

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

**(WT/DS431)**

**Answers of the United States of America  
to Questions from the Panel to the Parties  
in Connection with the Second Substantive Meeting of the Panel**

**July 8, 2013**

### Table of Reports

<b>Short Form</b>	<b>Full Citation</b>
<i>China – Raw Materials (Panel)</i>	Panel Report, <i>China – Measures Related to the Exportation of Various Raw Materials</i> , 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
<i>China – Raw Materials (AB)</i>	Appellate Body Report, <i>China – Measures Related to the Exportation of Various Raw Materials</i> , WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R, adopted 22 February 2012
<i>Korea Beef (AB)</i>	Appellate Body Report, <i>Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef</i> , WT/DS161/AB/R, adopted 10 January 2001
<i>U.S. – Gasoline (AB)</i>	Appellate Body Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/AB/R, adopted 20 May 1996
<i>U.S. – Shrimp (AB)</i>	Appellate Body Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products</i> , WT/DS58/AB/R, adopted 6 November 1998

**Table of Exhibits**

<b>Joint Exhibit Number</b>	<b>Description</b>
JE-174	E/PC/T/33, Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment (February 1946)
JE-175	E/PC/T/C.II/50, Meeting of the Preparatory Committee of the International Conference on Trade and Employment (13 November 1947)
JE-176	E/PC/T/34, Report of the Drafting Committee of the Preparatory Committee of the United Nations Conference on Trade and Employment (20 January to 25 February 1947)
JE-177	EPCT/C/II/32, Preparatory Committee of the International Conference on Trade and Employment, Note of the Delegations of the Netherlands and of the Belgian-Luxembourg Economic Union Concerning General Commercial Policy (30 October 1946)
JE-178	E/PC/T/C.II/QR/PV/5, Meeting of the Preparatory Committee of the International Conference on Trade and Employment; Sub-Committee on Quantitative Restrictions and Exchange Control (18 November 1946)
JE-179	EPCT/C.II/QR/PV/1, Meeting of the Preparatory Committee on Trade and Employment (11 November 1946)
JE-180	E/PC/T/CII/59, Report of Preparatory Committee of the International Conference on Trade and Employment, (21 November 1946)
JE-181	The New Shorter Oxford English Dictionary, Volume 1, Calendon Press, Oxford (1993), p. 527.
JE-182	L Alan Winters: Response to Paragraph 53 of China's Opening Statement to the Second Hearing
JE-183	L Alan Winters: Response to Professor De Melo (CHN-157)
JE-184	Collins English Dictionary, HarperCollins Publishers (1999), p. 1036.
JE-185	Nciku Dictionary, available at <a href="http://www.nciku.com/search/zh/detail/%E5%AE%9E%E7%B%A9/37694">http://www.nciku.com/search/zh/detail/%E5%AE%9E%E7%B%A9/37694</a> (visited on 4 July 2013)

JE-186	Baike, available at <a href="http://www.baike.com/wiki/%E5%AE%9E%E7%BB%A9">http://www.baike.com/wiki/%E5%AE%9E%E7%BB%A9</a> (visited on 4 July 2013)
JE-187	Roskill, Rare Earths & Yttrium: Market Outlook to 2015, 14th Edition, November 2011 (excerpt)

**66. To the parties:** Please comment on the European Union’s argument about the meaning of “conservation” at paragraph 48 of its second written submission. Is the European Union correct that China’s interpretation of conservation reads protectionism into the provision? Is the European Union correct that the scope of paragraph (g) of Article XX must be limited by the context of the chapeau?

1. **Answer:** The United States agrees with the argument by the European Union (“EU”) that China’s interpretation of conservation untenably reads protectionism into Article XX(g) of the *General Agreement on Tariffs and Trade 1994* (“GATT 1994”). Through its submissions, China consistently contends that “conservation” incorporates the concept of the “management” of the “supply and use” of exhaustible natural resources to permit “foster[ing] the sustainable development of [Members’] domestic economies.”<sup>1</sup> According to China, this would permit the use of export quotas whose direct effect is to change the distribution or allocation of the flow of resources. However, the ordinary meaning of “conservation” in context and in light of the object and purpose of the GATT 1994 is to limit or otherwise affect the pace of extraction or consumption of the resources so as to conserve those resources, and not to favor one Member’s economic interests over other Members’ interests.
2. The United States considers that China’s interpretation of “conservation” in Article XX(g) is incorrect, not only for the reasons identified by the EU in its second written submission,<sup>2</sup> but also because the text and structure of Article XX(g) itself as well as the *chapeau* contain clear anti-protectionist and anti-discriminatory requirements, which China’s interpretation of “conservation” directly contradicts.
3. Article XX(g) provides that a challenged measure must be “made effective in conjunction

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<sup>1</sup> See China Second Written Submission, para. 18.

<sup>2</sup> See EU Second Written Submission, paras. 36-48.

with restrictions on domestic production or consumption” – a requirement that has been interpreted by panels and the Appellate Body as requiring a challenged trade restrictive measure to be counter-balanced by a corresponding domestic restrictive measure in order to qualify for the exception as a conservation measure. China’s reading of “conservation” as permitting protectionism is contrary to this part of Article XX(g), which is often referred to as the “even-handedness” requirement.<sup>3</sup>

4. Additionally, the *chapeau* of Article XX also provides clear anti-protectionist and anti-discrimination disciplines with which China’s interpretation cannot be reconciled. The Article XX *chapeau* provides that challenged measures “not [be] applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade.” Whereas the “even-handedness” requirement in sub-paragraph (g) seeks to ensure that conservation cannot be undertaken at the expense of foreign interests only, the *chapeau* requirements seek to prevent the abuse of the Article XX exceptions by a Member<sup>4</sup> that would result in “a breach of the treaty rights of the other Members.”<sup>5</sup> Accordingly, China’s interpretation that “conservation” allows for the protection of domestic industries and interests at the expense of foreign industries and interests would be contrary to the context provided by the *chapeau*.

**69. To the complainants:** Do the complainants believe that the conservation objective in GATT Article XX(g) contains or embraces a “management” and/or a “rational utilization” aspect or component? Alternatively, do the complainants consider that measures aimed at the “management” and/or “rational utilization” of natural

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<sup>3</sup> See *U.S. – Gasoline (AB)*, p. 21.

<sup>4</sup> See *U.S. – Gasoline (AB)*, p. 22.

<sup>5</sup> *U.S. – Shrimp (AB)*, para. 158.

resources could “relate to conservation”? Finally, do the complainants believe that “management” and “rational utilization” are or could mean the same thing? Please comment in light of United Nations General Assembly Resolution 1831 (XXVI) of 18 December 1962.

5. **Answer:** As noted in paragraph 85 of the U.S. second written submission and in paragraph 7.372 of the panel report in *China – Raw Materials*, conservation under Article XX(g) may include measures dedicated to preventing the harm, loss or waste of exhaustible natural resources. This position is supported by the Appellate Body report in *China – Raw Materials*, which noted that “[t]he word ‘conservation’ ... means ‘the *preservation* of the environment, especially of natural resources.’”<sup>6</sup>

6. In appropriate circumstances, measures that are taken to manage or rationally utilize exhaustible natural resources could speak to the prevention of harm, loss or waste thereof and, therefore, could relate to conservation.<sup>7</sup> Moreover, it seems reasonable that measures that preserve natural resources could be characterized as both management and rational utilization of those resources to achieve conservation. Accordingly, the conservation objective in GATT Article XX(g) could be expressed in terms of management or rational utilization so long as this is understood to mean having the objective of the preservation of exhaustible natural resources.

7. Nevertheless, it would not be appropriate to equate to “conservation” the concepts of “management” and “rational utilization” if it is management or rational utilization for purposes of giving an advantage to domestic industries at the expense of other Members. Accordingly,

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<sup>6</sup> *China – Raw Materials (AB)*, para. 355 (emphasis added).

<sup>7</sup> An important question in this regard is management or rational utilization with respect to what objective. China avoids being clear in this respect. For example, in the abstract, “management” could refer equally to management for economic profit, but that objective would not be an appropriate one in the context of Article XX(g).

measures such as export quotas that are distributive in nature and operate to restrict and disadvantage foreign consumers of natural resources, even if they could for certain purposes be characterized as “management” or “rational utilization,” are not conservation measures for purposes of Article XX(g) because they do not speak directly to the preservation of exhaustible natural resources. Rather, they speak to the allocation of raw materials. As noted by the panel in *China – Raw Materials*, the Article XX subparagraph that protects domestic users of raw materials from market forces – *i.e.*, that allows for allocation – is Article XX(i) of the GATT 1994, not Article XX(g).<sup>8</sup>

8. The U.S. position (which is consistent with and supported by the Appellate Body’s interpretation in *China – Raw Materials*) finds additional support in United Nations General Assembly Resolution 1831. Resolution 1831 recommends measures that “preserve[], restore[], enrich[] and make[] rational use of natural resources and increase[] productivity.” However, Resolution 1831 did not define conservation to include rational use. Rather, Resolution 1831 noted that conservation was effectuated through “measures to preserve natural resources.” Furthermore, to the extent that Resolution 1831 recommends such measures, it is in light of the clear and uncontroversial danger that the conservation of flora and fauna and natural resources may be jeopardized by economic development. Here, in the case of China’s policies for rare earths, tungsten and molybdenum, China is seeking to justify domestic economic development goals under the rubric of conservation – which is not supported by the endorsements and recommendations of Resolution 1831.

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<sup>8</sup> *China – Raw Materials (Panel)*, para. 7.386.



**70. To the United States:** At paragraph 156 of its second written submission, the United States alleges that “none of [China’s] measures *actually* restrict either the production or consumption of rare earths in China”. Is it the position of the United States that “restrictions on domestic production or consumption” must be effective in order to satisfy the second clause of Article XX(g)? If yes, how would the United States assess the effectiveness of a domestic restriction?

9. **Answer:** The United States believes that restrictions on domestic production or consumption must actually restrict domestic production or consumption in order to satisfy the requirements set forth in the second clause of Article XX(g) of the GATT 1994.<sup>9</sup> Otherwise, there is no restriction. This position is supported by the panel report in *China – Raw Materials*, in which the panel noted that restrictions must “*actually* restrict or limit domestic production or consumption” to fulfil the requirements found in Article XX(g).<sup>10</sup> Applying this standard, the panel in that dispute found that extraction caps that were set at levels higher than the previous year’s extraction levels did not actually restrict production and, therefore, did not meet the requirements set forth in Article XX(g) of the GATT 1994.<sup>11</sup>

10. For a number of reasons, the United States does not believe that China’s extraction and production targets on rare earths actually restrict the extraction or production of rare earths. In particular, and as noted by Colombia in its third party submission, actual rare earth extraction and production in China have consistently exceeded the targets, including in recent years when China claims that it has cracked down on above-quota extraction. Data showing Chinese over-production are set forth in paragraph 163 of the U.S. second written submission.

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<sup>9</sup> The United States notes that the existence (or not) of a domestic restriction is a separate question from whether, if such a restriction is shown to exist, that restriction is “made effective in conjunction with” the measure at issue.

<sup>10</sup> *China – Raw Materials (Panel)*, para. 7.437 (emphasis added).

<sup>11</sup> *China – Raw Materials (Panel)*, paras. 7.452-7.453.

11. It should also be noted that the United States believes that the data provided by China, particularly data for 2010-2012, underestimate actual Chinese extraction of rare earths. As explained by China during the second Panel meeting, the data set forth in Exhibit CHN-137 rely on official reports by Chinese rare earth producers. In light of the fact that such reports would not cover extraction over the targets, such data do not capture the actual level of Chinese rare earth extraction.<sup>12</sup>
12. Another metric that the United States believes is important in assessing whether there are actual restriction on domestic production, especially when the restrictions are exceeded (as is the case here), is whether the country in question is taking actions to stimulate extraction or production. As set forth at paragraphs 173-178 of the U.S. second written submission, China (at various levels of government) takes actions to stimulate the extraction and production of rare earths. This is wholly inconsistent with China's claim that it restricts domestic production and explains why extraction and production have consistently exceeded their respective targets.
13. Lastly, in the context of this dispute, the United States believes that the Panel should also look at whether central level targets are enforced or ignored by the provinces in order to determine if there are actual restrictions on production. Here, the United States has provided documents, such as statements by the president of the largest Chinese producer of rare earths,<sup>12</sup> noting that local governments administering these central government production targets encourage rare earth producers to expand production beyond the target levels.
14. For these reasons, China has not met its burden to establish that it has domestic

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<sup>12</sup> For example, based on U.S. Geological survey data, China produced 95,000 metric tons of rare earths in 2012. Eggert Report, p. 8 (Exhibit JE-129) This is above China's extraction target. (Exhibit CHN-137.)

production or consumption restrictions as required under Article XX(g) of the GATT 1994.

**71. To the parties:** Do the parties agree with the statement by the Panel in *China – Raw Materials* that, to establish even-handedness under Article XX(g), a regulating Member would “need to show that the impact of the export duty or export quota on foreign users is somehow counter-balanced with some measure imposing restrictions on domestic users and consumers”?<sup>13</sup> Could the parties explain what, in their opinion, this test requires? Specifically, does the Panel’s use of the term “impact” suggest an “effects” test, under which the effects (in terms, e.g. of price, supply, etc.) of China’s export quotas and duties on foreign markets would need to be somehow replicated in or imposed on China’s domestic market? Also, what do the parties understand by the term “counter-balanced”? How should this criterion be measured?

15. **Answer:** As set out in the U.S. opening oral statement at the second Panel meeting,<sup>14</sup> and elsewhere, the United States agrees with the statement by the panel in *China – Raw Materials* that the regulating Member would “need to show that the impact of the export duty or export quota on foreign users is somehow counter-balanced with some measure imposing restrictions on domestic users and consumers.” In particular, in the context of an export quota (which only affects foreign consumers) paired with alleged production restrictions (which would impact domestic and foreign consumers equally), there is no even-handedness. Instead, the domestic measure would need to be a measure that imposes a restriction on domestic users, but not foreign users. Such a measure could counter-balance the export quota that restricts foreign consumers.

16. The United States does not believe that the panel’s statement in *China – Raw Materials* suggests a quantitative or rigid analysis of effects, especially when, as is the case here, there is no counter-balancing measure. Consistent with the Appellate Body reports in both *U.S. – Gasoline* and *U.S. – Shrimp*, the test set forth by the panel in *China – Raw Materials* requires a

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<sup>13</sup> *China – Raw Materials (Panel)*, para. 7.465.

<sup>14</sup> U.S. Opening Oral Statement at the Second Panel Meeting, paras. 37-43.

measure that acts “in conjunction with” the export quotas. Thus, in *U.S. – Gasoline* and *U.S. – Shrimp*, the Appellate Body looked for the presence of such a counter-balancing measure that impacted entities in the regulating Member without examining data on the actual effects of such a measure.

17. While the United States appreciates the Panel’s question about how such a criterion should be measured if, for example, the counter-balancing measure were to have minimal or no actual impact on domestic consumers, the United States respectfully submits that scenario is not at issue in this dispute, given that it is clear that China imposes no such counter-balancing measure on domestic users. In fact, in the context of the Panel’s even-handedness analysis, there is no difference between the measures at issue in *China – Raw Materials* and the export quotas at issue in this dispute, and in both disputes there is no counter-balancing measure on domestic users of the raw materials at issue.

**72. To the parties:** The European Union argues that for many years actual extraction and production of rare earths in China has exceeded Chinese targets. Assuming, *arguendo*, that this is true, does this fact undermine or negate the existence of a “restriction on domestic production or consumption” under Article XX(g)? In other words, does the efficacy of a domestic extraction and production quota affect whether it can be characterized as a “restriction on domestic production or consumption” for the purposes of Article XX(g)? The Appellate Body in *China – Raw Materials* reversed the Panel’s finding that the purpose of the challenged export restrictions must be to ensure the effectiveness of those domestic restrictions<sup>15</sup> in order to comply with the second clause of Article XX(g). In the opinion of the parties, does this decision of the Appellate Body in any manner influence a possible requirement to demonstrate the efficacy of a domestic extraction and production quota?

18. **Answer:** As explained in detail in our response to question 70, the United States believes that restrictions on domestic production or consumption must actually restrict in order

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<sup>15</sup> *China – Raw Materials (AB)*, para 361.

to satisfy the requirements set forth in the second clause of Article XX(g) of the GATT 1994.

The United States would also emphasize that the existence (or not) of a domestic restriction is a separate question from whether, if such a restriction is shown to exist, that restriction is “made effective in conjunction with” the measure at issue.

19. It is this second matter (that is, whether the domestic restriction is “made effective in conjunction with” the measure at issue) that was addressed by the Appellate Body report in *China – Raw Materials*. In particular, the Appellate Body found that the purpose of the challenged export restriction need not be to ensure the effectiveness of the corresponding domestic restrictions. Nothing about this finding calls into question that, as an initial matter, there must be an actual domestic restriction to invoke Article XX(g). In other words, the question of whether the domestic measure actually restricts production speaks to whether there is a domestic restriction for purposes of Article XX(g) of the GATT 1994. That particular issue was not before the Appellate Body in *China – Raw Materials* and, therefore, the Appellate Body’s report does not call into validity the standard that a production or consumption restriction must “actually restrict or limit domestic production or consumption.”<sup>16</sup>

**73. To the parties:** In the opinion of the parties, can a measure “restrict domestic production or consumption” even if it does not *reduce* domestic production or consumption? If yes, how would the parties measure the restrictive effect of domestic measures implemented under Article XX(g)?

20. **Answer:** As noted by the United States in paragraph 102 of its second written submission, “restrictions” on domestic production or consumption are measures that confine or fix definitely the extent, amount, duration, etc. of domestic production or consumption that is

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<sup>16</sup> *China – Raw Materials (Panel)*, para. 7.437.

permitted. And, as explained in our responses to questions 70 and 72, China has not met its burden to establish that it has production restrictions necessary to invoke Article XX(g) of the GATT 1994 because, *inter alia*, the measures in question do not actually restrict. Simply put, they do not actually restrict the extraction and production of rare earths as shown by, *inter alia*, the consistent over-extraction and over-production of such raw materials.

21. It does not necessarily follow, however, that a restriction on domestic production or consumption must *reduce* domestic production or consumption *from previous levels*. For example, a restriction on domestic production could mandate that production not exceed a previous base year. Nevertheless, the failure to reduce production or consumption from previous levels might provide evidence that a Member does not have actual restrictions. The failure to reduce production or consumption might also speak to: whether the non-conforming measure relates to conservation; if the non-conforming measure is even-handed; or if the non-conforming measure fulfills the requirements of the *chapeau*.

22. At the same time, a restriction should reduce domestic production or consumption in that, “but for” the restriction, domestic production or consumption would have been higher. For example, the panel in *China – Raw Materials* found that extraction caps that were set at levels that were higher than the previous year’s extraction levels did not actually restrict production and, therefore, did not meet the requirements set forth in Article XX(g) of the GATT 1994.<sup>17</sup> In such a scenario, the regulating Member could not show that, but for the measures, domestic production would have been higher.

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<sup>17</sup> *China – Raw Materials (Panel)*, paras. 7.452-7.453.

23. The same scenario from *China – Raw Materials* is applicable to the extraction targets on rare earths. As shown in Figure 1 of China's second written submission, the extraction targets for rare earths in 2011 and 2012 were higher than the previous year's extraction levels. For these reasons, China has failed to show that it has restrictions under Article XX(g) of the GATT 1994.

**75. To the parties:** The European Union states that until 2010, China's extraction and production targets were each exceeded by around 30%. How does the European Union calculate this figure? And how does China respond to this allegation?

24. **Answer:** The United States understands that this question is, in the first instance, directed to the EU and China. Accordingly, the United States will reserve the right to comment on the responses to this question provided by the parties.

**76. To the parties:** Please comment on the European Union's arguments at paragraph 200 of its second written submission. Do the parties agree that China's export duties and quotas "cannot be analyse[d] in isolation"? If so, why not? What are the implications of this argument? Do the parties agree that export duties may "at times lead the quota to have no [...] effect on foreign prices", and that therefore in the absence of export duties the quotas may increase the foreign price of rare earths? If so, why? In particular, could the parties comment on China's methodology to calculate adjusted foreign prices by deducting from the FOB price the export duty applicable to the rare earth product each year?

25. **Answer:** The United States agrees with the EU that the export duties and export quotas cannot be analyzed in isolation from each other. The primary reason for this is because China imposes the export duties at issue in conjunction with its export quotas and, as the EU notes, the resulting distortions in trade are a product of the interplay between the two types of restrictions. Analyzing one restriction in isolation from the other would risk failing to address meaningfully the problems created by China's export restrictive policies on these raw materials.

26. With respect to the impact of these export restrictions on prices, the United States notes that because China concurrently applies a number of non-conforming measures, such as duties

and quotas, to rare earth exports, China’s methodology of deducting from the FOB export price the export duty applicable to rare earth products is flawed because the methodology ignores that the export quotas are applied concurrently with export duties.

27. More generally, ignoring the export duties in the analysis of the quotas on rare earths would yield an unrealistic and biased view of the realities of the rare earths market. For example, China asserts that “even in a situation where domestic and foreign prices are equal [...] exporters would still prefer to sell to the foreign market, in order to keep their export quota share” based on the requirement of prior export performance (which is a non-conforming measure).<sup>18</sup> In this example, China’s argument ignores the fact that the exporter must pay export duties (another non-conforming measure) to the Chinese government in connection with any sale into a foreign market, whereas no corresponding charge applies to a domestic sale. If the domestic and foreign prices are equal, as China posits, the exporter plainly would prefer to sell into the domestic market, where the price that it receives for its rare earth product will not be effectively reduced by the amount of the export duties. As this example makes clear, China should not be allowed to arbitrarily select which non-conforming measures are at issue in the analysis of the export quotas.

28. China’s argument in this regard is also inconsistent with China’s assertion that it has a comprehensive policy of sustainable development, of which both duties and quotas are an integral part. China contends that the Panel should examine the export quotas as part of this comprehensive sustainable development policy, but that it should ignore the role of export duties

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<sup>18</sup> China Second Written Submission, para. 91.



in the Article XX(g) analysis, notwithstanding the fact that the duties are asserted to be part of the comprehensive policy.

29. The United States further notes that there are a number of reasons why the export quotas on rare earths in 2011 and 2012 were unfilled – including the fact that export duties appear to be the binding restriction for certain rare earth elements. As noted in a report by the *China Daily*, high export prices contributed to a drop in demand for rare earths, which is reflected in the lack of quota fill.<sup>19</sup> The duties that China imposes on rare earth exports – some of which are as high as 25 percent – contribute to such high export prices and, therefore, the lack of quota fill in certain years. If the duties were to be removed, it would likely increase the utilization of the export quotas.

**77. To the parties:** Under China's current cap and quota system, is there any legal way for a Chinese company to obtain rare earths in excess of the extraction and production limits? Does every unit of rare earth used by domestic companies count towards the total annual extraction and production quotas? For example, if a Chinese company extracts rare earth ores and then, rather than selling them, uses them itself in the production of value-added products, are these ores counted against the total annual extraction and production quotas?

30. **Answer:** As this question seeks to clarify China's domestic law related to the extraction and production targets on rare earths, the United States will provide any comments in response to the answers provided by China.

**78. To the parties:** Could the parties provide their view as to the relevant period of time to measure price gaps between foreign and domestic rare earth products?

31. **Answer:** The gaps between foreign and domestic rare earth product prices are relevant in confirming the restrictive effect of the export quotas (and export duties), the protection

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<sup>19</sup> Exhibit JE-109.

afforded to domestic consuming industries, and the discrimination against foreign consumers.

Accordingly, the relevant period of time for scrutinizing and measuring such price gaps would be the entire period of time that the export quotas (and export duties) have been imposed on rare earths – *i.e.*, from 1999 to the present. While the full set of such data are not available, the United States considers that all price gap data for periods of time falling within this band are relevant to the Panel’s assessment of China’s Article XX(g) defense. Furthermore, given the Panel’s terms of reference, the dramatic 2012 price gaps are highly relevant to the Panel’s analysis in making findings and recommendations regarding China’s use of its export quotas for rare earths.

**79. To the parties:** In the light of China’s comments in paragraphs 126-130 of its second written submission on the quality of price data, could the parties provide their views on the reliability of an analysis based on these data?

32. **Answer:** As noted by Professor Eggert, the data from Metal Pages are the “best known and most widely used public sources for rare earth pricing.”<sup>20</sup> In the industry, such data are regarded as “the most commonly cited and best-accepted source of price information for rare earths.”<sup>21</sup> Likewise, the Roskill report relied on by China in various submissions to the Panel notes that “[t]he most complete price series for rare earths are the oxide prices quoted by Metal Pages and Asian Metal.”<sup>22</sup>

33. Simply put, data from Metal Pages are the best data available. Consequently, the vast differences reflected in such data between domestic and foreign rare earth prices can be relied

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<sup>20</sup> Exhibit JE-129, p. 4.

<sup>21</sup> Exhibit JE-129, p. 29.

<sup>22</sup> Roskill Report, 19.1 (Exhibit JE-187).

upon by the Panel to confirm further the fact that the export quotas on rare earths are not even-handed nor do they fulfill the requirements of the *chapeau*.

34. In the sections of China’s second written submission that are highlighted in the Panel’s question, China asserts that the Metal Pages data are artificially inflated by traders to manipulate the rare earths market. China has provided no such evidence to support what is a very serious and, perhaps, criminal allegation. China also questions the Metal Pages data by providing documentation from a single, lone sale. It is hard to see how this one sale calls into question the accuracy of the data provided by Metal Pages.

35. China also asserts that the Metal Pages FOB export data are called into question by low sales volumes in certain months and CIF values from another publication, which China has provided for some of 2012. However, as noted in the report by China’s own expert, low sales volumes for certain rare earth products are one of the general characteristics of the market.<sup>23</sup> Accordingly, low sales volumes are not abnormal and there is simply no reason to think that prices in such months are distorted. It is also hard to see how the CIF data would call into question the FOB data, given the relatively lower volume of the former as compared to the latter and the fact that the CIF data does not even cover all of 2012. Also of note, the CIF data only cover three products.<sup>24</sup>

**80. To the complainants:** Please comment on China’s claim, at paragraph 91 of its second written submission, that “even in a situation where domestic and foreign prices are equal [...] exporters would still prefer to sell to the *foreign* market, in order to keep their export quota share”.

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<sup>23</sup> China Second Written Submission, para. 56; Humphrey Report, p. 4 (Exhibit CHN-153).

<sup>24</sup> China Second Written Submission, para. 129.

36. **Answer:** China asserts that its quota allocation formula, coupled with its prior export performance requirements for applicant exporters, incentivizes rare earths traders to export under the quotas. It should be noted up-front that China's argument is fundamentally circular – China is arguing that exporters want to sell in the foreign market because they will want to sell in the foreign market at a later date.

37. China's argument is that the export quotas – an export *restriction* – and the prior export performance requirements – *restrictions* on the right to trade – are in actuality *promoting* exports. The absurdity of this argument is obvious. First, export quotas do not encourage exports; they create a hard ceiling on the volume of a product that can be exported. They are not, as China is trying to argue, a guaranteed set-aside for foreign markets. Second, prior export performance requirements (as well as minimum capital requirements) for traders to qualify to export rare earths are a restriction that further circumscribe who can ship within the export quotas' hard ceiling – and an additional source of market and trade distortion.

38. With respect to China's argument regarding the likely effects of its quota allocation formula and prior export performance requirement on the behavior of its traders as ordinary and rational market participants, the most critical flaws flow from significant facts and factors that China fails to take into account.

39. First, China's argument fails to acknowledge the fact that under its quota allocation formula, an individual exporter whose behavior follows that of the other exporters consistent with the overall market trends would not be penalized by having its export quota share diminished in the following year. Pursuant to the formula, the quota allocation for an applicant in a given year is derived from the ratio of that applicant's volume/value for the last three years

(“A”) divided by the total volume/value of China’s exports (“T”), or A/T.<sup>25</sup> When the behavior of an individual company (A) reflects the trends in the broader market (T) and, for example, that company exports less in a particular year along with the rest of the traders, this would have no impact on its future allocations because A and T would both be reduced in the same proportion. For example, if overall export sales are down 10 percent (T), and the individual applicant’s sales follow other exporters and are also down 10 percent (A), it would have no negative or other impact on the company’s future allocation because A and T will be lessened by an equal amount. Thus, China’s argument set forth in paragraph 91 of its second written submission is overly simplistic and fails to account for the fact that, given rational behavior and general market trends, the formula would not necessarily operate to create incentives to export.

40. In addition, China’s argument also fails to account for the effect of the export duties that are in reality simultaneously imposed on the products subject to the export quotas. As noted above in the response to question 76, all other things being equal, rare earth exports would be discouraged due to the presence of an extra tax – *i.e.*, the export duty – imposed on such sales.

41. More fundamentally, China’s argument rests on the assumption that rare earths exporters are regular market participants behaving rationally in response to normal market forces. This simply is not the reality. Here, the market reflects severe distortions resulting from the imposition – in some cases over many years – of export quotas and export duties. Furthermore, the population of eligible traders is also restricted due to the prior export performance and minimum capital requirements that China imposes. With fewer traders, there would be a higher

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<sup>25</sup> China’s Answers to the Panel’s Written Questions Subsequent to the First Substantive Meeting with the Parties, fn. 169.

likelihood of non-rational behaviors predicated only on “normal” market and economic factors and incentives. In addition, China’s argument does not take into account the nature of the traders that are approved to export – that is, according to China, the majority, if not all, of the qualified rare earth exporters are state-owned entities.<sup>26</sup> The behavior and decisions of these state-owned companies may be influenced by factors other than simply ordinary economic and market factors and incentives – and could very well include other kinds of factors and incentives created by the government including, but certainly not limited to, the goals and instructions reflected in, among other things, China’s various five year industrial plans and guidelines – many of which call for the development and protection of China’s domestic high value-added rare earths processing capabilities.

42. Accordingly, China’s argument that the export quota allocation formula and prior export performance requirements incentivize exports is overly simplistic, disregards significant and relevant facts, and is premised on a number of fictions.

**81. To the complainants:** Please comment on the evidence provided by China in Figures 1 and 2 of its second written submission. Do the complainants agree that this evidence shows that, *as a result of the quotas*, the extraction and production of rare earths have decreased?

43. **Answer:** Figures 1 and 2 of China’s second written submission do not establish that, as a result of the extraction and production targets, the extraction and production of rare earths in China have decreased. Rather, the graphs show that, for the vast majority of time periods, the extraction and production of rare earths in China have been above the applicable targets.

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<sup>26</sup> See China Opening Statement at the First Panel Meeting, Annex: Major Producers of Rare Earth Smelted and Separated Products in China.

44. And, as discussed in our response to question 70, the United States believes that (i) the data provided by China for 2010-2012 (where China asserts that extraction was below the target) underestimate actual Chinese extraction of rare earths, and (ii) Figure 1 shows that the extraction quota for rare earths in 2012 was set above the actual level of extraction in 2011. According to the panel in *China – Raw Materials*, when an extraction target is set above the previous year’s extraction, it is not a restriction for purposes of Article XX(g) of the GATT 1994.<sup>27</sup>

45. A further problem with the two figures cited in the Panel’s question derives from the fact that China’s extraction and production targets do not address individual rare earths. As we have previously explained,<sup>28</sup> because the demand for individual rare earth elements differs, China has no way of showing that its targets actually restrict the extraction and production of any given rare earth element. This is reflected in China’s first written submission in which it noted that “[w]e cannot treat rare earths as a single commodity.”<sup>29</sup> Figures 1 and 2 arbitrarily and irrationally treat rare earths as a single commodity in violation of China’s own understanding, and reality, of the rare earth market.

46. Finally, China’s attempt to tie actual extraction and production levels to the targets is without merit. Most fundamentally, China has failed to meet its burden to establish that any reductions in those levels were caused by the targets, as opposed to market forces such as the global financial crisis. For these reasons, China has failed to show that it has production

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<sup>27</sup> *China – Raw Materials (Panel)*, paras. 7.452-7.453.

<sup>28</sup> See, e.g., U.S. Second Written Submission, paras. 166-172.

<sup>29</sup> Exhibit CHN-4, p.9; see also China First Written Submission, para. 249 (asserting that demand for one medium/heavy rare earth (samarium, used in samarium-cobalt magnets) may be different than the demand for another (terbium, used in phosphors)).

restrictions under Article XX(g) of the GATT 1994.

**82. To the complainants:** Please comment on the methodology and on the results of the price-gap analysis reported in Annex 1 of China’s second written submission. In particular, please provide an evaluation of China’s evidence that the 10% fee deduction from the FOB China price is “obtained based on a survey conducted by the CCCMC”.

47. **Answer:** The United States does not believe that China has substantiated its claim that a 10 percent fee deduction should be made to the FOB China price based “on a survey conducted by the CCCMC.”<sup>30</sup> First, in the interest of clarity, the United States notes that CCCMC is “a subordinate unit of [the Chinese Ministry of Commerce]” and that CCCMC’s report was created solely for purposes of this dispute.<sup>31</sup> Moreover, a number of the fees that are alleged to be included in the 10 percent fee deduction are also incurred on domestic sales – such as freight, insurance and packing<sup>32</sup> – and China has made no effort to deduct those expenses from the domestic sales price in order to make an “apples-to-apples” comparison.

48. Moreover, as noted by Japan in its opening statement at the second meeting,<sup>33</sup> the 10 percent fee deduction includes expenses related to the export quota itself, specifically an “export commission fee” associated with purchasing an export quota license on the re-sale market. This practice is outlined in Exhibits JE-170 and 171, which discusses the expenses (or “facilitation payments”) associated with the re-sale of rare earth export quota rights from the original applicant to another exporting entity. Clearly, China should not deduct fees associated with the imposition of export quotas in an attempt to isolate the effects of the quotas.

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<sup>30</sup> China Second Written Submission, para. 136.

<sup>31</sup> See Exhibit CHN-162.

<sup>32</sup> *Id.*

<sup>33</sup> Japan Opening Statement at the Second Substantive Meeting of the Panel, para. 45.



49. While China previously acknowledged that the export commission fee was part of the 10 percent proposed fee deduction,<sup>34</sup> China's latest explanation of the exact same 10 percent deduction does not include the export commission element.<sup>35</sup> China has thus changed the composition of the fee deduction without changing the corresponding amount. Such a result is arbitrary and should be rejected.

50. As to the results in Annex 1, China's weighted average price gap analysis, which is not methodologically sound due to the deduction of the export duties and 10 percent fee deduction discussed above, still shows massive price differences in 2012 for the following products: dysprosium metal (24 percent) and oxide (93 percent), europium oxide (54 percent), terbium oxide (57 percent) and metal (64 percent), yttrium metal (54 percent), neodymium metal (13 percent), and praseodymium metal (33 percent). These price differences, which are the result of China's biased and arbitrary methodology, nevertheless confirm that the export quotas are not even-handed nor meet the requirements of the *chapeau*. Clearly, foreign consumers of rare earths suffer under inferior terms of access, as confirmed by the price gaps.

51. Moreover, China has failed to present any results in Annex 1 for a number of key rare earth products, such as samarium and gadolinium, or to provide 2012 results for a number of other products, such as praseodymium oxide, cerium oxide and metal, neodymium oxide, lanthanum oxide and metal, again without justification.<sup>36</sup> While China did not explain why it excluded such products, Professor Winters notes that these products "exhibit stronger increases

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<sup>34</sup> China Answers to the Panel's Written Questions Subsequent to the First Substantive Meeting with the Parties, para. 190.

<sup>35</sup> China Second Written Submission, para. 136.

<sup>36</sup> Winters Report, pp. 7, 9 (Exhibit JE-169).

in export prices from the tightening of the export quota than do the rare earths that China included.”<sup>37</sup>

**83. To the complainants:** Could the complainants please comment on paragraphs 29-38 of Exhibit CHN-157?

52. **Answer:** As noted in the U.S. opening statement at the second panel meeting,<sup>38</sup> China’s theoretical argument at paragraphs 29-38 of Exhibit CHN-157 that an under-filled export quota does not impact foreign consumers ignores two important and real-world scenarios, specifically (i) a market with imperfect competition and (ii) a storable commodity. As discussed in the statement by Professor Grossman, both apply in practice to the rare earth market. Accordingly, China’s argument is without merit and should be rejected.

**120. To the parties:** Could the parties comment on China’s argument that “[t]he fact that Complainants believe that China should have used *other* means to carry out this legitimate level of conservation effectively would have China adopt a *different* level of conservation”? Do the complainants agree with this proposition? If not, why not? Is there a difference between a Member’s level of conservation and the means it uses to achieve that level?

53. **Answer:** The United States disagrees with China’s argument, which seems to be premised on the assumption that a certain level of conservation can only be achieved through certain means. As a logical matter, the United States considers that there is a clear distinction between a “level of conservation” (presumably the pace of extraction) and the means it uses to achieve that level (the policy measures affecting the pace of extraction). Accordingly, China’s decision to adopt a certain “level of conservation” would be reflected in, *e.g.*, its domestic extraction and production targets, which are supposed to affect the level of extraction of the

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<sup>37</sup> *Id.* at 9.

<sup>38</sup> U.S. Opening Statement at the Second Substantive Meeting, paras. 53-54.

relevant exhaustible natural resources in China. However, the export quotas that China is attempting to characterize as conservation measures under Article XX(g) simply do not speak to the pace of extraction and, therefore, are not linked to the “level of conservation” that China has presumably adopted. As the panel observed in *China – Raw Materials*: “[f]or the purpose of conservation of a resource, it is not relevant whether the resource is consumed domestically or abroad; what matters is its pace of extraction.”<sup>39</sup>

54. While Members may set the level of conservation as they see fit, the means of achieving that goal must comply with the obligations that they have assumed under the WTO Agreement. For example, a purported conservation measure must not have just a trivial or passing relevance to contributing to the set level of conservation, but rather must be “primarily aimed at” conservation.<sup>40</sup> Here, the rare earth export quotas are not primarily aimed at conservation; rather, they are primarily aimed at industrial policy.

**121. To the complainants:** Could the complainants comment on China’s assertion, at paragraph 39 of its second written submission, that “suggestions that Complainants may have as to how China may increase – or decrease – the level or efficiency of its rare earth conservation efforts are deserving of little, if any, weight by the Panel”? Do the complainants agree with the proposition? If not, why not? At what point(s) of the Panel’s analysis should alternatives be considered?

55. **Answer:** While a Member may well have the “sovereign right” to set conservation goals and levels, a Member also has the sovereign right – as China has exercised here – of agreeing to comply with certain obligations under the WTO Agreement with respect to conservation measures. As the panel in *China – Raw Materials* observed: “the ability to enter into

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<sup>39</sup> *China – Raw Materials (Panel)*, para. 7.428.

<sup>40</sup> *U.S. – Gasoline (AB)*, p. 19.

international agreements such as the WTO Agreement is a quintessential example of the exercise of sovereignty. In joining the WTO, China obtained significant commercial and institutional benefits, including with respect to its natural resources. It also committed to abide by WTO rights and obligations.”<sup>41</sup> Accordingly, the United States fundamentally disagrees with the premise of China’s argument in paragraphs 38-39 of its second written submission that, because China’s right to set a “level of conservation” is a “sovereign right,” the alternative means for servicing that conservation goal that the co-complainants have pointed to are “deserving of little, if any, weight by the Panel.”

56. As noted above in the response to question 120, the goal of conservation (and aiming for certain levels of conservation/pace of extraction) of an exhaustible natural resource is distinct from the means to achieve the conservation (or the particular level/pace of extraction). Accordingly, the United States disagrees with China’s argument because it conflates these two concepts.

57. Simply put, the United States is not suggesting how China might improve the efficiency of its domestic rare earth regime. The suggestions made by the co-complainants are alternative means – other than export quotas – for achieving what China purports is its legitimate conservation goal. These alternatives are very much relevant to the Panel’s examination, in this dispute, as to whether the export quotas at issue relate to conservation based on their design and can be justified as conservation measures under Article XX(g). Examples by the complainants about what China could have done in lieu of export quotas illustrate how these particular

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<sup>41</sup> *China – Raw Materials (Panel)*, para. 7.382.

measures are not “primarily aimed at” conservation because they show that there are alternative measures, such as setting preconditions for export based on the filing of VAT-invoices, whose design and structure are more closely aligned with conservation. Such examples further show that the export quotas at issue in this dispute do not relate to conservation under subparagraph (g) of Article XX of the GATT 1994.

58. Accordingly, alternatives may be considered by the Panel at any point in its Article XX(g) analysis as it considers whether a challenged measure does in fact “relate to the conservation of exhaustible natural resources.”

**122. To the complainants:** Please respond in details to China’s arguments at paragraph 71 of its second written submission.

59. **Answer:** At paragraph 71 of its second written submission, China argues that it has imposed the export quotas on rare earths not just to the exhaustible natural resource at issue (*i.e.*, rare earth-containing ores), but also to semi-processed rare earth products (*e.g.*, rare earth metals), because such semi-processed products are “actually exported” and otherwise, China would not be able to “manage the supply and use” of rare earths exports.

60. China’s argument assumes that conservation of the supply and use of rare earths, as an exhaustible natural resource, must be accomplished through an export measure. This assumption is not true. As the United States has pointed out, China’s conservation goals could be accomplished through many other means, including production restrictions (without export restrictions), and measures to prevent the export of illegally produced products.<sup>42</sup>

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<sup>42</sup> U.S. Comments on China’s Answers to the Panel’s Written Questions Subsequent to the First Substantive Meeting of the Panel, para. 85.

61. Furthermore, the United States notes that China's own argument does not explain why the export quota covers semi-processed rare earth products but *not* further processed or finished products such as magnets – which are also exported.

62. In fact, as the United States has noted before, China encourages the export of finished products containing rare earths.<sup>43</sup> The fact that China restrains the export of semi-processed products, while encouraging the export of finished products, shows that the export quotas on rare earths are not conservation measures and, therefore, are not justifiable under Article XX(g) of the GATT 1994.

**123. To the parties:** The complainants have pointed to a number of alternative measures that China could use either to protect human, animal or plant life or health under Article XX(b), or for conservation purpose pursuant to Article XX(g) or pursuant to the chapeau of Article XX :

(a) In the context of Article XX(b), some complainants have suggested that China could: (1) increase volume restrictions on mining and production; (2) establish effective pollution controls on mining and production; (3) impose a resources tax on consumption; (4) impose a pollution tax; and (5) develop and impose an export licensing system.

(b) In the context of Article XX(g) and the chapeau of Article XX, it has been suggested that China could develop an export licensing system to prevent smuggling, that China could ensure that unused export quotas are not made available to domestic consumers, or that China could enforce some other kind of domestic consumption restriction such as a domestic sales quota.

Could the complainants elaborate on these suggested alternatives? Could China please comment on those suggested alternatives, including those mentioned in paragraph 123 of European Union's second written submission and paragraph 11 of Japan's opening oral statement at the second Panel meeting?

63. **Answer:** In its second written submission, the United States explained that, if China is interested in reducing the health effects associated with mining and production of rare earths,

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<sup>43</sup> U.S. Second Written Submission, para. 62.

tungsten and molybdenum, China could impose volume restrictions on mining and production, or establish effective pollution controls on mining and production activities, or rely upon a resource tax to help ensure that the prices of rare earths, tungsten and molybdenum reflect the environmental costs of their mining and production.<sup>44</sup>

64. These alternatives differ from export duties in two important respects. First, effective limits on mining and production, and controls on the pollution created by such mining and production, would directly address the degree of pollution and in turn the health effects associated with such effects, which China's export duties do not address. As China explains, it is the mining and production of the products at issue that can cause pollution.<sup>45</sup> The pollution caused by mining and production is the same whether the good is ultimately consumed domestically or exported. Indeed, as the United States explained in its second written submission, and as the panel noted in the *China – Raw Materials* dispute, export duties can actually undermine efforts to reduce pollution, by providing an incentive for domestic consumption of the goods at issue.<sup>46</sup>

65. Second, unlike export duties, these alternatives do not discriminate against foreign consumers. To the extent that volume limits or pollution controls on mining and production or resource taxes reflect environmental costs, those costs would be borne by all consumers, whether foreign or domestic. The cost of export duties is simply an additional cost imposed only on foreign consumers. The discriminatory nature of such duties goes to the heart of why the export

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<sup>44</sup> U.S. Second Written Submission, paras. 67-71.

<sup>45</sup> China Substantive Defense of its Export Duties on Rare Earths, Tungsten and Molybdenum, paras. 3-11.

<sup>46</sup> U.S. Second Written Submission, paras. 56, 60; *China – Raw Materials (Panel)*, para. 7.533.

duties are not “necessary” to protect life or health. Put simply, China has not shown why it needs to impose such a cost only on exports in order to achieve its purported health objective.

66. Regarding the export quotas, the United States has explained that if China were interested in preventing the smuggling of rare earths produced beyond the production targets, China could impose preconditions on rare earth exports to ensure their legality, such as by checking VAT-invoices.<sup>47</sup> As noted by China, the VAT-invoices “provide a reliable basis to identify mining without permits, and production over the compulsory production caps or extraction caps.”<sup>48</sup> Unlike the export quotas, such preconditions would not suffer from the problem of over-breadth because they would not prohibit the export of legally-produced rare earths.<sup>49</sup>

67. The United States has also explained that if China were interested in having an even-handed conservation regime, China could enforce a domestic consumption restriction such as a domestic sales quota. Such a regime would prevent the export quota from diverting rare earths from the foreign market into China and, in the process, undermining China’s alleged conservation goals. This very problem was acknowledged by both China and the panel in *China – Raw Materials*.<sup>50</sup> China does not impose such a counter-balancing measure, which further

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<sup>47</sup> U.S. Comments on China’s Answers to the Panel’s Written Questions Subsequent to the First Substantive Meeting of the Panel, para. 85.

<sup>48</sup> China First Written Submission, para. 220.

<sup>49</sup> *U.S. – Shrimp (AB)*, para. 141 (examining whether a measure is overbroad in determining if it relates to conservation).

<sup>50</sup> *China – Raw Materials (Panel)*, para. 7.526 (“China’s qualitative argument relies on the standard economic theory of the effects of an export restriction: an export restriction on polluting raw materials, by reducing foreign demand for the good on which it is imposed, shifts supply of the good to the domestic market, thus putting downward pressure on the domestic price of the product.”). In *China – Raw Materials*, the panel also explained, “An export restriction on an exhaustible natural resource, by reducing the domestic price of the materials, works in effect as a subsidy to the downstream sector, with the likely result that the downstream sector will demand over time more of these resources than it would have absent the export restriction.” See *China – Raw Materials (Panel)*, para. 7.430 (internal citations omitted).



shows that the export quotas do not relate to conservation. In addition, for the reasons set forth in the U.S. response to question 71, the export quotas are not even-handed due to the lack of a counter-balancing domestic measure, such as a restriction on domestic sales.

**127. To the parties:** In light of Japan’s argument in paragraph 272 of its second written submission, is it the position of the parties that the phrase “measures relating to the conservation of exhaustible natural resources” in GATT Article XX(g) includes or covers only those measures that directly regulate an environmental impact? Is it the parties’ position that China could control where extracted rare earths are consumed only if the place of consumption had environmental significance or impact?

68. **Answer:** The phrase “measures relating to the conservation of an exhaustible natural resource” includes or covers only those measures that are “primarily aimed at” the conservation of an exhaustible natural resource. In the interest of clarity, the United States notes that it is not arguing that the non-conforming measure must apply directly to the exhaustible natural resource in question (of course, the non-conforming measure must still be “primarily aimed at” conservation of that resource). For example, in *U.S. – Gasoline*, the non-conforming measure did not apply to the exhaustible natural resource at issue (*e.g.*, clean air). Rather, it applied to gasoline. Here, the United States is simply noting that China’s argument as to why it includes semi-finished products in the scope of the rare earth export quotas would also apply to finished products. China’s failure to apply the export quotas to such finished products, while also encouraging their export, provides further proof that the export quotas are a tool of industrial policy, not conservation.

69. Moreover, it is not the position of the United States that, under Article XX(g) of the GATT 1994, a Member can control where extracted materials are consumed *only if* the place of consumption has environmental significance or impact. Rather, in the course of this dispute, the

United States has simply noted that the place of consumption example<sup>51</sup> is one example of a trade restriction that could relate to conservation because it directly speaks to the place of consumption and place of consumption, in the hypothetical, is the relevant conservation concern.

70. Here, however, the pace of extraction is the relevant conservation concern and China’s export quotas simply do not speak to the pace of extraction. The U.S. position in this regard is consistent with the panel’s observations in *China – Raw Materials* that “[f]or the purpose of conservation of a resource, it is not relevant whether the resource is consumed domestically or abroad; what matters is its pace of extraction.”<sup>52</sup>

**129. To the parties:** Is it the position of the complainants that semi-processed rare earths are not “natural resources” for the purposes of Article XX(g)? Do the complainants agree that, to borrow the language of the United States, the term “natural resources” is limited to resources in their “raw [...] naturally occurring form”?<sup>53</sup> If not, at what point, in the complainants’ opinion, do processed natural resources cease to be “natural resources” for the purposes of Article XX(g)? What is China’s opinion on this issue?

71. **Answer:** In general, the United States does not believe that semi-processed rare earths (such as rare earth metals and ferroalloys) are natural resources for purposes of Article XX(g) of the GATT 1994. Such items are manufactured products. However, as discussed in the U.S. response to question 128, that does necessarily mean that measures taken vis-à-vis further processed products cannot ever relate to the conservation of an exhaustible natural resource, but it is difficult to imagine how such measures could relate to the conservation of an exhaustible natural resource where, as here, only the export of semi-processed rare earths (*e.g.*, rare earth

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<sup>51</sup> U.S. Answers to the Panel’s Written Questions Subsequent to the First Substantive Meeting with the Parties, para. 91.

<sup>52</sup> *China – Raw Materials (Panel)*, para. 7.428.

<sup>53</sup> U.S. Second Written Submission, para. 149; *see also* Japan Second Written submission, paras. 55-57.

metals) but not finished products (*e.g.*, rare earth magnets) are restricted.

**130. To the parties:** At paragraph 169 of its second written submission, the United States argues that “[t]here is no reason why China could not impose a restriction on the sale or further processing of individual rare earth ores once they have been separated into specific rare earth oxides”. In the opinion of the parties, do such oxides, once separated through manual or mechanical processes, remain “exhaustible natural resources” for the purposes of Article XX(g)?

72. **Answer:** The United States does not believe that China has met its burden to establish that rare earth oxides are exhaustible natural resources for purposes of justifying the export quotas on such products under Article XX(g) of the GATT 1994. The United States notes that, as discussed in our response to question 128, even if rare earth oxides are not exhaustible natural resources *per se*, it does not necessarily mean that measures taken vis-à-vis further processed products cannot ever relate to the conservation of an exhaustible natural resource, but it is difficult to imagine how such measures could relate to the conservation of an exhaustible natural resource where, as here, only the export of certain further processed products (*e.g.*, rare earth oxides) but not others (*e.g.*, rare earth magnets) are restricted.

73. Moreover, China’s lack of a domestic restriction on the sale or further processing of individual rare earth elements speaks to whether China has effective domestic restrictions that actually restrict. As explained in the U.S. response to question 81, because the demand for individual rare earth elements differs, China has failed to show that it restricts the production of individual rare earths based on a restriction on the extraction of rare earth ores.

74. For example, assuming a production restriction of 100 metric tons (MTs) of rare earth ore, and that the ore contains 10 percent neodymium, the production restriction on rare earths will only restrict the production of neodymium if overall demand for neodymium is above 10

MTs. Otherwise, the extraction cap is above the level of extraction that would occur absent the cap and, as noted by the panel in *China – Raw Materials*, there would not be a production restriction in the scenario under Article XX(g) of the GATT 1994.

**133. To the parties:** To what extent are the criteria relating to prior export performance and export experience similar? Or are they distinct and separate criteria?

75. **Answer:** The criteria relating to prior export performance and export experience are similar in that prior export performance implies prior export experience. Pursuant to the *2012 Rare Earth Export Quota Application Procedures* and *2012 Molybdenum Export Quota Application Procedures*, in addition to satisfying other criteria, an applicant for a quota must have exported (or supplied for export) the requisite amount of rare earths or molybdenum in the previous three-year period; in addition, the allocation of the rare earths quota and molybdenum quota is based on the applicant’s prior exports.<sup>54</sup>

76. Satisfying this prior export performance requirement necessarily requires a demonstration of prior export experience. A quota applicant would need to be in the business of exporting in order to meet the requisite level of exports. Thus, achieving such an export target would confer experience in exporting on a quota applicant as well.

77. The notion of prior export experience as encompassing prior export performance is consistent with the ordinary meanings of the terms “performance” and “experience.” For example, “experience” can be defined as “[t]he action of putting to the test, trial;” “[p]roof by

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<sup>54</sup> U.S. First Written Submission, paras. 108-111 (rare earths); 122-125 (molybdenum); *see also* Exhibit JE-55; Exhibit JE-57; Exhibit JE-61; Exhibit JE-63. China does not dispute that it imposes prior export performance (as well as minimum registered capital) requirements with respect to rare earths and molybdenum. *See, e.g.*, China First Written Submission, paras. 238-244, 392-396.

actual trial; practical demonstration.”<sup>55</sup> “Performance” is defined as “[t]he execution or accomplishment of an action, operation, or process undertaken or ordered; the doing of any action or work; the quality of this, esp. as observable under particular conditions . . . .”<sup>56</sup> In other words, a company that has accomplished particular export levels in order to meet a prior export performance requirement will also have demonstrated experience in exporting.

**135. To the United States and the European Union:** In their first written submissions, as part of their trading rights claims, the United States and the European Union developed argumentation relating to three eligibility criteria that China allegedly imposes (e.g. para 152 of the United States’ first written submission and paragraph 137 of the European Union’s first written submission): prior export performance, export experience, and minimum registered capital requirements. In their second written submissions, the United States and the European Union no longer seem to be challenging the alleged “experience” criterion (e.g. paragraph 330 of the United States’ second written submission and heading 5.1.1. of the European Union’s second written submission). Could the United States and the European Union please clarify exactly which of the three criteria in paragraphs 83 and 84 referred to above they are challenging?

78. **Answer:** The United States challenges China’s imposition of prior export performance, prior export experience and minimum capital requirements. As explained in response to Question 133, prior export performance is a subset of prior export experience; that is, by requiring an exporter to satisfy specific prior export performance requirements for rare earths and molybdenum and basing the quota allocation on prior export amounts, China also requires exporters to demonstrate prior export experience. In addition, the use of the term “performance” in the U.S. second written submission is consistent with the presentation in China’s first written

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<sup>55</sup> New Shorter Oxford English Dictionary (1993 ed.), vol.1, p. 886, Defs. 1a and 2.

<sup>56</sup> New Shorter Oxford English Dictionary (1993 ed.), vol. 2, p. 2160, Def. 1.

submission,<sup>57</sup> which the U.S. submission in turn rebuts.<sup>58</sup>

**144. To the parties:** Please comment on Exhibit JE-170, in particular whether licenses for export quotas are sold as mentioned in that exhibit and by Japan in paragraph 11 of its opening oral statement at the second substantive meeting.

79. **Answer:** As explained in our response to question 82, licenses to export rare earths are commonly sold in China. This practice is documented not just in Exhibit JE-170, which is a report by the Xinhua News Service, but also in Exhibit JE-171, which is a report by the Economic Information Daily.

80. As discussed in Japan’s opening statement at the second panel meeting, the thriving market for export quota licenses further shows that the export quotas do not relate to conservation.<sup>59</sup> During this dispute, China has argued that the export quotas on rare earths serve as enforcement mechanisms for the domestic extraction and production targets. However, given the sale of export rights from successful applicants to other entities, China fails to track the pedigree of exported rare earths. As such, the ultimate exporting company need not extract and produce rare earths in a manner consistent with the extraction and production targets. China’s allowance of such a practice shows, yet again, that the export quotas on rare earths do not relate to conservation.

**145. To the complainants:** Please comment on Professor de Melo’s arguments that:

“With an export tax of 25% or less, it is very unlikely that a removal of that tax would increase exports significantly enough such that the export quota is filled because demand for rare earths is generally seen as rather inelastic for most uses.” (Exhibit CHN-195, para. 1)

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<sup>57</sup> China First Written Submission, paras. 239-240, 259-261, 269, 280, 283-284, 385, 395, 401.

<sup>58</sup> See, e.g., U.S. Second Written Submission, paras. 311-312, 317-320, 325-327.

<sup>59</sup> Japan’s Opening Statement at the Second Substantive Meeting of the Panel, para. 18.

81. **Answer:** The United States has provided a number of reasons why the rare earth export quotas for 2011 and 2012 were not filled, with the export taxes and the resulting high prices being one reason. For example, de-stocking during 2011 and 2012 following China's 2010 reduction in the rare earth export quotas were another market phenomenon that contributed to the under-filled quotas.

82. As noted in Professor de Melo's argument, demand elasticities for individual rare earth products varies.<sup>60</sup> Accordingly, while the export taxes may not contribute to the lack of quota fill for every rare earth products, it is clear that high prices for some rare earths lessened demand and, therefore, contributed to the lack of quota fill. This is shown in a report by the *China Daily*, which reported that high export prices contributed to a drop in demand for rare earths.<sup>61</sup>

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<sup>60</sup> Exhibit CHN-195, para. 1.

<sup>61</sup> Exhibit JE-109.