 7.533-7.534, 7.538.

19. As the Appellate Body reasoned in *US – Gasoline*, the analysis under Article XX is “two-tiered: first, provisional justification by reason of characterization of the measure under [the subparagraph]; second, further appraisal of the same measure under the introductory clauses of Article XX.”<sup>8</sup> A measure that is inconsistent with obligations in the GATT 1994 may nevertheless be permitted under Article XX(g) if it:

- (1) “relate[s] to the conservation”
- (2) “of an exhaustible natural resource,” and
- (3) is “made effective in conjunction with restrictions on domestic production or consumption.”

20. If the measure meets these requirements, it must then also satisfy the requirements of the Article XX *chapeau* that it not be applied in a manner that would constitute “arbitrary or unjustifiable discrimination,” or “a disguised restriction on international trade.”

21. For China to justify its quotas under Article XX, China must demonstrate that each measure satisfies the specific conditions set out in subparagraph (g) of Article XX and that it also satisfies the requirements of Article XX’s *chapeau*. As the United States will discuss, China has not met either burden.

#### **A. China Has Not Demonstrated that Its Export Quotas Relate to the Conservation of Exhaustible Natural Resources**

##### **1. China Presents the Wrong Legal Standard of “Relating To”**

22. China frames the relevant legal standard under the first prong of the Article XX(g) analysis as whether China maintains “a comprehensive conservation policy.”<sup>9</sup> In examining whether measures “relate to conservation” under Article XX(g), panels and the Appellate Body have asked

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<sup>8</sup> Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline* (“*US – Gasoline (AB)*”), WT/DS2/AB/R, p. 22 (adopted 20 May 1996).

<sup>9</sup> See, e.g., China’s First Written Submission, para. 45.

whether the challenged measures are “primarily aimed at” the conservation of exhaustible natural resources and whether there is a “close and substantial relationship of means and ends” between the export quotas and conservation.<sup>10</sup> China’s articulation appears to confuse the Article XX(g) “relating to” analysis with the Appellate Body’s interpretation of the requirements of Article XX(b) and whether a challenged measure is “necessary” for the protection of human, animal or plant life or health. Furthermore, by arguing that all it needs to show to satisfy the “relating to” requirement of Article XX(g) is the existence of a comprehensive conservation policy, China has even confused and distorted the Article XX(b) standard.

23. In addition, even under China’s own mis-statement of the legal standard for the wrong subparagraph of Article XX, China’s arguments would fail because it does not have a “comprehensive conservation policy” for the materials in question. Rather, as articulated in documents such as the *Guidance on Enhancing the Management of Raw Material Industries*<sup>11</sup> and the *12th Five-Year Development Plan for New Materials*,<sup>12</sup> China’s export quotas are designed and implemented to encourage the production and export of higher value-added products. In fact, according to these central government guidance and planning documents, China sets explicit production goals for such downstream products so as to encourage their increased production and, as a result, increase domestic demand for rare earths, tungsten and molybdenum. This wholly contradicts China’s assertion that it has a “comprehensive conservation policy” for these materials. More importantly, it undermines any attempt by China to establish that its export quotas have a “close and substantial relationship of means and ends” with the goal of conservation.

## **2. China Has Not Established that the Various Materials Subject to the Export Quotas Are “Exhaustible Natural Resources”**

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<sup>10</sup> Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres (“Brazil – Tyres (AB)”)*, WT/DS332/AB/R, para. 151 (adopted 17 December 2007).

<sup>11</sup> JE-12.

<sup>12</sup> JE-28.

24. At the outset, the United States would like to observe a fundamental gap in China’s argumentation regarding what its export quotas are seeking to conserve. China argues that, because the panel in *Raw Materials I* found, and it was uncontroverted, that bauxite and fluorspar were exhaustible natural resources, the raw materials at issue here are also “exhaustible natural resources” whose conservation China is seeking to service through the export quotas.<sup>13</sup> However, the bauxite and the fluorspar at issue in *Raw Materials I* were a clay and a mineral which, like raw ores, are basically in the form in which they are mined from the earth.<sup>14</sup> In the present dispute, China’s export quotas cover not just ores but even further processed products, such as salts and metals and alloys like rare earth ferroalloys, tungsten carbides and molybdenum powders.

25. The United States also notes that China subjects certain intermediate products to export quotas while excluding other, higher valued-added intermediate products from the export quota regime. For example, China limits the export of certain rare earth fluorides, but does not limit the export of rare earth magnets. In fact, China encourages increased production of rare earth magnets. And while China limits the export of intermediate forms of tungsten and molybdenum, it does not limit the export of high-end steel products containing these elements. China has not explained what it considers to be the “exhaustible natural resources” here. China has therefore not established that its export quotas serve the conservation of “exhaustible natural resources,” in particular because these export quotas cover materials that span so many stages of the upstream to downstream progression of processing.

**3. China Has Not Shown that the Export Quotas Are Primarily Aimed at Conservation and Have a Close and Substantial Relationship of Means and the Ends of Conservation**

26. China also has not shown that the export quotas are primarily aimed at conservation and

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<sup>13</sup> See China’s First Written Submission, paras. 85-87.

<sup>14</sup> *Raw Materials I (Panel)*, para. 7.369.

have a close and substantial relationship of means and ends of conservation. The “relating to” requirement of Article XX(g) has been interpreted as meaning that the measures at issue must be “primarily aimed at” the conservation of an exhaustible natural resource<sup>15</sup> and there must be a “close and substantial relationship of means and ends” between the means represented by the measure at issue and the ends of conservation.<sup>16</sup>

27. China asserts for several reasons that the export quotas on rare earths, tungsten and molybdenum are measures that are related to the conservation of these respective resources.<sup>17</sup> However, as the United States will describe, none of these proffered justifications meet the “relating to” requirement of Article XX(g).

**a. References to Conservation in China’s Measures for Rare Earths, Tungsten and Molybdenum**

28. Regarding references to conservation in China’s measures for rare earths, tungsten and molybdenum, China argues in its first submission that its export quotas “relate” to conservation because some of the measures that administer the export quotas on rare earths, tungsten and molybdenum now state that their purpose is to conserve natural resources. However, despite the fact that some of these export quotas have been in existence for more than a decade, references to conservation only began to appear in China’s annually renewed export quota measures during or after the *Raw Materials I* proceeding, as China attempted to defend its export restrictions under Article XX(g) in that dispute.

29. The United States would like to note that there is very limited value in these types of statements in China’s export quota measures, which have a self-serving purpose and appear to be incorporated in *post hoc* circumstances. This is especially relevant in the case of molybdenum,

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<sup>15</sup> See, e.g., GATT Panel Report, *Canada – Herring and Salmon*, L/6268, BISD 35S/98, para. 4.6 (adopted March 22, 1988); *US – Gasoline (AB)*, p. 19.

<sup>16</sup> See, e.g., Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products* (“*US – Shrimp (AB)*”), WT/DS58/AB/R, para. 136 (adopted 6 November 1998).

<sup>17</sup> China’s First Written Submission, paras. 91-112, 135-145.

where China’s only argument that the quotas relate to conservation is that there exist such self-serving statements in the measures.

30. To take just one of many examples, China cites in its first written submission the reference to conservation in the 2012 Rare Earth Export Quota Application Procedures.<sup>18</sup> However, the 2012 document includes only cursory references to conservation, and the 2011 version of this document had no reference at all.<sup>19</sup> This pattern is repeated in the measures relating to tungsten and molybdenum.

31. The *post hoc* and self-serving nature of these conservation incantations becomes even more obvious when put into the context of China’s pre-existing statements about the purpose of export restraints in its industrial policy documents. A number of these documents are discussed at paragraphs 26-36 of our first written submission, and we will not take the Panel’s time by discussing these documents here. Rather, the United States will briefly emphasize two points.

32. First, China has not – and cannot – attempt to rebut or explain away any of its written statements showing that the measures were adopted for purposes of industrial policy.

33. Second, even documents supplied by China in its first written submission show that China’s export quotas are not for conservation. For example, in its first written submission, China cites to the “Emission Standards of Pollutants from Rare Earths Industry” issued by China’s Ministry of Environmental Protection.<sup>20</sup> According to China, this document shows that the country has a “comprehensive conservation regime” for rare earths.

34. However, in the corresponding “Explanation for the Compilation of Emission Standards of Pollutants from Rare Earths Industry,”<sup>21</sup> which China did not provide to the Panel, the Ministry of Environmental Protection makes it very clear that the export quotas and duties on rare earths are not meant for conservation, but rather to promote Chinese industry at the expense of the rest of the

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<sup>18</sup> *Id.*, para. 92.

<sup>19</sup> See 2011 Rare Earth Export Quota Application Procedures (JE-101).

<sup>20</sup> China’s First Written Submission, paras. 30, 196-198, CHN-31-B.

<sup>21</sup> Explanation for the Compilation of Emission Standards of Pollutants from Rare Earths Industry, 17-18 (JE-99).

world. According to the Ministry, the export quotas help realize China’s industrial policy goal of “transforming rare-earth resource advantage into economic advantage” and the export duty regime is designed to “promote the sustained, fast and steady development of the rare earth industry.”

35. In addition, the panel in *Raw Materials I* found that it is relevant in determining whether an export restriction relates to conservation how the measure characterizes the relationship between the restriction and the goal of conservation.<sup>22</sup> In other words, beyond just a rote mention of conservation, how does the measure explain its material contribution to the goal of conservation. Here, China has not cited a single explanation in the measures that articulates this relationship – nor does one exist.

**b. China’s Theory That Export Quotas Signal the Rare Earth and Tungsten Markets**

36. China argues that the export quotas relate to the conservation of rare earths and tungsten by:

[S]ignaling to foreign users of rare earths [and tungsten] the need to develop and locate other sources of supply or develop substitutes. Export quotas, working in conjunction with domestic Chinese restrictions, create a dis-incentive to domestic Chinese producers to expand production, while simultaneously creating an incentive for foreign rare earth [and tungsten] producers to initiate and expand production.<sup>23</sup>

As the United States will now discuss, there are a number of reasons why this argument is baseless.

37. First, the export quotas are part of a regime that purposefully creates two markets – an internal and an external one – for these materials. The bifurcated markets result in a “two-tiered” pricing structure – i.e., lower prices in China, higher prices abroad – and a corresponding incentive for foreign users of rare earths and tungsten to relocate their manufacturing operations, technologies and jobs to China, so as to avoid being subject to the export quotas. Indeed, China actively encourages such behavior by offering access to resources in exchange for advanced

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<sup>22</sup> *Raw Materials I (Panel)*, para. 7.418.

<sup>23</sup> China’s First Written Submission, para. 140.

manufacturing technology. This type of encouragement, which is known as the “technology for resource” pillar of China’s industrial policy, was discussed in the U.S. first written submission at paragraph 29.

38. For example, China actively encourages foreign investment in a number of high value-added manufacturing processes that utilize rare earths (for example, rare earth magnets) and tungsten (for example, high temperature bearable tungsten filament) as inputs.<sup>24</sup> And because foreign users of rare earths and tungsten have an incentive to relocate to China, the export quotas increase domestic demand for Chinese-produced rare earths and tungsten, which is contrary to China’s claim that the export quotas relate to conservation of these resources in China.

39. The export quotas have, in fact, caused a number of downstream users of rare earths and tungsten to relocate to China.<sup>25</sup> Companies that move save money by manufacturing in China on account of the export restrictions and, consequently, increase domestic demand for rare earths and tungsten.

40. Second, China does not explain how export quotas, as opposed to domestic production restrictions, create an incentive for foreign rare earth and tungsten producers to increase production. China can readily send such a signal through domestic production restrictions and need not relate to discriminatory, trade-distorting export quotas.

41. Finally, it is unclear why China considers that its goal should be to stimulate or otherwise signal activity in the international market. It is a bit awkward that China considers that its conservation aims should lead it to impose export quotas in order to direct and regulate economic behavior and activity levels in other Members’ markets. China’s argument that it is using its export quotas to encourage increased production in the territory of other Members is at best not credible and at worst another example of how its export quotas are not, in fact, legitimate

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<sup>24</sup> See Catalogue of Industries for Guiding Foreign Investment, Catalog of Encouraged Foreign Investment Industries, III, 10(26) and 22(2) (Exhibit JE-16).

<sup>25</sup> Cost of ‘greener’ lighting explodes as China dominates rare-earth supply (JE-102); H.C. Starck Press Release (JE-103).

conservation measures.

**c. China’s Argument That Export Quotas Police Against Rare Earth Smuggling**

42. China claims that the export quotas on rare earths prevent the smuggling and subsequent foreign sale of materials produced above domestic production targets. This attempted justification fails because the alleged cure is, in fact, the problem.<sup>26</sup>

43. Specifically, China’s export duties and quotas, and the resulting substantial increase in prices for rare earths outside of China, have themselves caused the problem at issue by creating incentives for smugglers to take advantage of the price differences between domestic (Chinese) prices and prices in the rest of the world – i.e., the “two-tiered” pricing structure. In fact, according to the deputy director of China’s General Administration of Customs anti-smuggling bureau, China’s export restrictions on rare earths are one of the “main reasons” behind smuggling.<sup>27</sup> For China now to argue that the export quotas are needed to police against the very problem that they produced is capable of many characterizations – the most charitable being that it is disingenuous.

**d. China’s Argument That the Export Quotas are an Export Safeguard for Chinese Rare Earth Consumers**

44. China also contends that the export quotas on rare earths serve as an “export safeguard” that protects Chinese users from an unexpected surge in foreign demand. According to China:

[I]f the only tool that [China] had at [its] disposal in 2012 were production and extraction quotas for rare earths - not export quotas - then China ran the risk that unexpected surges in foreign demand could have negatively impacted China’s users . . . . In effect, the export quotas function as a “safeguard” mechanism to guard against unanticipated surging exports. This is analogous to the safeguard procedures for surges of unanticipated imports under the Agreement on Safeguards in the WTO.<sup>28</sup>

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<sup>26</sup> China’s First Written Submission, paras. 133-138.

<sup>27</sup> Smuggling blights rare earths industry (JE-104).

<sup>28</sup> China’s First Written Submission, para. 151.

As the United States will discuss, China’s argument lacks merit and should be rejected.

45. The United States notes that China’s safeguard argument has nothing to do with conservation, but rather confirms that the purpose of China’s export quotas is to provide a supply to downstream domestic industries. Moreover, as a factual matter, China has presented no evidence that an export surge has happened or is likely to happen.

46. In addition, the export “safeguard” concocted by China has no basis in the covered agreements. The GATT 1994 contains no provision that specifically allows Members to suspend obligations, such as those found in Article XI:1, to effect an export safeguard to protect domestic consumers from a surge in foreign demand. When Members wanted to create an exception to a WTO obligation, they made their intention clear – such as by providing an explicit mechanism (accompanied by procedural safeguards) to suspend obligations under the GATT 1994 in the case of an unanticipated import surge.

**4. China Has Not Established that the Export Quotas Are “Made Effective in Conjunction with Restrictions on Domestic Production or Consumption”**

47. For a trade restriction to fit within the parameters of Article XX(g) of the GATT 1994, the measure must “work together with restrictions on domestic production or consumption, which operate so as to conserve an exhaustible natural resource.”<sup>29</sup> Article XX(g) also requires “even-handedness in the imposition of restrictions, in the name of conservation, upon the production or consumption of exhaustible natural resources.”<sup>30</sup>

48. As the United States will discuss, China has failed to meet its burden to show that the export quotas work together with restrictions on domestic production or consumption to conserve an exhaustible natural resource. By the same token, China has also failed to show that the export quotas at issue in this dispute are even-handed.

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<sup>29</sup> *China – Raw Materials I (AB)*, para. 356.

<sup>30</sup> *US – Gasoline (AB)*, p. 21.

**a. China’s Export Quotas Do Not Work Together with Restrictions on Domestic Production or Consumption**

49. China has not, and cannot, meet its burden of demonstrating that the export quotas work together with restrictions on domestic production or consumption to conserve rare earths, tungsten and molybdenum. In particular, China has failed to show that it restricts domestic production or consumption. In fact, the export quotas only work to divert the subject material to Chinese users, at the expense of foreign users in the rest of the world, as the data confirm. Accordingly, the export quotas do not “work together” with restrictions on domestic production or consumption to conserve the resources in question.

50. For rare earths, China focuses on its domestic production targets, which it claims are set below the actual production rates in the previous year and, therefore, there is a restriction on domestic production within the meaning of Article XX(g).<sup>31</sup> China’s analysis is based on data that combine all 17 unique rare earths into one aggregated production number, and it is that aggregated “rare earths” number that China compares to the domestic production target. The analysis is fatally flawed because it is based on the erroneous premise that there is a single rare earths market.

51. According to the Roskill presentation submitted by China in its first written submission: “[t]he ‘rare earths market’ does not exist. We cannot treat rare earths as a single commodity.”<sup>32</sup> The Roskill presentation goes on to admonish the reader that “[a] market for ‘rare earths’ [is] a misguided concept.”<sup>33</sup> Indeed, China argues elsewhere in its first written submission that the demand for one medium/heavy rare earth (samarium) may be different than the demand for another (terbium).<sup>34</sup> However, China’s entire argument is based on the assumption, rejected in China’s own documents and arguments, that rare earths are a single commodity.

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<sup>31</sup> China’s First Written Submission, paras. 179-180.

<sup>32</sup> CHN-4, p. 7 (emphasis added).

<sup>33</sup> CHN-4, p. 9.

<sup>34</sup> China’s First Written Submission, para. 249.

52. To take one example, China has not shown that it sets the domestic production target for terbium in a way that ensures that it is below last year’s terbium production. Instead, China asks the Panel to assume that the production of terbium is limited because the production of “rare earths” is allegedly limited. This assumption wholly violates China’s own claim that rare earths is not a single commodity and, therefore, should be rejected.

53. China has also failed to show that the production restrictions on rare earths and tungsten actually restrain production given the amount of production over the target amount. For example, for the one year which China provided production data, China produced 62,693 metric tons (MTs) of tungsten concentrates, which is approximately 30 percent more than nominally allowed pursuant to the production target. As noted in Colombia’s third party submission, such gross over-production shows that the production caps are “ineffective to control domestic production” and, therefore, do not meet the requirements of Article XX(g).<sup>35</sup>

54. For molybdenum, China has not even argued that the domestic production targets are set below the actual production rates in the previous year and, therefore, that there is a restriction on domestic production of molybdenum within the meaning of Article XX(g) of the GATT 1994.<sup>36</sup>

55. As to the other restrictions on production, such as resource taxes, China has failed to demonstrate that these restrictions have a limiting effect on production. For example, the RMB 30 per ton tax on heavy rare earths would represent only 0.02 percent of the 2012 average price of yttrium oxide. In contrast, the export duty on yttrium oxide represents 25 percent of the price. The resource taxes on tungsten and molybdenum are similarly low when compared to the price. For these reasons, China has failed to meet its burden to show that there are restrictions on the domestic production of the materials in question.

56. In addition to the lack of binding domestic production restrictions, China’s export quotas on rare earths, tungsten and molybdenum do not work together with such restrictions to conserve

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<sup>35</sup> Colombia’s Third Party Submission, para. 19.

<sup>36</sup> China’s First Written Submission, paras. 366-370.

these resources. Rather, the export quotas only serve to divert these raw material supplies to domestic users.

57. According to the Roskill report provided by China in its first written submission, Chinese consumption of rare earths grew nearly 11 percent per year between 2005 and 2010.<sup>37</sup> At the same time, consumption in the rest of the world declined by 4 percent per year.<sup>38</sup> The domestic production restrictions that China has highlighted certainly did not restrain Chinese consumption. Indeed, the fact that consumption in China could continue to grow while consumption in the rest of the world was shrinking reflected “the tightening export quota.”<sup>39</sup>

58. In addition, Roskill predicts that Chinese supply of rare earths is forecast to increase by around 8 percent between 2011 and 2015 to 145,000 MTs of rare earth oxide (REO), but that “this increase in output will mainly serve to supply the growing demand for rare earths in China’s manufacturing industry.”<sup>40</sup> Roskill’s prediction is in line with China’s National Mineral Resource Plan for 2008-2015, which calls for China to extract 140,000 MTs of rare earths in 2015, which would be a substantial increase from current levels.<sup>41</sup>

59. Clearly, China’s export quotas on rare earths do not work together with restrictions on domestic production to conserve China’s rare earth resources. Rather, the export quotas enable China to continue to consume more rare earths at the expense of the rest of the world.

60. The story is similar for tungsten and molybdenum – the export quotas have diverted these raw materials to downstream industries, such as steel, and China has steadily increased production. Thus, as was the case with rare earths, the export quotas on tungsten and molybdenum do not “work together” with restrictions on domestic production to conserve the resources in question.

## **b. The Export Quotas Are Not Even-Handed**

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<sup>37</sup> CHN-9, p. 3; China’s First Written Submission, para. 119.

<sup>38</sup> CHN-9, p. 3.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*, p. 6.

<sup>41</sup> JE-105.

61. The panel in *Raw Materials I* observed, and China conceded in its first written submission, that domestic restrictions on the production of raw materials, such as taxes and production targets, affect both domestic and foreign users of the materials equally.<sup>42</sup> Export quotas, in contrast, affect only foreign users.<sup>43</sup> Therefore, in order to show even-handedness when a respondent applies both domestic restrictions and export quotas, the responding party “need[s] to show that the impact of the ... export quota on foreign users is somehow balanced with some measure imposing restriction on domestic users and consumers.”<sup>44</sup> Otherwise, foreign users are burdened with two restrictions (the domestic restriction and the export quota), domestic users only face one restriction (the domestic restriction), and the export quota is not even-handed.

62. In its first written submission, China implies that domestic users are restricted by the export quota because “[w]hat is left of the production after the export quota is filled can be purchased domestically.”<sup>45</sup> This statement is wholly inaccurate. There is no restriction on domestic Chinese users of rare earths, tungsten and molybdenum from purchasing any of the products even if they are eligible to be exported. In other words, China does not impose a restriction on domestic users that balances the export quotas on foreign users. Accordingly, China’s export quotas are not even-handed.

63. China also argues that the export quota system for rare earths actually “creates incentives for holders of the allocated export quotas to sell rare earths to supply foreign demand.”<sup>46</sup>

According to China, it uses an allocation formula that bases the size of an exporter’s quota share on past performance, thereby creating an incentive for each exporter to fully supply the allocated amount to foreign consumers.

64. China’s argument is baseless. China has presented no evidence that its export performance

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<sup>42</sup> *China – Raw Materials I (Panel)*, paras. 7.460, 7.465; China’s First Written Submission, para. 149.

<sup>43</sup> *China – Raw Materials I (Panel)*, paras. 7.460, 7.465.

<sup>44</sup> *Id.*, para. 7.465.

<sup>45</sup> China’s First Written Submission, para. 24.

<sup>46</sup> *Id.*, paras. 153, 244.

requirements cause foreign consumers to receive the amount of products specified in the quotas.

Indeed, China frequently highlights the fact that the export quotas for rare earths were not filled in 2012. Moreover, under the allocation formula, holders of export quota allocations will not have their share cut in the next year if sales of rare earths in the export market at large decrease.

65. The lack of a measure imposing any corresponding restriction on Chinese users has created what is commonly referred to as a “two-tiered” pricing structure for rare earths, tungsten and molybdenum, with prices outside China higher than prices inside China. And while the Appellate Body in *U.S. – Gasoline* noted that there is not an “effects-test” for Article XX(g), the vast differences in the domestic versus foreign prices of a number of the products provide more evidence that the export quota is not even-handed.

66. To take just a few examples, the average 2012 Chinese export price for yttrium was 250 percent higher than the average Chinese domestic price. The export prices for europium and terbium were more than double the corresponding domestic price.

67. In addition, relative changes in the export quotas as compared to the domestic production targets for rare earths, tungsten and molybdenum further demonstrate the lack of even-handedness in the measures at issue. In short, the export quotas have been decreasing, sometimes drastically, while production targets have been increasing. This fact also shows that the export quotas are not even-handed.

68. For rare earths, China’s Ministry of Land and Resources set an extraction target of 87,020 MTs of REOs in 2007.<sup>47</sup> Since then, the extraction target has swelled to 93,800 MTs of REOs in 2012.<sup>48</sup> In comparison, the export quota for rare earths in 2007 was 59,643 MTs in gross weight.<sup>49</sup> Since 2007, the export quota has been cut nearly in half, to 31,000 MTs in gross weight for 2012.<sup>50</sup>

69. For tungsten, China set the extraction target at 59,270 MTs in 2007, and that target has

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<sup>47</sup> CHN-5, p. 4.

<sup>48</sup> CHN-19.

<sup>49</sup> CHN-5, p. 4.

<sup>50</sup> CHN-63.

grown to 81,320 MTs in 2012.<sup>51</sup> Over the same period of time, the export quota fell from 17,200 MTs to 15,400 MTs.<sup>52</sup> And for molybdenum, China first set production targets in 2010 at 185,000 MTs. In 2012, the amount was 194,520 MTs.<sup>53</sup> Over the same period of time, the export quota fell from 25,500 MTs to 25,000 MTs.<sup>54</sup>

70. In sum, China has not demonstrated that its export quotas on rare earths, tungsten and molybdenum are even-handed. Accordingly, China has not shown, and cannot show, that its measures are justified under Article XX(g) of the GATT 1994.

##### **5. China’s Erroneous Interpretation of the Whole of Sub-Paragraph (g) Rests on a Flawed Foundation**

71. As was the case in *Raw Materials I*, China devotes a great deal of time and effort to underscoring China’s belief that its economic justification – that is, a purported right to adopt measures regarding the use of natural resources to pursue domestic economic policies regardless of WTO obligations – is somehow reflected in Article XX(g). China characterizes this as an issue of “sovereignty” over its natural resources, and also purports to find support in the principle of “sustainable development.”

72. The sovereignty of a WTO Member over its natural resources is not at issue under Article XX(g). Neither is the right of a WTO Member to choose its economic policies at issue under Article XX(g).

73. Instead, what is at issue under Article XX(g) is whether a measure that is otherwise inconsistent with the GATT 1994 fits within the plain terms of the Article XX(g) exception: that is, whether it relates to the conservation of an exhaustible natural resource; is made effective in conjunction with domestic restrictions on production or consumption; and is not applied in a

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<sup>51</sup> China’s First Written Submission, para. 325.

<sup>52</sup> U.S. First Written Submission, para. 90.

<sup>53</sup> China’s First Written Submission, para. 370.

<sup>54</sup> U.S. First Written Submission, para. 90.

manner which would constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade.

74. In an attempt to get around the plain terms of sub-paragraph (g), China asks the Panel to find that conservation encompasses the “use and management” of these resources, with “use and management” including the ability to direct resources to domestic users at the expense of foreign users.<sup>55</sup> This is inconsistent with the plain meaning of “conservation.” As noted by the Appellate Body in *Raw Materials I*, “conservation” means “the preservation of the environment, especially of natural resources.”<sup>56</sup> Conservation does not mean the preference of domestic industries over their foreign counterparts.

75. In rejecting similar arguments in *Raw Materials I*, the panel noted the fallacy of China’s argument when viewed within the structure of the GATT 1994, especially Article XX(i), which allows for “restrictions on exports of domestic materials ... [p]rovided that such restrictions ... not operate to increase the exports of or the protection afforded to such domestic industry.” According to the panel:

Article XX(g), which provides an exception with respect to “conservation”, cannot be interpreted in such a way as to contradict the provisions of Article XX(i), i.e., to allow a Member, with respect to raw materials, to do indirectly what paragraph (i) prohibits directly. In other words, WTO Members cannot rely on Article XX(g) to excuse export restrictions adopted in aid of economic development if they operate to increase protection of the domestic industry.

76. China also draws the Panel’s attention to the language in the Preamble of the WTO Agreement recognizing the importance of the social and economic benefits of trade, the optimal use of the world’s resources, sustainable development, protection and preservation of the environment, and that there are differences in the needs and concerns of Members at different levels of economic development. None of these WTO objectives indicates in any way that China should be exempted from complying with the terms of Articles XI and XX(g) in order to be able to

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<sup>55</sup> China’s First Written Submission, para. 53.

<sup>56</sup> *China – Raw Materials I (Panel)*, para. 355.

discriminate in favor of its domestic users of raw materials against users in every other Member. Indeed, the Preamble calls for the optimal use of the world's resources, and the same Preamble expresses the desire of Members to contribute to the objectives of the WTO by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations.

**B. *Chapeau*: “Arbitrary or Unjustifiable Discrimination or a Disguised Restriction on Trade”**

77. Regarding the requirements of the *chapeau* of Article XX, China has made no serious attempt in its first written submission to satisfy its burden. As noted in *US – Gasoline*, China has the “burden of demonstrating that a measure provisionally justified as being within one of the exceptions set out in the individual paragraphs of Article XX does not, in its application, constitute abuse of such exception under the *chapeau*.”<sup>57</sup>

78. In particular, China fails to present any facts or arguments regarding how it considers the application of the export quotas can constitute anything other than arbitrary or unjustifiable discrimination between China and its trading partners. While China focuses on the alleged lack of distinction in respect of the destination of the products that are exported,<sup>58</sup> the Appellate Body found in *US – Gasoline* that the responding party must also demonstrate that there is not discrimination between the respondent, here China, and its trading partners in order to meet the burden under the *chapeau*.<sup>59</sup>

79. In addition, while failing to provide any meaningful evidence or arguments showing that China's measures meet the non-discrimination requirements of the Article XX *chapeau*, China's first written submission in fact shows that a particular aspect of its export quotas on rare earths is

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<sup>57</sup> *US – Gasoline (AB)*, p. 22.

<sup>58</sup> See, e.g., China's First Written Submission, para. 128.

<sup>59</sup> *US – Gasoline (AB)*, p. 21; Australia's Third Party Submission, para. 26; Indonesia's Third Party Submission, para. 4.

both arbitrary and a disguised restriction on trade. Specifically, China denominates the export quotas on rare earths in gross weight, while it designates the production quota in REO equivalents, which captures the amount of rare earths in a given product.<sup>60</sup> According to China, “rare earth elements are most frequently separated and sold in their oxide form. Therefore, it is customary to present rare earth data in terms of REO equivalents.”<sup>61</sup>

80. Because the export quota is in gross weight, a 100 MT product that contains 1 MT of rare earths would count just as much against the quota as a 100 MT product that contains 99 MT of rare earths – both would count 100 MT against the quota. This is not a hypothetical problem, as different rare earth products have different REO content. This is shown by the fact that China requires exporters to report the different REO content of rare earth products upon export.<sup>62</sup> In contrast, China denominates the export quotas on tungsten and molybdenum based on metal content, thereby avoiding this problem.

81. It should also be noted that this discrepancy in the denomination used to impose production and export limits can be considered additional evidence that China’s export quota for rare earths is a tool for advantaging China’s domestic industrial interests at the expense of others’ rather than an even-handed conservation measure permitted by Article XX(g).

#### **IV. CHINA HAS NOT JUSTIFIED ITS USE OF MINIMUM CAPITAL AND PRIOR EXPORT PERFORMANCE REQUIREMENTS IN ADMINISTERING THE EXPORT QUOTAS FOR RARE EARTHS AND MOLYBDENUM**

82. China imposes minimum capital and prior export performance requirements as criteria for applicants to be eligible to receive an allocation of the export quotas on rare earths and molybdenum.

83. China attempts to defend its continued use of minimum capital and prior export

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<sup>60</sup> China’s First Written Submission, para. 128.

<sup>61</sup> *Id.*, fn. 266.

<sup>62</sup> See Announcement (2011) No.37 of the General Administration of Customs (1 June 2011) (JE-106).

performance in the administration of its export quotas by reference to its proffered defense for its export quotas. According to China, if its export quotas can be justified under Article XX(g) of the GATT 1994, breaches of its Paragraph 5.1 trading rights commitments are, by extension, also justified.<sup>63</sup> In so doing, China asks the Panel to extend its justification of the export quota under Article XX(g) to its *prima facie* violations of its trading rights commitments.<sup>64</sup>

84. As outlined above, the United States does not agree that the export quotas on rare earths and molybdenum are justified pursuant to Article XX(g). Moreover, even if China’s quotas were justified under Article XX(g), it does not follow that the criteria used to administer those quotas – which violate trading rights commitments in the Accession Protocol and the Working Party Report that are an integral part of the WTO Agreement – are automatically also justified.

85. To the extent that China argues that the minimum capital and prior export performance requirements are themselves justified under Article XX(g), China has made no such showing. As China’s own first written submission demonstrates,<sup>65</sup> those requirements do not regulate trade other than by limiting which enterprises may apply to export under the quota. In other words, China has not, and cannot, show that the minimum capital and prior export performance requirements themselves “relate to the conservation of an exhaustible natural resource,” are “made effective in conjunction with restrictions on domestic production or consumption”, and meet the Article XX *chapeau* requirements. Accordingly, China has not justified its use of minimum capital and prior export performance requirements.

86. China also notes that it removed these requirements in the *Foreign Trade Law*, which is a law of general application that broadly regulates the import and export of goods.<sup>66</sup> However, China’s amendment to the *Foreign Trade Law* is wholly irrelevant to the Panel’s analysis in this dispute, given that China does not dispute that it continues to maintain minimum capital and prior

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<sup>63</sup> China’s First Written Submission, paras. 269-282.

<sup>64</sup> *Id.*, para. 280.

<sup>65</sup> *Id.*, paras. 239-242.

<sup>66</sup> *Id.*, paras. 262-268.

export performance requirements through measures that administer the application process for the rare earth and molybdenum export quotas.

**V. CONCLUSION**

87. China took on obligations as part of its negotiated accession to the WTO and as part of the bargain to receive the benefits of its membership in this organization. Those obligations included ones that would ensure that China did not prevent access by other Members to its supplies of raw materials. China now, for reasons that do not appear to be anything other than industrial policy and economic benefit, wants to forego those obligations. China is all the more aware of its specific obligations under the WTO Agreement after the DSB recommendations and rulings in the *Raw Materials I* dispute, which involved these same policies. We respectfully request the Panel to find that China's measures at issue breach its commitments. This concludes the opening statement of the United States.