

**\*\*\* AS DELIVERED \*\*\***

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

**(DS431)**

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

**June 18, 2013**

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JE-163	David Humphreys, “ <i>Transatlantic Mining Corporations in the Age of Resource Nationalism</i> ,” Transatlantic Academy Paper Series, May 2012
JE-164	Statement by Professor Gene M. Grossman, <i>Export Restrictions: Possible Effects of Under Filled Quotas on Prices and Consumption</i>
JE-165	<i>Lower valuations spark investor interest in rare earths assets</i> , China Metals Weekly (2 November 2012)
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JE-171	<i>Rare earth fever drives skyrocketed export quota prices</i> , Economic Information Daily (29 April 2011)
JE-172	<i>Showa Denko To Restart Chinese Rare-Earth Alloy Plants</i> , Nikkei English News (12 June 2013)
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1. Good morning, Mr. Chairman and members of the Panel. On behalf of the United States, we would like to begin by thanking the Panel and the Secretariat staff for your time and hard work on this dispute. Our delegation looks forward to continuing to work with you, and with the delegations of China, the European Union (“EU”) and Japan, as you complete your work.

## **I. Introduction**

2. We recall that this dispute is about China’s policies to restrict the exportation – through the use of duties and quotas and criteria for accessing those quotas – of important industrial raw materials for which it is a leading global producer. These include rare earths as well as tungsten and molybdenum. In the case of rare earths, for which China is the world’s leading producer by far, China’s export restrictive policies have allowed China to control and dictate the conditions of the global market.

3. We would like to begin by making three observations regarding the development of China’s arguments in this dispute.

4. First, China is attempting to recast the dispute as a referendum on the legitimacy of the use of export quotas in the multilateral trading system. Such a categorical question is not before this Panel. Rather, what is at issue in this dispute is the fact-specific question of whether China has justified under Article XX the particular export restrictions imposed by China on rare earths, tungsten and molybdenum, which China does not contest are inconsistent with Article XI of the GATT 1994. On the facts of this dispute, no Article XX justification is available. Indeed, China’s own statements in official Chinese government documents do not support China’s arguments that

its export quotas relate to conservation, or that its export duties are necessary to protect human, animal, or plant life or health.

5. Second, we disagree with China's attempts to isolate the export quotas on tungsten, molybdenum, and especially rare earths, from their history and from the export duties that are and have been for many years simultaneously applied to these products. China has no basis for asking the Panel to ignore the background of these export quotas – one of which has been in place for 14 years – and the full panoply of different restrictions that China imposes on the exportation of these products. When the entire record is examined, the clear picture is that these export quotas are not now, nor were they originally conceived to be, resource conservation measures.

6. Third, by the time of this second panel meeting, it is apparent that China has all but conceded the complainants' claims regarding China's export quotas on tungsten and molybdenum. China's attempt to defend its export duties on these products is limited to a cursory, 13-paged submission made before the first meeting of the Panel with the parties in February. China's posture with respect to its export quotas undermines the credibility of China's argument that its rare earths export quota is WTO-consistent.

7. Having made these general observations, we now turn to addressing the key issues presented in China's most recent submission regarding China's defense of the export duties under Article XX(b), followed by China's defense of the export quotas under Article XX(g) of the GATT 1994.

**II. Article XX of the GATT 1994 is Not Available as a Defense for China’s Export Duties and Would Not in Any Event Justify China’s Measures**

8. As noted earlier, China imposes export duties simultaneously with quotas on the various rare earths, tungsten and molybdenum products at issue. We have already argued that: (1) Article XX of the GATT 1994 is not available as a defense for China’s export duties; and (2) *even if Article XX were available to justify breaches of Paragraph 11.3 of the Accession Protocol*, China has not satisfied any element of an Article XX(b) defense with respect to the export duties at issue in this dispute, just as it failed to do in the previous dispute regarding export duties.

9. The burden to establish an Article XX(b) defense is China’s. And, China has not met it. Indeed, China did not even address the complainants’ export duties claim or its Article XX(b) defense in its second written submission. Like the duties at issue in *China – Raw Materials*, China’s export duties on rare earths, tungsten and molybdenum impose costs only on foreign consumers, while creating an incentive for domestic consumption that could even undermine supposed anti-pollution efforts. In the absence of any new argumentation by China, the United States has nothing further to rebut and considers that it has more than made out its case on China’s export duties.

**III. China Has Not Established That the Export Quotas on Rare Earths, Tungsten and Molybdenum Satisfy the Requirements of Article XX(g)**

10. Next, we address China’s argument that the export quotas at issue are justified as conservation measures under Article XX(g) of the GATT 1994. We would like to highlight several themes that have emerged in China’s Article XX(g) argumentation in its second written submission.

11. First, as discussed at the outset, China is trying to frame the relevant legal question as whether there are *any* circumstances in which an export quota would fulfill the requirements of Article XX(g).<sup>1</sup> As we noted, that abstract question is not before the Panel. Furthermore, China has mis-represented U.S. arguments on this topic.

12. According to China, the United States has argued that no circumstances exist that can justify an export quota under Article XX(g) and, therefore, export quotas are *per se* prohibited under the GATT 1994.<sup>2</sup> The United States has not taken such a position – as evidenced in its submissions.<sup>3</sup>

13. Second, China’s second written submission is rife with other distortions of U.S. arguments. For example, China makes the unfounded assertion that the United States is asking the Panel to disregard the operation of the rare earth export quotas in 2012<sup>4</sup> or, relatedly, that China’s quota regime before 2012 must be wholly ignored because it is outside the Panel’s terms of reference.<sup>5</sup> This is incorrect. What the United States has stated is that the Panel should take into account the fact that references to conservation in the annually renewed measures at issue only appeared after the conclusion of the *China – Raw Materials* dispute. And, the fact that these references were not made earlier is relevant evidence relating to whether the design and structure of these measures legitimately speak to a conservation objective. As the Appellate Body in *EC – Customs Matters*

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<sup>1</sup> China’s Second Written Submission, para. 1.

<sup>2</sup> China’s Second Written Submission, paras. 1, 19.

<sup>3</sup> U.S. Answers to the Panel’s Questions Following the First Substantive Meeting of the Panel, para. 91.

<sup>4</sup> China’s Second Written Submission, para. 1.

<sup>5</sup> China’s Second Written Submission, para. 21.

noted: “[a] panel is not precluded from assessing a piece of evidence for the mere reason that it pre-dates or post-dates its establishment.”<sup>6</sup>

14. Third, there are a number of inconsistencies in China’s second written submission vis-à-vis prior assertions made by China in this dispute. For example, China argues, without support, that the Panel cannot take into account “whether the combined operation of the export duties and export quotas result[] in a lack of even-handedness or a disguised restriction on trade.”<sup>7</sup> China’s assertion is facially inconsistent with the text of the chapeau of Article XX, which addresses, *inter alia*, how non-conforming measures are applied.<sup>8</sup> Here, China applies duties and quotas in conjunction with each other – which is clearly relevant to an Article XX analysis.

15. China’s argument is also inconsistent with its assertion that it has a comprehensive policy of sustainable development, of which both duties and quotas are an integral part.<sup>9</sup> 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 in the Article XX(g) analysis, notwithstanding the fact the duties are asserted to be part of the comprehensive policy. China also asks the Panel to examine the export duties as part of a comprehensive sustainable development policy, but then ignore the role of the export quotas in the Article XX(b) analysis, again notwithstanding the fact that the quotas are asserted to be part of the same comprehensive

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<sup>6</sup> *EC – Customs Matters (AB)*, para. 188.

<sup>7</sup> China’s Second Written Submission, para. 21.

<sup>8</sup> *See also U.S. – Gasoline (AB)*, p. 22 (“The chapeau by its express terms addresses, not so much the questioned measure or its specific contents as such, but rather the manner in which that measure is applied.”).

<sup>9</sup> China’s Substantive Defense of Its Export Duties on Rare Earths, Tungsten and Molybdenum, paras. 20-21.

policy. Neither approach makes sense in light of the fact that China’s export quotas and export duties are co-existing or in light of China’s own arguments.

16. Lastly, China’s second written submission also makes incomplete and, therefore, inaccurate statements of Chinese law. China contends that “were a foreign rare earths-using company to move to China, it is subject to the quantitative restrictions in the same way as the wholly Chinese-owned company.”<sup>10</sup> This assertion is contradicted by the provisions of the *Catalogue of Industries for Guiding Foreign Investment*, which prohibits foreign companies from engaging in the separation and smelting of rare earths without forming a joint venture.<sup>11</sup> Foreign rare earths-using companies cannot themselves separate or smelt rare earths and, consequently, cannot form fully integrated companies the way their wholly-owned Chinese competitors do. In short, foreign companies cannot even access the quantitative restriction.

**A. The Export Quotas on Rare Earths Are Not Conservation Measures That Are Justifiable Under Article XX(g) of the GATT 1994**

17. As discussed in the U.S. opening statement at the first Panel meeting,<sup>12</sup> in examining whether measures “relate to conservation” under Article XX(g), the Appellate Body has interpreted the starting point of analysis under Article XX(g) as whether the challenged measures are “primarily aimed at” conservation and whether there is a “close and substantial relationship of means and ends” between the measures and conservation.<sup>13</sup> China attempts to lower the applicable standard by arguing that the export quotas on rare earths need not be “primarily aimed at”

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<sup>10</sup> China’s Second Written Submission, para. 79.

<sup>11</sup> Exhibit JE-16, III.10(3).

<sup>12</sup> U.S. Opening Statement at the First Panel Meeting, para. 22.

<sup>13</sup> *Brazil – Tyres (AB)*, para. 151.

conservation.<sup>14</sup> According to China, the “primarily aimed at” standard was rejected in both *China – Raw Materials* and *U.S. – Gasoline*.<sup>15</sup> A simple review of those reports reveals that China is mistaken.

18. The panel in *China – Raw Materials* rejected China’s attempt to invoke Article XX(g) because, *inter alia*, the export quota and export duty at issue there did not relate to conservation. In so doing, the panel found that it “could not conclude ... that China’s export policy at issue is *primarily aimed at conservation*.”<sup>16</sup> In considering this part of the panel’s analysis, the Appellate Body in *China – Raw Materials* did not raise any concern with the panel’s use of the “primarily aimed at” standard.<sup>17</sup>

19. In *U.S. – Gasoline*, the Appellate Body used and endorsed the approach of examining the primary aim of the measures in question in determining whether they related to conservation under Article XX(g).<sup>18</sup> Clearly, the interpretation that an Article XX(g) analysis starts with the question of whether the measure is “primarily aimed at” conservation is well-established and has not, as China contends, been rejected.

20. China also argues that the new conservation references in the 2012 rare earth export quota measures reflect that China has taken “careful note of the guidance provided by a dispute settlement panel and the Appellate Body with respect to WTO law applied to measures” that were, in China’s own words, “similar to previous challenged measure[s] found to be WTO

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<sup>14</sup> China’s Second Written Submission, para. 15.

<sup>15</sup> China’s Second Written Submission, para. 15.

<sup>16</sup> *China – Raw Materials (Panel)*, para. 7.457 (emphasis added).

<sup>17</sup> *China – Raw Materials (AB)*, para. 348.

<sup>18</sup> *U.S. – Gasoline (AB)*, p. 19.

inconsistent.”<sup>19</sup> While the United States agrees that the rare earth export quotas are – at the very least – “similar” to (if not essentially the same as) the WTO-inconsistent measures at issue in *China – Raw Materials*, the facts contradict China’s assertion that it has actually changed its policies in light of that dispute.

21. China conflates the modification of the stated justification for a policy with changing the actual policy. Simply put, the post-*China – Raw Materials* measures, which include references to the word “conservation,” are new bottles into which China has poured the old wine of its industrial policy.

22. With respect to that industrial policy, China justifies the fact that the export quotas on rare earths do not apply to higher value-added products by asserting that China limits the scope of the quota to “tradeable products.”<sup>20</sup> This obfuscation is new and, once again, is not supported by the facts. As noted in the report provided by Professor Eggert, final products made from rare earths, such as rare earth magnets, are tradeable products.<sup>21</sup>

23. This assertion regarding what products are “tradeable products” also contradicts China’s previous assertions in this dispute. In an earlier submission, China stated that rare earth salts are “not considered [to be] a saleable product outside China as most end users require separate oxides.”<sup>22</sup> This statement formed the basis for China’s argument that denominating the rare earth export quotas in gross weight is not distortive because of the small share of internationally-traded

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<sup>19</sup> China’s Second Written Submission, para. 24.

<sup>20</sup> China’s Second Written Submission, para. 35.

<sup>21</sup> Rare Earth Report, p. 21 (Exhibit JE-129).

<sup>22</sup> China’s Answers to the Panel’s Written Questions Subsequent to the First Substantive Meeting of the panel with the Parties, paras. 186, 246.

rare earth salts, which have a significant difference in their rare earth oxide (REO) weight (which, in turn, captures how much rare earths are in a given product) and their gross weight (which does not).<sup>23</sup> Now, by contrast, China is arguing that “[i]n order to protect the non-renewable rare earth ores from excessive depletion, China’s export quotas cover the products it can control and that are traded internationally – [such as] rare earth ... salts.”<sup>24</sup>

24. In reality, and as the record shows, China controls the export of rare earth salts, while it does not control the export of rare earth magnets. This is not because salts are “tradeable products,” but because salts are lower value-added products, while magnets are higher value-added products. As the United States has explained, Chinese industrial policy favors exports of the latter.

25. The essential point is that the structure of the rare earth export quotas, as observed through its product scope, can be explained by China’s industrial policy, set forth clearly in documents like the Twelfth-Five Year Plan and the Guidance on Enhancing the Management of Raw Material Industries, which is primarily aimed at “encourag[ing] the export of high value-added products and deep processing products.”<sup>25</sup> The same structure is not consistent with a policy primarily aimed at conservation. This is one of several reasons why the rare earth export quotas are not justified under Article XX(g).

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<sup>23</sup> China’s Answers to the Panel’s Written Questions Subsequent to the First Substantive Meeting of the panel with the Parties, para. 246.

<sup>24</sup> China’s Second Written Submission, para. 12 (emphasis added).

<sup>25</sup> Twelfth Five-Year Plan, Chapter 51 Section 1 (“There will be perfection of policies and measures ... [to extend] domestic value-added chain”) (Exhibit JE-15); Eleventh Five-Year Plan, Chapter 37 Section 3 (“carry out value-added foreign trade”); Guidelines for Industrial Management of Raw Materials, para. 6 (Exhibit JE-12).

26. China also argues that the quantitative export restrictions imposed by the rare earths quotas “send a signal to domestic producers that it is not worth starting up illegal mining or production.”<sup>26</sup> China’s argument is logically flawed for a simple reason: these export quotas do not differentiate between legally and illegally produced rare earths. As such, they are both overly broad<sup>27</sup> and ineffective with respect to enforcing mining limits. The restriction imposed by the quota is quantitative in nature and does not take into account or otherwise relate to the legality of a rare earth product’s mining or production.

27. Similarly, China argues that “if foreign users believed that they could have unlimited access to all of China’s annual production quota, then they would have little incentive or need to seek alternative sources of supply.”<sup>28</sup> China’s argument has no merit. The argument ignores the fact that, absent the export quotas, foreign users would not have unlimited access to China’s rare earth products; rather, they would have to compete with Chinese users on a level playing field – and respond to any domestic production restrictions in the same way.

28. But even more fundamentally, China’s argument relates the quotas to distribution, and not conservation. Accordingly, China once again attempts to invoke Article XX(g) not to justify a conservation measure, but rather to justify a measure that is aimed at providing supplies of raw materials to domestic industries. As the United States has noted, this type of measure is addressed by a different exception, Article XX(i). Indeed, at one point in its second written submission, China admits that “the rare earth export quotas seek to distribute trade of [China’s] rare earth

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<sup>26</sup> China’s Second Written Submission, para. 47.

<sup>27</sup> *U.S. – Shrimp (AB)*, para. 141 (examining whether a measure is over-broad in determining if it relates to conservation).

<sup>28</sup> China’s Second Written Submission, para. 51.

products.”<sup>29</sup> And that is one of the other key flaws with China’s position in this dispute – Article XX(g) requires that the non-conforming measures relate to conservation of the exhaustible natural resource, not to distribution among various users.

**B. China’s Export Safeguard Argument is Not Supported by the GATT 1994 or China’s Report**

29. In support of its argument that the rare earth export quotas constitute an “export safeguard,” China submits a report from a consultant that attributes the massive price increase in foreign rare earth prices in 2010 to foreign “speculation.” As previously discussed by the United States, the concept of an “export safeguard” is not provided within the definition of conservation under Article XX(g) or, for that matter, anywhere else in the GATT 1994. But beyond its irrelevance, the theory set out in China’s report is based on a number of substantial flaws and shortcomings that should be highlighted.

30. First, China’s report asserts that “China sought in 2010 to take significant steps in the conservation of its rare earth resources ... through the reduction in its export quotas.”<sup>30</sup> However, outside of the context of this dispute, the author of the report – in a publication titled “Transatlantic Mining Corporations in the Age of Resource Nationalism” – characterized the same export quotas as instruments of “resource nationalism.”<sup>31</sup>

31. China’s report also uses the term “speculation”<sup>32</sup> in a mis-leading manner. According to the report, “[a] purchase of only a few tonnes of [rare earths], costing only a few million dollars,

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<sup>29</sup> China’s Second Written Submission, para. 52.

<sup>30</sup> Dr. Humphreys’ Report, p. 10 (Exhibit CHN-153).

<sup>31</sup> Exhibit JE-163, p. 10.

<sup>32</sup> Dr. Humphrey’s Report, p. 3 (Exhibit CHN-153).

would have a major impact on the market and could easily induce fears of shortage within it”<sup>33</sup> – and this would lead the market to be prone to “speculation.” In such a market, purchases to create reserves – or stockpiling – of rare earths cannot be considered market “speculation.” Rather, it is prudent risk management for a downstream company dependent on Chinese exports, which had just been cut in half.

32. Elsewhere China’s report notes that the “widespread perception” that a commodity price will rise can cause “speculation.”<sup>34</sup> Such a perception in the 2010 rare earths market was caused, of course, by China drastically cutting the export quota. This cut resulted in both risk management behavior by market actors, for example through stockpiling by foreign companies, and also resulted in a 2,000 metric ton (MT) shortage between supply and demand acknowledged in the report.<sup>35</sup> The fact that the slashing of the export quota led to a change in the perception of the market is a point that the report does not dispute. However, the report confuses cause and effect. Instead of acknowledging that the severe market disruptions were caused by China’s actions, the report attempts to place the blame on the “speculative” behavior of the market actors responding to China’s actions.

33. The analysis in the report is further flawed because it fails to address how the 2,000 MT shortage was distributed among the various rare earth elements.<sup>36</sup> For example, were certain rare earth elements, particularly heavy rare earths, disproportionately impacted by the shortage? The

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<sup>33</sup> Dr. Humphrey’s Report, p. 4 (Exhibit CHN-153).

<sup>34</sup> Dr. Humphrey’s Report, p. 5 (Exhibit CHN-153).

<sup>35</sup> Dr. Humphrey’s Report, p. 7 (Exhibit CHN-153).

<sup>36</sup> Dr. Humphrey’s Report, p. 7 (Exhibit CHN-153).

report does not provide an answer. For all these reasons, the report does not support China's argument that the export quota operates as a safeguard against speculation.

**C. The Export Quotas on Rare Earths Are Not Made Effective in Conjunction with Restrictions on Domestic Production or Consumption**

34. The second clause of Article XX(g) requires that a challenged measure be “made effective in conjunction with restrictions on domestic production or consumption.” Even if a respondent can demonstrate that the measure is “primarily aimed at” conservation, this second requirement helps ensure that the goal of conservation does not operate to protect domestic interests. In *U.S. – Gasoline*, the Appellate Body called this “a requirement of *even-handedness* in the imposition of restrictions.”<sup>37</sup>

35. Here, the export quotas also fail to satisfy this requirement. First, the measures that China asserts establish “restrictions” on domestic production or consumption do not in fact do so. Second, even if they did, the restrictions imposed on domestic and foreign users in the name of conservation would not be even-handed.

**1. China Has Failed to Establish That It Has Binding Limitations on Rare Earth Production or Consumption**

36. As the United States has already noted, China has failed to establish that it has binding limitations on either the domestic production or consumption of rare earths.<sup>38</sup> However, China continues to argue that 2012 extraction and production data for rare earths show that actual extraction and production were within the respective targets. China's argument is undermined by

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<sup>37</sup> *U.S. – Gasoline (AB)* at 20-21 (original emphasis).

<sup>38</sup> *See, e.g.*, U.S. Second Written Submission, paras. 156-191.

the fact that it is based on an unpublished document that China has not submitted to the Panel. If and when China chooses to submit this document and data, the United States reserves the right to review and comment on them.

## 2. The Export Quotas on Rare Earths Are Not Even-Handed

37. China has also not shown, in the words of the panel in *China – Raw Materials*, that the “impact of the ... export quota on foreign users is somehow balanced with some measure imposing restrictions on domestic users and consumers.”<sup>39</sup>

38. In its latest submission, China argues that the United States (and, by extension, the panel in *China – Raw Materials*) ignores the fact that Article XX(g) speaks disjunctively of “domestic production *or* consumption” restrictions.<sup>40</sup> According to China, the even-handedness test adopted by the panel in *China – Raw Materials* would mandate the use of consumption restrictions in violation of the disjunctive “or” in the text of Article XX(g). This argument is not supported by the text of Article XX(g) or the GATT 1994.

39. The GATT 1994 covers tariffs and trade in goods. Many different kinds of measures affecting trade in goods may be subject to its disciplines. Article XX – including sub-paragraph (g) – provides for exceptional circumstances where a measure that is subject to the GATT 1994 and would otherwise breach its disciplines, may nevertheless be permitted. How the requirements of Article XX’s exceptional circumstances are applied in a particular challenge depends on the measure at issue and the relevant facts. This would mean that under certain circumstances, a challenged measure might meet the requirements of Article XX(g) because, among other things, a

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<sup>39</sup> *China – Raw Materials (Panel)*, paras. 7.460, 7.465.

<sup>40</sup> China’s Second Written Submission, para. 85.

production restriction is in place whereas under other circumstances, a different challenged measure might meet the requirements of Article XX(g) because a consumption restriction is in place. In short, the United States does not ignore the disjunctive “or.” Rather, the United States is pointing out that the inclusion of any particular language in Article XX(g) – such as “or consumption” – does not necessarily mean (as China implies) that a particular measure at issue in a dispute can be justified under a particular branch of Article XX(g).

40. Furthermore, as noted by the Appellate Body in *U.S. – Gasoline*, the even-handedness analysis requires not just that a production or consumption restriction be in place (depending on the nature of the challenged measure), but that the challenged measure also be “made effective in conjunction with” such domestic restrictions.<sup>41</sup> As noted by the Appellate Body in *China – Raw Materials*, the phrase “made effective in conjunction with” means that the non-conforming measure must “work together with restrictions on domestic production or consumption, which operate so as to conserve an exhaustible natural resource.”<sup>42</sup>

41. Here, the export quotas on rare earths do not “work together” with domestic production restrictions. Rather, the export quotas are unique restrictions, without a domestic parallel, that impact only foreign consumers. In contrast, China’s alleged “restrictions” on domestic production affect equally both domestic and foreign users of rare earths. When juxtaposed with export quotas that restrict supply only to foreign users, it becomes clear that there is no counter-balance to the export quotas, no domestic measures that work together with the export quotas, and, therefore, no even-handedness.

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<sup>41</sup> *U.S. – Gasoline (AB)*, pp. 20-21.

<sup>42</sup> *China – Raw Materials (AB)*, para. 356.

42. Lastly, China argues that implementing a domestic consumption restriction would “likely” be administratively burdensome.<sup>43</sup> China has not, however, provided any evidence in support of this assertion. Moreover, China’s assertion is inconsistent with China’s first written submission, in which it claimed that its VAT invoice system allowed it to track “individual enterprises’ volume of production *and sales*.”<sup>44</sup> Finally, it is important to note that under the GATT 1994, “administrative burdensomeness” does not provide a basis for permitting otherwise GATT-inconsistent measures.

43. In summary, none of the facts and arguments that China has proffered in this dispute satisfy the requirements of Article XX(g).

#### **IV. China Has Not Met Its Burden to Show That the Export Quotas on Rare Earths Fulfill the Requirements of the Chapeau**

44. Because China has failed to meet its burden to show that the export quotas on rare earths are justified under Article XX(g) of the GATT 1994, the Panel need not reach the question of whether the export quotas meet the additional requirements of the Article XX chapeau.

Nevertheless, for the sake of argument and completeness, the United States will also address the flaws in China’s chapeau arguments.

45. The Article XX chapeau provides that a challenged measure that satisfies the requirements of one of the sub-paragraphs must also “not be applied in a manner which would constitute arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade.”<sup>45</sup> China, as the Member adopting a measure

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<sup>43</sup> China’s Second Written Submission, paras. 98-100.

<sup>44</sup> China’s First Written Submission, para. 220 (emphasis added).

<sup>45</sup> *U.S. – Gasoline (AB)*, p. 22.

inconsistent with Article XI of the GATT 1994, has the burden of proving that its measure meets the chapeau requirements. As we will now discuss, China has not met this burden.

**A. China’s Argument Improperly Shifts the Burden Under the Chapeau and Ignores the Wealth of Information Provided by the Complainants**

46. In its chapeau argument, China faults the complainants for not providing, to China’s satisfaction, evidence that the objective of China’s rare earth export quotas is to promote and develop China’s domestic downstream industries.<sup>46</sup> Aside from the fact that such an argument cannot meet China’s burden and, more generally, shifts the burden from China to the complainants, China’s assertions are incorrect. Indeed, the complainants have provided a wealth of information, in the form of Chinese government documents and statements by Chinese officials and downstream companies, showing how China uses export quotas to encourage the growth of downstream industries.

47. For example, the United States provided a report by China’s Ministry of Industry and Information Technology Department of Raw Materials that clearly articulates China’s industrial policy goal to “encourage the export of high-end products; restrain the export of general processing products.”<sup>47</sup> Other documents, such as the State Council’s *China’s Policy on Mineral Resources*, note that increasing added value is a primary policy goal with respect to export of raw materials, including rare earths.<sup>48</sup>

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<sup>46</sup> China’s Second Written Submission, para. 101.

<sup>47</sup> MIIT, *Hastening the Progress of Optimizing and Upgrading the Raw Materials Industry’s Structure* (December 18, 2009) (Exhibit JE-125).

<sup>48</sup> *China’s Policy on Mineral Resources*, IV, para. 8 (Exhibit JE-27).

48. The complainants have even proffered evidence of such policies at the sub-central level of government in China. For example, the *Inner Mongolia Autonomous Region’s Twelfth Five-Year High Tech Industries Development Plan* seeks to upgrade the rare earth industry from one focused on “raw material exports” to one centered on “exports of new rare earth products.”<sup>49</sup>

49. The United States also produced statements by Chinese officials noting the inevitable result of such policies – the growth and relocation of downstream industries into China. For example, a deputy director in Chinese customs observed that “[t]o get past government regulations, some foreign companies are investing in their own rare earth metal processing centers in China, aiming to obtain more of the metals at a cheaper price.”<sup>50</sup>

50. In addition, the United States provided documents from downstream rare earth industries that discuss how “[d]ifferential raw material pricing provides a cost advantage to companies located in China, encouraging additional western companies to relocate product manufacturing to China.”<sup>51</sup> Clearly, the evidence that China uses export quotas to stimulate its downstream industry is both plentiful and credible, as much of it is based on China’s own documents and official statements.

**B. China’s Argument Ignores the Concurrent Application of Export Duties and Export Quotas**

51. Also in the context of China’s assertion that it does not use export quotas to provide its domestic downstream industry with a cost advantage, China notes that it could easily provide such

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<sup>49</sup> Inner Mongolia Autonomous Region’s Twelfth Five-Year High-Tech Industries Development Plan, III(II) (Exhibit JE-29).

<sup>50</sup> Xinhua Insight, China tightens regulation of rare earth industry (June 15, 2011) (Exhibit JE-118).

<sup>51</sup> Arnold Magnetic Technologies, Magnet FAQs, p. 36 (February 7, 2013) (Exhibit JE-112); *see also* Ohara Announcement (Exhibit JE-147).

an advantage through an export duty.<sup>52</sup> Of course, China concurrently imposes duties on rare earth exports, but in no way does it logically follow that China does not also use export quotas to achieve similar goals – i.e., to “encourage the export of high-end products; restrain the export of general processing products.”<sup>53</sup> Accordingly, China’s assertion is baseless.

**C. China’s Argument That it is Economically Impossible That the Export Quotas Have Caused Price Differences is Fatally Flawed**

52. At the outset before addressing the specific flaws in China’s economic arguments, which China presented for the first time in its second written submission, we would like to make a basic – and important – observation. That is that even if the Panel were to accept these arguments, the co-complainants would still prevail on Article XX(g). Under the analytical framework of subparagraph (g), China must show, among other things, that its export quotas are even-handed. The fact is that the export quotas apply to foreign consumers, but there is no separate, corresponding consumption restriction applied to domestic consumers; China’s defense fails. Or, put in the context of the chapeau of Article XX, the export quotas amount to unjustifiable discrimination between countries where the same conditions prevail; China does not meet the chapeau.

53. Nevertheless, as noted, we will rebut each of China’s arguments for purposes of completeness. First, China argues that, because the rare earth export quotas were not filled in 2011 and 2012, “it is economically *impossible* that the quota has caused any difference between domestic and foreign prices.”<sup>54</sup> In support of this argument, China provides a report. China’s

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<sup>52</sup> China’s Second Written Submission, para. 117.

<sup>53</sup> MIIT, Hastening the Progress of Optimizing and Upgrading the Raw Materials Industry’s Structure (December 18, 2009) (Exhibit JE-125).

<sup>54</sup> China’s Second Written Submission, para. 123.

report, however, fails to support China’s proposition. In particular, it fails to establish that the export quotas did not cause the drastic differences between domestic and foreign prices that resulted after China shrank the rare earths export quota in mid-2010 and continuing through 2012.

54. As noted in the statement from Professor Grossman, the report does not address either the impact of export quotas in an environment of imperfect competition or the impact of such quotas on a storable commodity like rare earths. Rather, China’s report assumes, inaccurately, a market with perfect competition and a non-storable commodity. In imperfect competition, export quotas can facilitate the exercise of market power because they limit the scope for response by rivals to aggressive pricing strategies. As noted by Professor Grossman, “[s]tandard analyses of [a market with imperfect competition] with quantity constraints imply that a quota will influence prices and sales and that, if the quota licenses are distributed directly to producers (as China does with its licenses for rare earth exports) then some or all of the firm-specific quotas may be under-filled.”<sup>55</sup> In addition, an unfilled export quota can impact prices and consumption when the product is a storable commodity, as is the case with rare earths.<sup>56</sup>

**D. China’s Price Analysis is Methodologically Flawed, Biased and Arbitrary**

55. In an effort to show that its export quotas did not cause the massive differences between domestic and foreign prices in 2012, China uses price data for three different time periods – 2008, 2010 and a nebulous time period referred to as “the end of 2012 or beginning of 2013.”<sup>57</sup>

Regarding the 2008 and 2010 price data, China’s argument is difficult to follow. However, it

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<sup>55</sup> Statement by Professor Grossman (Exhibit JE-164).

<sup>56</sup> Statement by Professor Grossman (Exhibit JE-164).

<sup>57</sup> China’s Second Written Submission, para. 125.

appears that China is arguing that the 2012 export quotas had no effect on 2012 prices because the differences between domestic and foreign rare earths prices did not consistently increase for each individual element following the 2008 and 2010 cuts in the export quota amount.<sup>58</sup>

56. Of note, China does not address the price differences in 2012, which is the time period of the measures challenged by the United States. China separately acknowledges, of course, that the complainants “have challenged China’s 2012 export quota systems.”<sup>59</sup>

57. Moreover, China’s analysis suffers from a significant methodological flaw, specifically its focus on “the lack of any consistent temporal relationship between increases of price differences and decreases in the amount of the export quotas.”<sup>60</sup> As noted in Professor Grossman’s statement, changes in export quota levels “can have delayed effects on these market outcomes if consumers draw down their inventories once they begin to expect prices will stabilize or begin to fall.”<sup>61</sup> In short, China’s argument ignores the fact that rare earths are a storable commodity and, therefore, that the change in the quota levels can have delayed effects.

58. Regarding “the end of 2012 or beginning of 2013” time period, China’s analysis relies on a selective choice of data to provide a more positive picture for China. China arbitrarily selected the latter half of 2012, thereby completely ignoring the first half of 2012 and the dramatic price differences in the market at that time. An analysis that includes data from the first part of 2012 would presumably be a better reflection of market conditions. China does not explain why it has excluded these data.

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<sup>58</sup> China’s Second Written Submission, paras. 145, 151.

<sup>59</sup> China’s Second Written Submission, para. 21.

<sup>60</sup> China’s Second Written Submission, para. 121.

<sup>61</sup> Statement by Professor Grossman (Exhibit JE-164).

59. In the price analysis, China also relies on a report by a consulting company – the Antaike Report.<sup>62</sup> According to China, this report shows that there is no consistent difference between domestic and foreign rare earth prices.<sup>63</sup>

60. Like Dr. Humphreys’ report, statements contained in the Antaike Report are inconsistent with statements made by that company in other contexts. For example, according to the Antaike Report, “[t]he Chinese government ... is making unremitting effort[s] to improve the regulation on the rare earth industry.”<sup>64</sup> Outside this dispute, however, Antaike’s analysis of China’s rare earth policies are very different. Antaike previously observed that “Beijing’s campaign to root out illegal practices [in the rare earth sector] launched earlier in October was not enough. The system of [VAT] invoices introduced earlier this year needs stricter supervision as illegal producers have had little problem obtaining the documents. Further regulation and a more punitive approach are necessary to control the industry.”<sup>65</sup>

61. But even beyond its inconsistencies, the Antaike Report is flawed in its econometric methodology. As noted in Professor Watson’s statement, “procedures used by [Antaike] are not appropriate for the question at hand, that they likely lead to faulty statistical conclusions, and therefore that the substantive conclusions reached by [Antaike] are unsupported.”<sup>66</sup>

62. For these reasons, China’s price analysis is deserving of no weight.

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<sup>62</sup> China’s Second Written Submission, para. 116; Exhibit CHN-154.

<sup>63</sup> China’s Second Written Submission, para. 116.

<sup>64</sup> Exhibit CHN-154, p. 5.

<sup>65</sup> Lower valuations spark investor interest in rare earths assets, China Metals Weekly (Nov. 2, 2012) (Exhibit JE -165).

<sup>66</sup> Statement of Professor Watson (Exhibit JE-166).

**E. China’s Analysis of Growth Rates in Other Raw Materials Uses a Flawed Comparator**

63. China also argues that there is no causal link between growth in China’s downstream rare earth industry and the export quotas.<sup>67</sup> As evidence, China submits another report that asserts that China’s downstream rare earth industry has grown due to the growth of the Chinese end-use market and the overall Chinese economy.<sup>68</sup>

64. This report suffers from two notable flaws. First, just because China’s rare earth industry may have grown for other reasons besides the export restrictions (such as growth in the end-use market) that does not mean that the export restrictions do not also support Chinese downstream growth at the expense of other Members. This is shown in documents such as Exhibit JE-147, which discusses the relocation of a Japanese optical glass producer driven by both the growth in China and China’s “stable supply of rare earth materials.”

65. Indeed, the report does not appear to contend that the export quotas are not a factor; rather, the report states that the export quotas have not given Chinese producers a “significant” advantage or that raw material access is “particularly significant.”<sup>69</sup>

66. Second, the report uses data from other raw materials (copper, lead, nickel and iron ore) that, themselves, are subject to export restrictions such as export duties.<sup>70</sup> Accordingly, while the report asserts that the consumption of rare earths in China follows the same broad growth in

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<sup>67</sup> China’s Second Written Submission, paras. 162-170.

<sup>68</sup> Dr. Humphreys’ Report, p. 2, p. 8 (Exhibit CHN-163).

<sup>69</sup> Dr. Humphreys’ Report, pp. 8, 14 (Exhibit CHN-163).

<sup>70</sup> See Exhibit JE-45 (for copper, HTS 26030000, 74010000 and 74050000; for lead, HTS 78011000 and 78020000; for nickel, HTS 26040000, 72026000; for iron ore, HTS 26011110, 26011120; 26011190 and 26011200

consumption of other minerals,<sup>71</sup> consumption of those other minerals selected in the report is also a function of export restrictions.

#### **F. China Ignores the Long History of the Rare Earth Export Quotas**

67. Finally and very importantly, as noted earlier, China’s chapeau argument and its entire second written submission ignores the fact that rare earths have been subject to export quotas for 14 years. For example,

- China asserts that since 2007 the rate of increase of consumption of rare earths in China has only averaged 3.5 percent as opposed to 21 percent for the years before 2007.<sup>72</sup> But, China imposed an export quota on rare earths before 2007 and during the years of 21 percent growth in Chinese consumption.
- China argues that there was a speculative surge in the rare earth markets in mid-2010. There was an export quota on rare earths during 2010.
- China asserts that foreign investment in batteries containing rare earths took place “mainly before 2008.”<sup>73</sup> There was an export quota on rare earths before 2008.
- China argues that “foreign investments in the catalysts-producing industry in China took place mainly between 2004 and 2007.”<sup>74</sup> Again, there was an export quota on rare earths between 2004 and 2007.

68. Using China’s own language from its second written submission, it is a “Fundamental Truth” that China has imposed an export quota on rare earths since 1999. And that export quota

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<sup>71</sup> Dr. Humphreys’ Report, p. 8 (Exhibit CHN-163).

<sup>72</sup> Dr. Humphreys’ Report, p. 19 (Exhibit CHN-163).

<sup>73</sup> China’s Second Written Submission, para. 169.

<sup>74</sup> China’s Second Written Submission, para. 169.

was part and parcel of a 21 percent growth rate in China’s consumption of rare earths, a “speculative” surge in foreign demand in mid-2010, as well as surges in foreign investment in both rare earths-containing batteries and the catalyst-producing industry.

69. This also explains the flaw in China’s further argument that, because the 2012 export quota volumes for rare earths mirrored Roskill’s prediction for 2012 foreign demand, the export quotas fulfill the requirements of the Article XX chapeau.<sup>75</sup> The fact of the matter is – and part of what makes this dispute so significant for China, for the co-complainants, the global rare earths market, and the multilateral trading system – current and recent demand for rare earths is the highly distorted result of a set of long-standing, comprehensive, and multi-faceted policies, including quotas, duties, and prior export performance and minimum capital requirements.

## **V. Conclusion**

70. Mr. Chairman and members of the Panel, this concludes the oral statement of the United States. We thank you for your attention and would be pleased to respond to any questions you may have.

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<sup>75</sup> China’s Second Written Submission, para. 111.