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

AB-2014-3 / DS431
AB-2014-5 / DS432
AB-2014-6 / DS433

ORAL STATEMENT OF THE UNITED STATES OF AMERICA

June 4, 2014

1. Good morning, Mr. Chairman and members of the Division. On behalf of the United States, we would like to thank you for the opportunity to appear before you today.

I. Introduction: This Dispute Is about Industrial Policy Premised on the Use of Trade Tools Fundamentally at Odds with the Rules of the Multilateral Trading System

2. We would like to begin by taking a step back and appreciating what this dispute is about. At the heart of the dispute is a far-reaching industrial policy aimed at promoting China's domestic manufacturing industries at the expense of China's trading partners, and adopted without regard to China's WTO obligations. China's industrial policy is effectuated through the use of export restraints imposed on a wide range of industrial raw materials – including the three types of raw materials at issue in this dispute that are used as inputs in the manufacture of both everyday items and some of today's most highly sophisticated products, such as wind turbines and hybrid car batteries. These export restraints are blunt trade measures that are, by China's own admission, facially inconsistent with WTO rules.

3. In the Working Party Report accompanying its Protocol of Accession to the WTO, China represented that it was in the process of *reducing* its use of export restraints and that it subjected only 58 categories of products covering a total of 73 items to non-automatic export licensing and export restrictions.[1] At the time, China also indicated that it subjected 84 items to export duties.[2] In response to the concerns expressed by members of the Working Party with respect to these

[1] Working Party Report, para. 158 (Exhibit JE-1); *see also* U.S. First Written Submission, para. 2.

[2] Working Party Report, para. 156 (Exhibit JE-1); *see also* U.S. First Written Submission, para. 3.

restraints,[3] in particular those applied to "raw materials or intermediate products that could be subject to further processing, such as tungsten ore concentrates, rare earths and other metals,"[4] China committed, as part of the terms of its accession, to eliminate their use, subject only to certain limited, well-defined exceptions.[5]

4. In the years since its accession, however, China's use of export restraints has intensified in number, type, and severity. For example, when this dispute was initiated in 2012, China subjected over 670 items to non-automatic export licensing, 26 categories of products to export quotas, and over 360 items to export duties.[6] At the same time, the export restraints on rare earths and tungsten, specifically discussed in the Working Party Report as of concern to Members, have become more restrictive.[7]

5. During the time that China has maintained its export restraints on rare earths, China has dramatically increased its consumption of rare earths and its production of corresponding downstream goods.[8] While production of rare earth magnets in other countries at best increased only modestly, and often stagnated or declined, China's production skyrocketed by a factor of ten.[9]

6. In addition, as China's export restraints became more severe in mid-2010, dramatic price differences emerged between what Chinese consumers and non-Chinese consumers paid for rare

[3] Working Party Report, paras. 155, 164.
[4] Working Party Report, para. 164 (emphasis added).
[5] *See* Working Party Report, para. 165 and Accession Protocol, para. 11.3.
[6] U.S. First Written Submission, para. 6.
[7] Exhibits CHN-127, CHN-138.
[8] *See* Exhibit JE-129 at 10-14.
[9] *See* Exhibit JE-129 at 16 (Table 5.1).

earths.[10] For example, non-Chinese consumers of high purity yttrium paid more than three times what Chinese consumers paid.[11] The export restraints on these raw materials, and the price differences they created, placed strong pressure on firms that produced high value-added downstream products to relocate their facilities, technologies, and jobs to China to have the same access to the lower-priced raw materials as Chinese domestic producers.

7. On appeal, we note that none of the issues that China has appealed can change the outcome of this dispute. In particular, China has not appealed the Panel's findings related to the *chapeau* to GATT 1994 Article XX or the Panel's findings on Article XX(b). China's efforts appear, instead, to be focused on loosening WTO disciplines and establishing a general basis under WTO rules for accommodating its policy of actively restraining exports of the raw materials for which it is a world leading producer.

II. China's Appeal Regarding the Panel's Interpretation of Article XII:1 of the WTO Agreement and Paragraph 1.2 of China's Accession Protocol Should Be Rejected

8. In Paragraph 11.3 of its Accession Protocol, China committed to eliminate taxes and charges applied to exports, *except for* the products listed in Annex 6, for which China reserved the right to impose export duties up to specified percentages. However, China imposes export duties of up to 25 percent *ad valorem* on various forms of rare earths, tungsten, and molybdenum for which China did not reserve a right to impose export duties. It is the export duties on those products that – along with the export quotas imposed on those products – are being challenged in this dispute as being inconsistent with China's Accession Protocol commitment.

[10] *See* Exhibit JE-129 at 29-34.
[11] *See* Exhibit JE-129 at 29 (Table 7.1).

9. As the Panel in this dispute and the panel and the Appellate Body in the *China – Raw Materials* dispute all concluded, based on a thorough analysis of the text of Paragraph 11.3 and relevant context, China cannot avail itself of the exceptions of Article XX of the GATT 1994 for breaches of its commitment to eliminate export duties.

10. China continues to challenge that conclusion in this appeal. According to China, provisions in China's Accession Protocol that have what China refers to as an "intrinsic relationship" to the GATT 1994 are an integral part of the GATT 1994. While the rationale for this argument evolved over the course of this dispute, one aspect has been consistent: China has never addressed the text or context of Paragraph 11.3 itself.

11. The Panel was not persuaded by China's arguments. Like the panel and the Appellate Body in the *China – Raw Materials* dispute, the Panel found that Article XX of the GATT 1994 is not available to justify breaches of Paragraph 11.3 of China's Accession Protocol. Also like the panel and the Appellate Body in the *China – Raw Materials* dispute, the Panel found that, in any event, China had failed to demonstrate that its export duties satisfy the requirements of the Article XX(b) exception.

12. China has not appealed either of those findings. In fact, China does not even cite Paragraph 11.3 of China's Accession Protocol in its appeal.[12]

13. What China has appealed is intermediary analysis by the Panel with respect to the interpretation of Article XII:1 of the WTO Agreement, read in conjunction with Paragraph 1.2 of China's Accession Protocol. We note the very strange approach of China in this appeal. China's

[12] U.S. Appellee Submission, para. 29; Japan's Appellee Submission, para. 156.

appeal cannot affect the Panel finding that China's export duties on rare earths, tungsten, and molybdenum breach China's obligations. And China has not asked the Appellate Body to find that Article XX of the GATT 1994 is available to justify such a breach.[13] Given that China's appeal would not change the Panel's legal conclusion, the Appellate Body could validly exercise judicial economy over this issue.[14]

14. In any event, China's appeal should be rejected on the merits. First, as explained in detail in the U.S. submissions, China has shown no legal error in the Panel findings that it is challenging. The text and context of Paragraph 1.2 of China's Accession Protocol fully support the Panel's conclusion that the term "WTO Agreement" as used in Paragraph 1.2 means that the Accession Protocol is an integral part of the WTO Agreement, not that individual provisions within the Accession Protocol are integral parts of the multilateral trade agreements. Article XII:1 of the WTO Agreement does not suggest otherwise. As the Panel recognized, Article XII:1 requires an acceding WTO Member to take on all of the obligations of the WTO Agreement and the multilateral trade agreements annexed thereto. Article XII:1 does not render the provisions of an accession protocol an integral part of the annexed multilateral trade agreements, nor mandate the interpreter to attempt to determine to which multilateral trade agreements the provisions of a protocol "intrinsically relate."

15. Indeed, in previous disputes interpreting provisions of China's Accession Protocol, panels and the Appellate Body have looked at "the terms" agreed between the acceding party

[13] U.S. Appellee Submission, paras. 29-31.
[14] *See, e.g.*, *US – Steel Safeguards*, paras. 482-484.

and the WTO and applied the customary rules of treaty interpretation to determine whether the exceptions of Article XX of the GATT 1994 are applicable to the provision at issue. In so doing, they did not look for the existence of some "intrinsic relationship." Rather, and correctly so, they looked at the text and context, in light of the object and purpose of the treaty.

16. Similarly, the Panel in this dispute observed that while a provision of China's Accession Protocol could be an integral part of the GATT 1994 or another multilateral trade agreement, that would occur by virtue of the language included in the individual provision, not as a result of Paragraph 1.2. As the Appellate Body has recognized, Paragraph 11.3 of China's Accession Protocol – in contrast to other provisions of China's Accession Protocol – includes no such language.

17. Moreover, while China suggests that the "intrinsic relationship" test that it developed in the course of this dispute would somehow lend coherence to the exercise of interpreting China's Accession Protocol, it would do no such thing. Under China's argument, the enforceability of Accession Protocol commitments under the DSU depends upon the establishment (presumably through dispute settlement) of an undefined "intrinsic relationship" between the commitment and one of the covered agreements.[15] If this argument is accepted, it is possible that, in the absence of such an "intrinsic relationship," certain commitments would be deemed not enforceable at all. And whether the "intrinsic relationship" exists could only be determined by a proceeding under the DSU that may not have been valid to begin with, if an "intrinsic relationship" is found *not* to

[15] China's Other Appellant Submission (DS431), para. 10; China's Appellant Submission (DS/432, DS/433), paras. 10, 65-69.

exist.

18. There is no reason to adopt such an illogical approach and no basis for adopting China's "intrinsic relationship" approach. As clearly explained by the Panel in this dispute, and as reflected in previous panel and Appellate Body reports, commitments in China's Accession Protocol are enforceable under the DSU because the WTO Agreement is enforceable under the DSU, and China's Accession Protocol is an integral part of the WTO Agreement. And for the same reason, the customary rules of interpretation of public international law apply in disputes regarding provisions of China's Accession Protocol.[16] In other words, to interpret the terms of China's Accession Protocol, the interpreter examines the language actually agreed to in China's Accession Protocol.

19. That is precisely what the Panel did in this dispute, and what the panel and the Appellate Body did in the *China – Raw Materials* dispute. They examined the text of Paragraph 11.3 of China's Accession Protocol, which plainly sets forth the exceptions that apply to the export duty commitment set forth therein, and relevant context, in light of the treaty's object and purpose. In the course of its arguments on this issue – before the Panel, and again on appeal, China has not presented any flaws in the interpretations of Paragraph 11.3 in the *China – Raw Materials* dispute. China has never even addressed the text or context of Paragraph 11.3 itself, notwithstanding that it is the provision at issue in this dispute.

20. This might be consistent with China's proposed interpretive approach: ignore the actual terms set out in China's Accession Protocol, and instead apply an undefined "intrinsic

[16] DSU, Article 3.2.

relationship" test. But it is neither logical, nor consistent with the interpretive approach called for in the DSU and applied in past disputes.

III. The Panel Did Not Err in the Interpretation and Application of the GATT 1994 Article XX(g) Exception

21. China's appeal regarding the Article XX(g) exception, if successful, would significantly diminish the scope of the disciplines under the GATT 1994 in two ways. First, it would mean that the non-conforming measure at issue need only make a mere "contribution" to conservation to meet the "relating to" prong of Article XX(g). It would also effectively read the "made effective in conjunction with" requirement out of Article XX(g).

1. The "Relating to" Prong

22. China's appeal of the Panel's findings that the export quotas on rare earths and tungsten were liable to send an anti-conservation signal to Chinese consumers is based on a flawed legal foundation and derived from flawed reasoning. On the first point, China's argument that the Panel should have ignored the anti-conservation signals sent by the export quotas to domestic consumers is a function of China's broader attempt to weaken the relationship between the non-conforming measure and conservation that is necessary to invoke Article XX(g) successfully.

23. Specifically, China asks the Appellate Body to adopt an approach that export quotas may relate to conservation based solely on the signals sent to *foreign* consumers, while ignoring the that the very same restrictions *shift consumption* from foreign consumers to domestic consumers. This selective approach is needed if China is to have any chance of satisfying its own weakened standard, which requires only that the export quotas make a mere contribution to conservation.

24. But the standard articulated by China is incorrect. The Appellate Body has made clear

that a mere contribution is not enough. Rather, there must be a "substantial relationship" such that the non-conforming measure is not "merely incidentally or inadvertently aimed at" conservation.[17]

25. As the Panel correctly recognized, it needed to examine the likely impact on Chinese consumers for it to be able to determine whether there is "a close and genuine relationship of ends and means" between the export quotas and resource conservation. And the Panel found that the export quotas would in fact serve to shift demand from foreign consumers to domestic consumers. China even conceded that one of the purposes of its rare earth export quotas was to ensure adequate domestic supplies in the (hypothetical) event of a surge in foreign demand.

26. The export quotas that China imposed on rare earths and tungsten undoubtedly shift demand. And China's proposed interpretation of Article XX(g), as only requiring a mere contribution to conservation, when combined with an exclusive focus on foreign consumers, would mean that <u>any</u> demand-shifting mechanism would be permissible under the GATT 1994 *because* the impact falls on foreign consumers. Such a result is untenable and would encourage the discrimination and resource nationalism at the heart of China's policy.

27. Beyond these legal inaccuracies, China's argument is logically flawed. China finds fault with the Panel's analysis of the design and structure of the export quotas in determining whether they bore a "substantial relationship" to conservation. China would have preferred that the Panel look at the "actual effects" in the rare earths and tungsten markets. But that is not how the

[17] *US – Gasoline (AB)*, p. 18.

Appellate Body has envisioned the analysis.[18] Moreover, China's argument that the Panel should have looked at the "actual effects" in the market mistakes correlation with causation, as China never attempts to show that the alleged "actual effects" were caused by the export quotas.

28. China's argument would mean that, for example, the rare earth export quotas may have borne a substantial relationship to conservation in parts of 2012, but perhaps not in other parts of the year, depending on the vagaries of the rare earth market. Such an absurd result is why the Appellate Body in *US – Gasoline* noted that an empirical effects test is not a element under Article XX(g).[19]

2. The "Made Effective In Conjunction With" Standard

29. China's appeal of the Panel's findings that China had failed to meet its burden to establish that the export quotas on rare earths, tungsten, and molybdenum were "made effective in conjunction with" domestic restrictions on these materials is similarly flawed. China argues that a Member invoking Article XX(g) need only have a "genuine" domestic restriction and thereby wholly ignores the relationship between the non-conforming measure and the domestic restriction. But that is not the standard set forth in Article XX(g). Article XX(g), and the requirement that the non-conforming measure be "made effective in conjunction with" domestic restrictions, clearly calls for an analysis of the conjunction between the two measures.

30. More generally, if accepted, China's interpretation would transform Article XX(g) into a formalistic checklist; and it would shelter GATT-inconsistent measures that promote resource

[18] *US – Gasoline (AB)*, p. 21.

[19] *US – Gasoline (AB)*, p. 21 ("the problem of determining causation, well-known in both domestic and international law, is always a difficult one").

nationalism if a responding party can merely show that it happens to have in place any domestic restrictions, regardless of how or whether the challenged measure is "made effective in conjunction with" those domestic restrictions.

31. Rather, as the Panel correctly explained, the requirements set forth in Article XX(g) "are a kind of 'proxy' for detecting the purposes of an alleged conservation objective: by requiring domestic restrictions, subparagraph (g) prevents GATT-inconsistent measures that are not really about conservation from being brought within its scope. This is also the reason why the Panel is of the view that to show even-handedness in the imposition of domestic restrictions, China also needs to establish that its export restraints work together with a corresponding domestic restriction."[20]

IV. China's Arguments Regarding The Panel's Rejection of the 17 July 2013 Data Are Baseless

32. The United States would like to address briefly two points raised in China's Appellee Submission on the Panel's rejection of the 17 July 2013 data: (1) the fact that the United States did not specifically cite eight of the ten exhibits rejected by the Panel; and (2) the necessity of Exhibits JE-196 and JE-197.

33. With respect to the first issue, China's argument ignores the fact that the Panel's decision to exclude the exhibits was a single decision that excluded all ten as a group.

34. Regarding Exhibit JE-196, which was Chinese rare earth production data from Dudley Kingsnorth, China asserts that these data were "not necessary" to the Panel's objective analysis

[20] Panel Report, para. 7.333.

of the facts at issue. By way of background, the United States and China fiercely disputed the level of rare earth extraction in China, with the United States supplying data from the U.S. Geological Survey and China providing evidence based on submissions from its industry (who, of course, would not be inclined to report over-production). This issue was particularly relevant in regards to the Panel's determination if China had domestic production restrictions under Article XX(g). Data from Kingsnorth, whom China had just characterized as "the world's leading rare earth market expert," provided objective support for the U.S. argument that the Chinese data vastly underestimated actual Chinese production.

35. Regarding Exhibit JE-197, Professor Grossman's report gave a very specific and detailed rebuttal to Professor De Melo's points regarding the impact of an unfilled export quota, which had been submitted as part of China's answers to the Panel's questions. China's argument that the United States already had the opportunity to comment on unfilled export quotas is simply false and takes a simplistic approach to a very complicated and heavily litigated issue in this dispute.

V. Conclusion

36. China has benefitted tremendously from WTO Membership, and its own economic and industrial ambitions are premised on continued access to the markets of its trading partners. Under the WTO's rules, China's trading partners are likewise entitled to rely on China's adherence to its commitments. The WTO's rules provide for carefully considered disciplines on the trade in raw materials – both in terms of liberalizing that trade and in terms of defining the conditions under which deviation from liberalization can be legitimately justified.

37. This concludes the U.S. opening statement. We welcome the opportunity to answer any questions that you may have.