

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

(WT/DS431)

**Comments of the United States of America on China's
Answers to the Panel's Written Questions After
the Second Substantive Meeting of the Panel with the Parties**

July 17, 2013

Table of Reports

Short Form	Full Citation
<i>Brazil – Retreaded Tyres (AB)</i>	Appellate Body Report, <i>Brazil – Measures Affecting Imports of Retreaded Tyres</i> , WT/DS332/AB/R, adopted 17 December 2007
<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>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>Korea – Alcoholic Beverages (AB)</i>	Appellate Body Report, <i>Korea – Taxes on Alcoholic Beverages</i> , WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999
<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

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Joint Exhibit No.	Description
JE-188	Web-Published Notice on the 2013 Initial Approval List of Enterprises Qualified to Export Rare Earths in the Annual Review (Ministry of Commerce, Department of Foreign Trade, December 17, 2012)
JE-189	Sina.com.cn, Rare Earth Mining Controls said to “might as well not exist”, real production remains over-quota every year (April 1, 2011)
JE-190	Yangcheng Evening News, Rare Earth Industry Reorganizing, Guangdong Staking an Early Claim (February 28, 2012)
JE-191	Xinhuanet.com, China Minmetals Proposes Production Freeze, Revealing Unspoken Rules inside RE Industry
JE-192	Quotes from China’s Export Quotas and Measures Promoting Downstream Industries
JE-193	Professor L Alan Winters: <i>Comments on China's replies to Questions 76 and 87</i>
JE-194	Professor L Alan Winters: <i>Comments on China's replies to Questions 78 and 86</i>
JE-195	Professor L Alan Winters: <i>Response to Professor De Melo, Exhibit CHN-206 and certain points in China's Answers of 8th July 2013</i>
JE-196	Dudley Kingsnorth, “Rare Earths: An Industry Undergoing Rejuvenation,” June 2013, published jointly by Curtin University and IMCOA
JE-197	Professor Gene Grossman: <i>Response to Professor Jaime de Melo</i>

1. The United States takes this opportunity to provide comments on a number of the points raised in China's July 8, 2013 Answers to the Panel's Written Questions After the Second Substantive Meeting of the Panel with the Parties. The absence of a U.S. comment on any particular answer by China does not indicate that the United States agrees with China's answer. For some questions that involve common topics, the United States has grouped its comments to China's answers.

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?

2. In China's response, China asserts that, under Article XX(g) of the GATT 1994, China has a "right of supply-management under Article XX(g) to promote its domestic industry."¹ In support of this argument, China cites a statement by Brazil's representative to the Committee on Quantitative Restrictions that export restrictions should be permitted "to preserve scarce natural resources where the resources are so limited that, in case of unlimited export, the supply would be inadequate for domestic needs."² According to China, Brazil's proposal was "unobjectionable," provided that such restrictions be "subject to sufficient safeguards."³

3. As an initial matter, under the customary rules of interpretation reflected in Articles 31 and 32 of the Vienna Convention on the Law of Treaties, recourse "may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable." China is not using supplementary means of interpretation to confirm the meaning derived from the application of the rule in Article 31, but rather to alter that meaning. Nor has China established that the application of the rule in Article 31 leads to a result that is manifestly absurd or unreasonable. Accordingly, China's attempt to resort to supplementary means of interpretation is not consistent with customary rules of interpretation.

4. Nevertheless, the *travaux préparatoire* cited by China does not support its argument. By way of background, in the Committee on Quantitative Restrictions, Brazil's representative suggested that a provision should be enacted whereby contracting parties could use export restrictions to protect their domestic industries from market forces. Importantly, the Brazilian

¹ China's Answers to the Panel's Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 5.

² *Id.*, at para. 4.

³ *Id.*

representative recognized that Article 32(j), which read “relating to the conservation of exhaustible natural resources if such measures ... are made effective in conjunction with restrictions on domestic production or consumption” and would become Article XX(g), would not encompass such measures within its terms.⁴ Rather, Brazil’s representative proposed that Brazil “*should like either to have 32(j) amended to that extent or to have something of this kind included in Article 19*”.⁵

5. Of course, Article 32(j) was not amended in the manner suggested by the Brazilian representative. Instead, other representatives noted that “something of this kind” existed to remedy the concerns of Brazil’s representative – *i.e.*, the short supply provisions that would become Article XI:2(a) of the GATT 1994.⁶ And, the “sufficient safeguards” are those provisions set forth in Article XI:2(a) – *e.g.*, the requirement that such measures be “temporarily applied.”

6. China also cites negotiating history in which (allegedly) Brazil’s representative’s proposal was found to be “unobjectionable.”⁷ Again, by way of background, the history cited by China comes from a proposal that “export restrictions should be permitted for the preservation of scarce natural resources even if there were no restrictions on domestic consumption, as would be required under Article 32(j).”⁸ Of course, it was not “unobjectionable” that such actions would be encompassed under Article 32(j). Quite the opposite – such measures are clearly not included in the scope of Article 32(j). Rather, it was “unobjectionable” that other provisions, such as Article XI:2(a) and Article XX(i), might be applicable in the scenario set forth by Brazil’s representative, again subject to “sufficient safeguards.”

7. For these reasons, the negotiating history does not support China’s argument that Article XX(g) of the GATT 1994 includes a right of supply-management to promote a Members’ domestic industry. Rather, it is another example of how China has sought to create new exceptions under the GATT 1994, using elements of the exceptions actually provided by that Agreement, in order to justify an unjustifiable trade measure.

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

⁴ Exhibit JE-179, p. 15.

⁵ *Id.* (emphasis added).

⁶ Exhibit JE-178, p. 80.

⁷ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 4.

⁸ Exhibit CHN-189, p. 5.

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”? 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?

8. China’s response to this question is premised on the new and, more importantly, incorrect assertion that a domestic production restriction is equivalent to a domestic consumption restriction. According to China, “[d]omestic production and consumption restrictions *produce the same effect*: a production cap on the resources subject to conservation limits the access of domestic consumers to the newly produced resources – just like a consumption cap for such newly produced resources.”⁹ As a result, China argues that its export quotas are even-handed – *i.e.*, they are “made effective in conjunction with restrictions on domestic . . . consumption” even though China only has in place measures that appear to (but may not in fact) restrict domestic production. As discussed below, China is incorrect in asserting that domestic production and domestic consumption restrictions have the same effect – indeed, with respect to the key issue of even-handedness, the two types of measures (at least on the facts in this dispute) have very different effects.

9. Earlier in the course of this dispute, China deployed a different argument to attempt to show that it maintains restrictions on domestic *consumption*. China argued that the combination of a domestic production restriction and an export quota result in a restriction for Chinese consumers.¹⁰ The United States has identified and explained multiple times the flaws in this argument.¹¹ Additionally, the United States notes that China’s argument, which attempts to characterize the export quota as a restriction on domestic consumption, is also contradicted by China’s own arguments in the *China – Raw Materials* dispute, in which China asserted that “export restraints encourage the domestic consumption of [raw materials subject to export restraints] in the domestic economy.”¹²

⁹ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 9.

¹⁰ Panel Question 31. The United States rebutted China’s argument in this regard at paragraphs 50-53 of its Answers to the Panel’s Questions In Connection With the First Substantive Meeting of the Panel.

¹¹ U.S. Answers to Questions from the Panel to the Parties in Connection with the First Substantive Meeting of the Panel, paras 49-52; U.S. Second Written Submission, paras. 192-199.

¹² *China – Raw Materials (Panel)*, para. 7.514.

10. Now, in this most recent submission, China has resorted to a new argument – that a domestic production restriction can be considered a domestic consumption restriction because they produce the same effect. However, this argument is factually incorrect. A domestic production restriction, if one were to exist, would restrict production that takes place domestically within China – which would in turn impact the supply from China to any and all potential consumers, whether domestic or foreign. By contrast, a domestic consumption restriction, if one were to exist, would impact Chinese consumers only and, therefore, could potentially counter-balance the presence of the export quotas, which only affect foreign consumers. Indeed, the difference between the two types of measures has been recognized by the Appellate Body, which noted that the text of the Article XX(g) exception speaks disjunctively of domestic production *or* consumption restrictions.¹³ As a result, China’s argument must be rejected because a domestic production restriction does not in fact have the same effect as a domestic consumption restriction, and in this case, China is still not able, even with new arguments, to change the fact that its export quotas are not even-handed.

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 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?

11. In an attempt to establish that it actually maintains restrictions on the domestic production of rare earths for purposes of Article XX(g) of the GATT 1994,¹⁴ China argues that since the extraction and production targets on rare earths were introduced in 2006 and 2007, respectively, the extraction and production of rare earths in China have fallen.¹⁵ As the United States has shown multiple times already, China has not met its burden to establish that it has put

¹³ *U.S. – Gasoline (AB)*, p. 21.

¹⁴ As discussed in paragraphs 9-14 and 18-23 of the U.S. Answers to Questions from the Panel to the Parties in Connection with the Second Substantive Meeting of the Panel, China’s domestic production targets must actually restrict production to meet the requirements set forth in Article XX(g) of the GATT 1994.

¹⁵ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 16.

in place restrictions on the domestic production of rare earths that would satisfy the requirement of Article XX(g) of the GATT 1994.¹⁶ In fact, as we explain below in our comments on China's response to question 75, even though China's production of rare earths did decline during the global recession, it still exceeded China's extraction and production targets during those years, as in previous years.

12. It is important to note, however, that China's new methodology (employed by China in its response to this question) – *i.e.*, the comparison of extraction and production levels before and after the enactment of the targets – appears to be the closest attempt by China to address the relationship between China's measures (here, the extraction targets) and the pace of extraction of rare earths in China. Pace of extraction is especially relevant to the Article XX(g) analysis in this dispute because, as the panel observed in *China – Raw Materials*, “[f]or the purpose of conservation of a resource ... what matters is its pace of extraction.”¹⁷

13. Applying China's new methodology instead to an examination of the rare earth export quotas by looking at extraction levels before and after the enactment of the export quotas, it is again apparent that the export quotas have had no impact whatsoever on the pace of extraction in China. In 1999, when the rare earth export quotas were instituted, China extracted 70,000 MTs of rare earths.¹⁸ By 2006 (when China had introduced extraction targets) Chinese extraction had nearly doubled to 132,506 MTs and to 129,405 MTs in 2008 (when China had introduced both extraction and production targets).¹⁹ Based on these facts, it would appear that the rare earth export quotas made no contribution whatsoever to reducing the pace of extraction. In fact, the only factor that appears to have observably impacted China's extraction of rare earths to reduce the pace has been the global financial crisis which began in 2008 – not the export quotas, nor for that matter, the extraction and production targets.

14. In other words, despite China's assertions that the rare earth export quotas help stop illegal mining and signal the need for other Members to develop alternative sources of rare earths,²⁰ the export quotas have had no impact on slowing the pace of extraction of China's rare earth resources for conservation purposes. This is another core flaw with China's position in this dispute – the fact that the rare earth export quotas do not speak to the pace of extraction means

¹⁶ U.S. Answers to Questions from the Panel to the Parties in Connection with the Second Substantive Meeting of the Panel, paras. 9-14; 18-23.

¹⁷ *China – Raw Materials (Panel)*, para. 7.428.

¹⁸ Exhibit CHN-137.

¹⁹ *Id.* The United States notes that it contests China's reported rare earth extraction and production levels for 2010, 2011 and 2012. *See, e.g.*, U.S. Second Written Submission, para. 164.

²⁰ China's First Written Submission, para. 89.

that they do not relate to conservation – and another reason why China’s attempts to justify those export quotas fail.

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)?

15. In the course of China’s response to question 73 from the Panel, China notes that the extraction target for rare earths “increased slightly between 2010 to 2011 (from 89,200 to 93,800 REO tons), and has stayed the same in 2011 and 2012 (at 93,800 REO tons).” While the relevance of these facts to the Panel’s immediate question is unclear, they do highlight another thematic flaw in China’s argumentation – *i.e.*, the use of selective and arbitrary time periods to attempt to mitigate facts that are inconvenient and do not support China’s explanations. Another example of this can be found in China’s efforts to look at price gaps between domestic and foreign rare earth prices in the latter half of 2012, while excluding the entire first half.²¹

16. With respect to the extraction targets, one must take account of the evolution of the rare earth extraction target over time. As discussed above, the extraction target on rare earths was first introduced in 2006. Since that time, China increased the target from 86,520 MTs to 93,800 MTs.²² Over the exact same period, however, China slashed the rare earth export quota nearly in half – from 60,321 MTs to 30,996 MTs.²³

17. In sum, in 2006, China restricted foreign consumption to no more than approximately half of its rare earth production while ensuring domestic consumers no less than half of its rare earth production. By 2012, China had restricted foreign consumption to no more than approximately one quarter of production while ensuring domestic consumers at least three quarters of total production. From the perspective of conservation, there is no reason why consumers outside of China should shoulder the burden of such drastic cuts to their access to rare earths while Chinese consumers enjoy a substantial increase in their guaranteed supply. In light of the fact that the discrimination between access levels afforded to domestic and foreign consumers is arbitrary and unjustifiable, it violates the principle of even-handedness embodied in Article XX(g) as well as the principle of non-discrimination between countries where similar conditions prevail that is captured in the *chapeau* of Article XX.

²¹ U.S. Opening Statement at the Second Meeting of the Panel, para. 58; *see also* U.S. Comments on Questions 78, 79, 86 and 88.

²² Exhibit CHN-137.

²³ *Id.*

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?

18. As previously noted, the United States disagrees with China’s purported production data for 2010 and 2011, and also disagrees with the 2012 data.²⁴ Most importantly, China’s data are based on self-reporting by Chinese rare earth producers who presumably would not have an incentive to report on any production they may have engaged in over and above the officially set production targets. Accordingly, such data are not reliable because they would not capture the actual level of Chinese rare earth production.

19. The U.S. concern with the accuracy of China’s production data and, in particular, its problem with under-reporting is reinforced by Dudley Kingsnorth, a source whom China credits as “the world’s leading rare earth market expert.”²⁵ According to Kingsnorth, despite the promulgation of extraction targets, China continued to produce above those targets in 2010, 2011 and 2012 – an assessment which is also consistent with data provided and analysis conducted by Professor Eggert and the U.S. Geological Survey (USGS):

Source:	2010 (MTs in REOs)	2011 (MTs in REOs)	2012 (MTs in REOs)
China’s Extraction and Production Targets for Ore Products ²⁶	89,200	93,800	93,800
Actual Production as reported by China ²⁷	89,259	84,943	76,029

²⁴ U.S. Answers to Questions from the Panel to the Parties in Connection with the Second Substantive Meeting of the Panel, para. 11.

²⁵ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 42.

²⁶ Exhibit CHN-137.

²⁷ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 23, Table 1.

Actual Production as Reported in the Eggert Report ²⁸	123,000	105,000	95,000
Actual Production as Reported by Dudley Kingsnorth ²⁹	109,000	98,000	95,000

20. Unlike the data presented by China, which tells a very different story, the Eggert and Kingsnorth data show the same trend, *i.e.*, China has consistently produced above the production target in 2010, 2011 and 2012. In fact, the Eggert Report, like the Kingsnorth data, shows that China has, in every single year since the targets were introduced, produced above the targets.³⁰ In addition, China’s data are also unique and not credible in showing a widening gap between the set targets and lower and lower levels of reported production – facts that are not consistent with the data observed and presented by third party and industry estimates. Accordingly, China’s attempt to use producer-reported data to show that it maintains restrictions on domestic production for purposes of Article XX(g) of the GATT 1994 is unpersuasive.

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?

21. China responds to question 76 from the Panel by making the baseless assertion that the Panel is “jurisdictionally required to examine the facts relating to export quotas and duties separately.”³¹ China provides no support for this argument. Indeed, there is none (as the United States has explained at paragraphs 14-15 of its opening statement at the second Panel meeting

²⁸ Exhibit JE-129, p. 8. The Eggert Report used data from the U.S. Geological Survey.

²⁹ Exhibit JE-196.

³⁰ U.S. Second Written Submission, paras. 163-164.

³¹ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 28.

and elsewhere).³² Later in its response, China acknowledges that “there can be situations where the export taxes and export quotas interact.”³³ And since even China concedes that these two types of measures can interact, there is no legal bar to considering that interaction.

22. The United States takes this opportunity to make one additional point – China’s argument in this dispute, specifically its contention that the “export duties and export quotas ... are distinct measures with distinct ... effects,”³⁴ is directly contradicted by arguments China made to the panel in *China – Raw Materials*. (Indeed, as the United States has noted, China has repeatedly presented arguments in this dispute that are inconsistent with China’s positions in the *China – Raw Materials* dispute.) In *China – Raw Materials*, China asserted that, as an economic matter, “an export duty and an export quota are ‘functionally equivalent measures’ that ‘have similar effect on the volume of export and, hence, international and domestic supply (...).”³⁵ Here, China would have the Panel ignore the fact that export duties and export quotas “have similar effect” under the guise of a supposed limitation on the Panel’s terms of reference that does not exist. Although China has chosen to defend its export quotas and export duties under separate sub-paragraphs of Article XX of the GATT 1994, this choice does not alter the fact that these two types of measures have similar effect. Accordingly, China’s argument should not be given any weight as a substantive argument.

Questions 77 and 139

- 77. To all 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?
- 139. To China:** The Panel would appreciate clarification from China on the existence, extent, and nature of “stockpiling”.
- a) Can rare earths be stockpiled, and what volume of rare earths can be stockpiled yearly. China’s Provisional Measures for the Administration of

³² U.S. Answers to Questions from the Panel to the Parties in Connection with the Second Substantive Meeting of the Panel, paras. 25-29.

³³ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 30.

³⁴ *Id.*, para. 27.

³⁵ *China – Raw Materials (Panel)*, para. 7.231.

Exploration and Mining of the Specified Minerals of which the Protective Mining is Prescribed (Exhibit CHN-18) provides in Article 16 that miners who extract minerals above the quota limit must “keep the extra specified minerals for which the protective mining is prescribed beyond the quota properly from being sold”. Is the Panel correct in understanding that, pursuant to this provision, China has policies requiring the stockpiling or warehousing of ores that have been mined beyond the quota levels? Moreover, could China please indicate whether it has ever stockpiled any rare earths, tungsten, and/or molybdenum products? If so, could China please clarify the amount of rare earths products, tungsten, and/or molybdenum that have been and/or are currently stored or stockpiled?

- b) The Panel would appreciate information on how stockpiled rare earths (if applicable) are used. Could China please clarify whether resources extracted beyond the quota limit must be stored by the mining enterprise and cannot be sold or processed, or whether some stockpiled resources may be processed and sold to downstream industries.
- c) Could China please indicate whether resources extracted by an enterprise in excess of its quota are fully deducted from that enterprise’s quota in the following year?

23. In China’s response to question 77, China asserts that “[t]here is no legal way for a Chinese rare earth miner to produce more rare earth concentrates than the amount assigned to them by the extraction quota.”³⁶ However, later in its response to question 139, China provides a clarification that is in tension with its response to question 77. Specifically, China notes that, in the situation of light rare earths (which are predominately produced from ores that also contain iron), Chinese miners can extract beyond the extraction quota so long as such over-production is justified as an increase in the production of the iron, not the rare earths.³⁷ It appears, therefore, based on China’s own representation of its system, that Chinese producers of light rare earths have a major loophole by which they can extract above the extraction target. As a result, for this reason as well, the extraction targets are not restrictions under Article XX(g) of the GATT 1994.

24. The United States notes that the same provision that allows above-quota extraction for rare earths also applies to tungsten. As China stated in its first written submission in the context of tungsten, “[t]he rules governing access to the quota provide that if the enterprise were to expand the mining scale, to the point where output exceeded the allocated quota, the enterprise

³⁶ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 32.

³⁷ *Id.*, paras. 287 - 288.

must ‘keep the extra specified minerals of which the protective mining is prescribed beyond the quota properly from being sold.’”³⁸

25. China represents that rare earth (and, by extension, tungsten) extracted above the extraction quota can only be stockpiled by companies and cannot be sold or further processed.³⁹ However, as a result of the allowance for over-extraction, Chinese companies would be allowed to create stockpiles of rare earths (and tungsten) that do not count against the extraction or production targets. Practically, the stockpiles held by domestic companies allow such companies to better manage price volatility. By contrast, if a company outside of China wishes to create a stockpile of rare earth or tungsten products, the company must purchase products that are subject to domestic production targets, export duties and export quotas. Chinese companies, at least for the purposes of stockpiling, are subject to none of these restraints. This result is further evidence of the absence of even-handedness in China’s measures and another example of how those measures combine to constitute arbitrary and unjustified discrimination between China and its trading partners under the *chapeau* of Article XX of the GATT 1994.

Questions 78, 79, 86 and 88

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?

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?

86. To China: Could China please comment on Japan’s claim, at paragraph 186 of its second written submission, that “[m]ost of the evidence China presents demonstrates significant export premiums for all of 2011 and most of 2012”?

88. To China: Could China please explain its view as to the determinants of the increase in the price of rare earths since 2011 for domestic and foreign prices? In particular, could China explain whether there is any contradiction between its claim that “China’s conservation policies have contributed to a significant increase in the domestic Chinese price of rare earths since 2011” (China’s Answer to the Panel’s Questions after the First Hearing, paragraph 90) and its statement that “the rare earth price increases in the period 2010-2012 were indeed caused by ... speculative and pre-emptive purchasing of rare earths, rather than actual supply shortage” (China’s second written submission, paragraph 57)?

³⁸ China’s First Written Submission, para. 319.

³⁹ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, paras. 290.

26. In its responses to questions 78, 79 and 86, China asserts that the relevant period of time to measure price gaps between foreign and domestic rare earth products is one particular month – *i.e.*, May 2013 – because, according to China, May 2013 is the one month in the last three years that the foreign rare earth market has been “normal.”⁴⁰ China further argues that, within that one particular month, the Panel should only examine price differences for eight specific rare earth products.⁴¹ This is another example of the strategically self-serving and arbitrary use of data employed by China observed in the U.S. comment on China’s answer to question 73 above.

27. Though it is apparent just on its face that China’s position is fatally flawed as a matter of objective assessment, the relevant period of time for scrutinizing and measuring price gaps is 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.⁴² 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.⁴³ These price gaps are present in not just the 8 rare earth products highlighted by China, but in the 20 products analyzed by the United States and that are subject to export quotas.

28. China’s argument that the 2012 price gaps should be ignored in favor of May 2013 data is based on one central and flawed premise – *i.e.*, that the price gaps in 2012 (and in 2010 and 2011) were not China’s fault but rather caused by foreign rare earth consumers. According to China, the price gaps from 2010 to 2012 were the result of irrational (or speculative) responses by foreign consumers to myriad changes in China’s rare earth policies, principal among them being large cuts in China’s production and extraction quotas.⁴⁴ In support of this argument, China notes that domestic rare earth prices also rose from 2010 to 2012, but in a more rational way.⁴⁵

29. This argument should be rejected because it confuses causes and effect and blames the victim for the problem. Indeed, China’s flawed argument is captured in the Panel’s inquiry at

⁴⁰ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 40.

⁴¹ *Id.*, para. 69.

⁴² U.S. Answers to Questions from the Panel to the Parties in Connection with the Second Substantive Meeting of the Panel, para. 31.

⁴³ *Id.*

⁴⁴ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, paras. 52-61.

⁴⁵ *Id.*, para. 55.

question 88, which China did not directly answer.⁴⁶ Simply put, China is unable to explain why it asserts that, for domestic rare earth consumers, the increase in domestic prices was a rational response by domestic consumers to domestic policies while, for foreign consumers, the increase in foreign prices was an irrational response by foreign consumers to export-targeted policies – *i.e.*, the 2010 cut in the export quota for rare earths.

30. Essentially, when rare earth prices rise in China, China contends that China’s domestic conservation policy was the cause. However, when rare earth prices rise in other Members’ jurisdictions, China contends that the irrational response of speculators is the cause, and the price increase is wholly unrelated to China’s export policies. China’s arguments are contradictory.

31. The simple facts are these – after the export quota was slashed in the latter half of 2010, the price gap between foreign and domestic rare earth products widened drastically. And while Chinese domestic prices may have increased, the key fact is that the price difference between foreign and domestic rare earth products reached the dramatic levels in 2010, 2011 and 2012 which, among other factors, prompted the United States and its co-complainants to bring this dispute, notwithstanding years of engagement by the United States to urge China to eliminate its WTO-inconsistent export restraint policies.

32. Moreover, the dramatic price gaps cannot be explained by China’s domestic measures. As China itself has noted, China’s domestic measures impact foreign and domestic rare earth consumers alike.⁴⁷ Rather, the price difference must be explained by a factor that impacts only foreign consumers; otherwise, there would be no gap. That factor is the export quota and export restraints that China imposes.

85. To China: The analysis of price differences for rare earth products that China provides in Annex 1 of its second written submission appears to suggest that in some cases, domestic prices are higher than adjusted foreign prices (examples include specific periods for Cerium oxide, Dysprosium metal, Europium oxide, Europium metal, Terbium oxide, Terbium metal, Yttrium metal, Praseodymium metal). Could China explain how domestic prices of exported goods can be higher than foreign prices?

33. Question 85 reflects the fact that China’s flawed methodology leads to an absurd proposition – *i.e.*, that domestic rare earth prices that were, in fact, higher than foreign rare earth

⁴⁶ *Id.*, paras. 93-96.

⁴⁷ See U.S. Comments on China’s Answers to the Panel’s Written Questions Subsequent to First Substantive Meeting of the Panel, para. 90; China’s Answers to the Panel’s Written Questions Subsequent to the First Substantive Meeting with the Parties, paras. 130-131.

prices. Such a result is absurd because it goes against basic economic norms – specifically the fact that a product subject to an export restriction will not have a lower foreign price. It also goes against common sense – the United States did not bring this dispute because its rare earth consumers were enjoying superior access to, and lower prices for, Chinese rare earth products.

34. In an attempt to rebut both basic economics and common sense, China has contended that foreign orders for rare earths are larger and, therefore, discounted vis-à-vis domestic orders. Despite promising at the second Panel meeting to provide support for this assertion, China has provided no such evidence. China’s argument should, therefore, be rejected. China’s other arguments related to this question have been previously addressed by the United States.⁴⁸

Questions 87 and 126

87. To China: In Exhibit JE-141, the complainants argue that export quotas impose costs on non-Chinese users of rare earths, even if they are not fully utilized. Could China comment on the various reasons put forward in the Exhibit to support such claim?

126. To China: At paragraph 74 of its second written submission, China argues that “the fact that the 2012 export quotas were not filled suggests that this administrative correction did not lead to any tightening of the availability of rare earth products to meet foreign users’ needs”. Does the fact that the export quotas were not filled indicate that export quotas are unnecessary to conserve China’s rare earths? If the quotas are not being filled, why is there a need to limit the amount of rare earths available to foreign users?

35. In China’s response to question 87, China asserts that its comprehensive conservation policy on rare earths, which is alleged to include the rare earth export quotas, imposes costs on both domestic and foreign consumers of rare earths.⁴⁹ China notes that such costs are the “unavoidable consequences of any conservation measure that brings the extraction of a limited natural resource down to a sustainable level.”⁵⁰ However, in the very same paragraph, China makes the illogical claim that, notwithstanding the fact that the export quotas on rare earths are

⁴⁸ U.S. Answers to Questions from the Panel to the Parties in Connection with the Second Substantive Meeting of the Panel, paras. 32-42.

⁴⁹ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 85.

⁵⁰ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 85.

alleged to be part of China’s comprehensive conservation policy, the quotas do not “particularly” impose costs on foreign consumers.⁵¹

36. China’s argument raises the question: if the export quotas do not have an impact on foreign consumers, then how are they considered, by China’s own logic, as conservation measures? China’s overarching theory as to why the export quotas are justified under Article XX(g) of the GATT 1994 is contradictory and unrealistic. China argues that the export quotas are conservation measures (in order to satisfy the “relating to” prong) that somehow manage not to impose particular costs on foreign consumers (so as to fulfill the even-handedness and *chapeau* requirements). The simple fact is that China has not met its burden under Article XX(g) because China has failed to demonstrate that the export quotas are conservation measures because those quotas do not impact the pace of extraction, but instead impose costs only on foreign consumers. This position is logically sound, consistent with the panel report in *China – Raw Materials*, and supported by China’s own documents, which show that the export quotas are part and parcel of China’s industrial policy.⁵²

37. The logical flaw with China’s argument is succinctly captured in question 126 posed by the Panel, which asks how the unfilled (and, according to China, costless) export quota could meet the “relating to” prong of the Article XX(g) analysis. In China’s response, China asserts that, even when unfilled, the export quota serves as an export “safeguard against the uncertainty in the market in respect of sudden speculative and pre-emptive demand surges.” China’s argument fails, however, because, as the United States has noted time and again, an export safeguard is not encompassed within the definition of conservation.

38. Of course, in reality, the export quotas do impose costs on foreign consumers of rare earths, such as higher prices, substitution for inferior products and uncertainty. The fact that the export quotas impose these costs is not disputed by China’s expert. Rather, China’s expert asserts, for example, that Chinese companies also face substitution and uncertainty costs due to China’s domestic conservation policies.⁵³ But the expert’s analysis overlooks one key fact – while Chinese consumers may face substitution and uncertainty costs as a function of domestic restrictions, to the extent they exist, foreign consumers face greater such costs because they face both domestic restrictions, to the extent they exist, and export restrictions. This double dose of substitution and uncertainty highlights why China’s export quota regime is not even-handed

⁵¹ The illogic of China’s argument from an economics perspective is discussed by Professor Grossman at Exhibit JE-197, para. 2.

⁵² See U.S. Opening Statement at the Second Meeting of the Panel, paras. 47-50.

⁵³ Exhibit CHN-195, pp. 5, 11.

under Article XX(g) and is arbitrary and unjustified under the *chapeau* to Article XX of the GATT 1994.

90. To China: The European Union suggests that “it is wrong to assume that if there is a decrease in the number of mining licenses granted, this will necessarily result in less mining”. How does China respond to this argument? Can China provide any evidence showing that its limiting of mining licenses has resulted in less mining? Does China limit the amount of rare earths each license-holder is entitled to extract and produce?

39. In commenting on China’s response to question 90 (in which China asserts that it limits new rare earth mining through licensing), the United States refers to the arguments and facts set forth in paragraphs 157-162 of the U.S. second written submission.

91. To China: Could China respond to the European Union’s assertion at paragraph 157 of its second written submission? Specifically, could China provide additional details about its rare earth recycling program? How is recycling made effective? And how, if at all, are recycled rare earths accounted for within the general scheme of China’s production quotas?

40. The United States notes that China’s response to question 91 includes a clarification that the 2012 domestic production target for rare earths did not cover products made from recycling until the second half of the year.⁵⁴ Recycled rare earths were, therefore, not accounted for in the general scheme of China’s production targets. Accordingly, Chinese producers of rare earths could use recycled rare earth feedstock without such inputs counting against their production targets. In contrast, recycled rare earth products were included in the rare earth export quotas in the same restrictive manner as non-recycled products.

41. Consequently, for the first half of 2012, the rare earth export quotas were not made effective in conjunction with restrictions on domestic production or consumption as required under Article XX(g) of the GATT 1994. That is, the fact that domestic consumers enjoyed unfettered access to recycled rare earth products, while foreign consumers were subject to limited access on account of the export quotas, further shows that China’s measures are not even-handed. For these same reasons, the measures also constitute arbitrary and unjustifiable discrimination under the *chapeau* of Article XX.

Questions 92, 94, 101 and 113

⁵⁴ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 109.

- 92. To China:** Could China comment on the European Union’s arguments at paragraph 216 of its second written submission? Why does China determine foreign demand (at least in part) on the basis of current consumption? On what basis is current consumption considered an effective or reliable indicator of future demand? Further, does China consult with foreign producers and exporters in setting its export quotas? If so, how are the views of these exporters taken into account when China sets its export quotas? If not, why not?
- 94. To China:** At paragraph 43 of its second written submission, China argues that its export quotas “facilitate the efficacy of China’s rare earth conservation policy”. Would export quotas set at a higher level, for instance at 50% of all extracted and produced rare earths, fulfill this function?
- 101. To China:** Please comment on paragraph 235 of the European Union’s second written submission. In particular, did China allocate any export quotas for tungsten ore in 2012?
- 113. To China:** Could China please provide information about the criteria on the basis of which quotas for tungsten and molybdenum are set for each year?

42. The United States notes that China’s answers to these questions are another instance in which China had chosen not to respond fully to a question from the Panel related to the process by which China establishes the export quotas – *i.e.*, the numerical limits – for rare earths, tungsten and molybdenum. By way of background, in the first set of questions, the Panel asked China to provide documentation (beyond an exhibit prepared solely for purposes of the instant dispute that covered only rare earths) related to the process for establishing the export quotas on the products at issue. China declined to provide the requested documentation and, moreover, failed to address the question as it relates to tungsten and molybdenum in any manner whatsoever.⁵⁵

43. Now, China has failed to address the Panel’s question as to why current non-Chinese consumption is considered an effective or reliable indicator of future non-Chinese demand. This is an important question because, for example, rare earths have been subject to export quotas for 14 years, a fact that has distorted foreign demand over time. China has provided no evidence whatsoever as to how it accounts for distortions in foreign demand caused by the export quotas (and other restrictions) – specifically how such distortions might make current consumption a poor indicator of future demand.

⁵⁵ See U.S. Comments on China’s Answers to the Panel’s Written Questions Subsequent to First Substantive Meeting of the Panel, paras. 61-64; China’s Answers to the Panel’s Written Questions Subsequent to the First Substantive Meeting with the Parties, para. 114.

44. The export quotas have served as a thumb on the scale that, *inter alia*, incentivizes foreign companies to relocate their operations (and their technologies) to China, thereby decreasing foreign demand (and increasing Chinese demand).⁵⁶ Such relocations and other forms of demand destruction cause a feed-back effect, as China continues to justify cuts to the export quotas based on decreasing demand, which itself is a function of the previous export quotas. China wholly ignores this phenomenon. Rather, China contends that the rare earths export quota level, which is based on current foreign demand shaped by 14 years of export restrictions, represents “normal market circumstances.”⁵⁷ China’s methodology is directly contradicted by the Appellate Body’s observations in *Korea – Alcoholic Beverages* that “consumer behaviour might be influenced, in particular, by [previous protectionist acts].”⁵⁸

45. China’s failure to take these distortions into account when establishing the export quotas on rare earths,⁵⁹ tungsten and molybdenum further illustrates that China’s measures are not even-handed, and that they constitute arbitrary and unjustified discrimination under the *chapeau* of Article XX.

46. In addition, in its answer to question 113, China has finally responded to the Panel’s repeated questions about the mechanism by which China determined the export quotas for tungsten and molybdenum in 2012. According to China, the law that governs how export quotas for tungsten and molybdenum are set mandates that the quotas should be determined based on, *inter alia*, the development plans, objectives and policies of China and the security of the national economy.⁶⁰ These goals, of course, are wholly unrelated to conservation and further show that the export quotas on tungsten⁶¹ and molybdenum do not even “relate to” conservation as required by Article XX(g).

⁵⁶ See, e.g., U.S. Comments on China’s Answers to the Panel’s Written Questions Subsequent to First Substantive Meeting of the Panel, paras. 24-27.

⁵⁷ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, paras. 109, 125.

⁵⁸ *Korea – Alcoholic Beverages (AB)*, para. 120.

⁵⁹ The United States also notes that China uses the product mix from previous years to convert the rare earth export quotas from rare earth oxides to gross weight. China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, paras. 184-185. Again, China does not take into account how the export restrictions may have distorted the product mix in making this conversion.

⁶⁰ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 124.

⁶¹ In China’s response to question 101, China asserts that it did not allocate any of the tungsten export quota to concentrates due to the lack of current and previous demand for such products. China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, paras. 167-169. As discussed above, China’s use of previous and current demand to set the export quotas is distortive.

Questions 93, 97 and 98

- 93. To China:** With reference to paragraph 37 of its second written submission, could China explain why it imposes restrictions on the smelting and separation of rare earths but not on the use of rare earths at later stages of production? In other words, why does China restrict production of rare earths at the second or third stage of processing but not further down the production chain, when rare earths are used as inputs by value-added industries?
- 97. To China:** Further to paragraph 65 of China’s second written submission, could China elaborate on its argument that “the product coverage of the challenged 2012 rare earth export quotas reflects China’s sovereign choice to set its conservation objective at a particular level”? Specifically, could China explain in more detail the relationship between its chosen level of conservation and the raw and semi-processed materials subject to export control?
- 98. To China:** Please comment on paragraph 149 of the United States’ second written submission. Specifically, could China explain why it controls the export of some semi-processed rare earths but not others? Why does China not restrict the export of value-added downstream products that are produced using rare earths?

47. The United States has addressed the specific points raised by China in its answers to questions 93, 97 and 98 in previous submissions.⁶² The United States has clearly shown that the scope of the export quotas at issue in this dispute – *i.e.*, the fact that the export quotas apply to lower value-added products but do not apply to higher-value added products – is driven by industrial policy, not conservation.

The United States further adds that China’s explanation for the scope of its export quotas in this dispute is directly contradicted by China’s explanation for the scope of its export restrictions in *China – Raw Materials*. In that dispute, China asserted that the scope of export restrictions was designed to encourage the export of higher value-added products and that this scope was justifiable under the GATT 1994. Indeed, the promotion of higher value-added products was the key to China’s unsuccessful attempt to invoke exceptions set forth in Article XX as demonstrated in the following excerpts from the panel report in *China – Raw Materials*. As the panel there found:

[T]he imposition of export restrictions will allow China to develop its economy in

⁶² See U.S. Opening Oral Statement at First Meeting of the Panel, paras. 24-25; U.S. Closing Oral Statement at First Meeting of the Panel, paras. 11-12; U.S. Comments on China’s Answers to the Panel’s Written Questions Subsequent to First Substantive Meeting of the Panel, para. 74; U.S. Second Written Submission, paras. 146-154, 222-231, 265-273.

the future . . . The reason for this is that export restraints encourage the domestic consumption of these basic materials in the domestic economy. Consumption of the basic materials at issue by downstream industries (such as the steel, aluminium, and chemical industries, and those industries further processing steel, aluminium and chemicals into), and the consequent additional production and export of higher value added products, will help the entire Chinese economy grow faster and, in the longer run, move towards a more sophisticated production bundle, away from heavy reliance on natural resource, labor-intensive, highly polluting manufacturing. This move towards higher-tech, low-polluting, high value-added industries, in turn, will increase growth opportunities for the Chinese economy, generating positive spillovers beyond those to firms directly participating in these markets.⁶³

And:

Development gains, [China] argues, are due in part to the conscious choice to develop value-added trade, diversify production and exports, and promote a higher value-added domestic industry.⁶⁴

And:

China claims that there is a strong link between export restrictions and economic growth. China's line of argument is that its export restrictions on raw materials help China to move away from an economy based on raw materials toward an economy based on higher value-added, more sophisticated sectors, and that this, in turn, will promote growth of the Chinese economy.⁶⁵

48. China's argument regarding the scope of its export restrictions, and the corresponding promotion of higher value-added trade, did not work in *China – Raw Materials*. That scope has not changed. Now, however, China has re-characterized the rationale for the scope of the export quotas in an effort to justify what are the exact same policies – restrict raw materials and promote value-added trade.⁶⁶ China's re-characterization should be rejected.

⁶³ *China – Raw Materials (Panel)*, para. 7.514.

⁶⁴ *Id.*, para. 7.314.

⁶⁵ *Id.*, para. 7.543.

⁶⁶ As was the case in *China – Raw Materials*, Chinese government documents clearly show that the scope of the export quotas is designed to promote value-added trade. See U.S. Opening Oral Statement at First Meeting of the Panel, paras. 24-25; U.S. Closing Oral Statement at First Meeting of the Panel, paras. 11-12; U.S. Comments on China's Answers to the Panel's Written Questions Subsequent to First Substantive Meeting of the Panel, para. 74; U.S. Second Written Submission, paras. 146-154, 222-231, 265-273.

Questions 95 and 107

95. To China: With reference to paragraphs 43, 44, 110 and 111 of its second written submission, could China explain why it has lowered its export quota rather than its domestic extraction and production quotas? Please explain this strategy in the light of China’s “comprehensive rare earth conservation” policies.

107. To China: Please comment on the European Union’s comments in paragraphs 23, 24, and 25 and the United States’ comments in paragraphs 46 and 47 of their respective comments on China’s responses to the Panel’s question no. 18.

49. In China’s response to question 95, China asserts that the Panel is mistaken in its understanding that China lowered the 2010 export quota on rare earths while, at the same time, it raised the 2010 domestic extraction and production targets on rare earths. China’s argument is, at best, misleading, as its subsequent answer to question 107 shows.

50. By way of background, the dramatic cut in the rare earth export quotas from 2009 to 2010 is reflected in the following quota volumes announced in those years in the context of the levels of extraction announced as targets for those years.⁶⁷

	2009	2010
Extraction Plan (MLR)	82,320	89,200
Production plan of ore products (MIIT)	119,500	89,200
Export quota	50,145	30,358

51. China refers the Panel to the decrease from 119,500 MTs to 89,200 MTs in the MIIT production plan, but ignores the corresponding increase in the MLR extraction plan from 82,320 to 89,200 MTs.⁶⁸ As the data show, the MIIT and MLR numbers were different in 2009, but then converged in 2010. China explains in its response to question 107 that:

The Directive Production Plan governing the production of rare earth ore products was instituted by the MIIT in 2007 while at the same time MLR issued its own separate extraction quota on ores. Thus, during the period 2007-2009, both the MIIT production plan and MLR’s extraction controlling quota covered the same product, i.e. ore concentrates produced by mining enterprises. Between 2007-2009, MIIT implemented

⁶⁷ Exhibit CHN-137.

⁶⁸ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 130.

the production plan by setting levels for ore extraction that were higher than the MLR extraction quota. Given this obvious policy incoherence, in 2010 MIIT and MLR launched a series of measures to rationalize and make consistent the extraction amounts of rare earths. Thus, by 2010, the MIIT and MLR agreed on the same quantity of, respectively, production/extraction plans.⁶⁹

52. In sum, MIIT and MLR released contradictory numbers covering the exact same products in 2009 before finally agreeing to a number in 2010 – *i.e.*, 89,200 MTs – which represented an increase from MLR’s previous extraction level of 82,320 MTs. As a result, Chinese rare earth producers could extract more rare earths in 2010 (and be in compliance with both MLR and MIIT) than in 2009 (when they would have violated MLR’s provisions) while foreign consumers faced a massive decrease in their access to rare earth products. For these reasons, China has failed to explain why it lowered the rare earth export quota rather than its domestic extraction and production quotas from 2009 to 2010, as requested by the Panel.

100. To China: The Panel would benefit from additional clarification on the following factual issues:

- a) Please comment on paragraph 44 of the United States’ first written submission, paragraphs 37 and 38 of the European Union’s first written submission, and paragraphs 41-44 of Japan’s first written submission. Specifically, does China agree with the descriptions in those paragraphs of the production processes for tungsten?
- b) Please comment on Exhibit JE-40. Specifically, does China agree with the descriptions in this exhibit of the production processes for molybdenum? Please also indicate what form of molybdenum product is meant by the term “molybdenum concentrates” used in the annexes of Exhibits CHN-94 and CHN-95.
- c) Please comment on paragraph 247 of the European Union’s second written submission. Do the 2012 extraction quotas and production quotas on tungsten cover the same products?
- d) Does China impose production quotas on tungsten products other than tungsten concentrates (referred to in Exhibits CHN-94 and 95), such as tungsten acid, tungsten hydroxides, ammonium paratungstate, sodium tungstate, calcium tungstate, ammonium metatungstate, tungsten carbide, ferro-tungsten, ferro-silico-tungsten, tungsten powder, and/or unwrought tungsten?

⁶⁹ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 182 (emphasis added).

- e) Please comment on paragraph 256 of Japan's second written submission and paragraph 47 of the United States' second written submission. Are the legal instruments referred to in Exhibits CHN-21, CHN-31, CHN-32, and CHN-33 applicable to tungsten and molybdenum?

53. China's response to question 100(e) shows that even at this advanced stage of the proceeding, it is not clear whether China asserts that it has a comprehensive environmental policy that applies to all three groups of products,⁷⁰ or whether it has distinct such policies tailored to each industry.⁷¹ In addition, it appears that one of the measures China cites, which relates to the inspection of tungsten and molybdenum smelting industries and which China provided for the first time in its response, was not promulgated until April 2013.⁷² As such, not only was this document issued after China offered its defense of its export duties as part of a comprehensive environmental policy, but there is also no information about how this measure was developed, or whether or the extent to which it has been implemented. And, like other measures that China did initially identify as part of a comprehensive policy in its substantive defense of export duties,⁷³ this measure says nothing about duties imposed only on exports or how they relate to purported anti-pollution goals.

54. That said, regardless of which of China's proffered patchwork of measures might be considered to be part of a comprehensive policy with respect to rare earths, tungsten, or molybdenum, the fact remains that China's export duties on those products do not form part of any such policy. Neither the new measure that China identifies in its response, nor China's response itself, demonstrates a connection between the measures that purport to regulate pollution associated with the production of rare earths, tungsten and molybdenum on the one hand and the duties (imposed only on exports of those products) on the other.⁷⁴ For purposes of establishing a defense under Article XX(b), it is simply not sufficient to cite a list of measures

⁷⁰ See China's Substantive Defense of its Export Duties on Rare Earths, Tungsten and Molybdenum, para. 22.

⁷¹ China's Answers to the Panel's Written Questions after the Second Substantive Meeting of the Panel with the Parties, para. 56 ("Given different environmental problems in each industry, it is natural that China use [sic] different legal instruments to address particular environmental problems in each industry."). At the same time, as China explains, it appears that many of the environmental standards cross-referenced in China's *Conditions for Admission to the Tungsten Industry* (Exhibit CHN-93) and *Conditions for Admission to the Molybdenum Industry* (Exhibit CHN-108) are more general standards broadly applicable to a broad range of industries. China's Answers to the Panel's Written Questions after the Second Substantive Meeting of the Panel with the Parties, para. 161.

⁷² China's Answers to the Panel's Written Questions after the Second Substantive Meeting of the Panel with the Parties, para. 163 (citing Exhibit CHN-217).

⁷³ U.S. Second Written Submission, paras. 49-51.

⁷⁴ *China – Raw Materials (Panel)*, para. 7.507.

that supposedly make up a comprehensive environmental policy, without offering evidence or explanation as to how the challenged measure (here, export duties) contributes to that supposed policy and is necessary to protect life or health.⁷⁵

- f) Could China please clarify whether its export quotas on tungsten and molybdenum are imposed at the same level as its domestic extraction and production quotas? In other words, are the tungsten and molybdenum products on which China imposes export restrictions the same as the products on which it imposes domestic extraction and production quotas? While China has indicated that some of its rare earth export quotas are applied to semi-processed rare earths for pragmatic reasons, the Panel would appreciate further information on the level at which its tungsten and molybdenum quotas are applied, i.e. whether such quotas are applied at the level of raw or semi-processed materials, and whether this corresponds with China's domestic restrictions.

55. In China’s response to question 100(f), China clarifies that it does not have domestic production targets on tungsten or molybdenum products beyond the concentrate stage.⁷⁶ Consequently, the fact that China has no domestic restrictions on intermediate tungsten and molybdenum products that are subject to the export quotas further undermines China’s claim of even-handedness.⁷⁷ In addition, the fact that domestic consumers enjoy unfettered access to further processed tungsten and molybdenum products, while foreign consumers are subject to limited access on account of the export quotas, demonstrates a lack of even-handedness as required by Article XX(g) and would also constitute arbitrary and unjustifiable discrimination under the *chapeau* of Article XX.

56. This clarification also presents a direct contradiction to China’s policy vis-à-vis rare earths. In China’s response to question 93, China asserts that it places a domestic production target on intermediate rare earth products “to help enforce the extraction quota.”⁷⁸ According to China, without this restriction on intermediate rare earth products, “illegal mines could sell their

⁷⁵ U.S. Second Written Submission, paras. 48-52.

⁷⁶ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, paras. 165-166.

⁷⁷ The products are: for tungsten, ammonium paratungstate (APT), tungstic acids and its salts, tungsten trioxide and blue tungsten oxide, as well as tungsten powder; and, for molybdenum, molybdenum oxides and hydroxides, ammonium molybdates, other molybdates, ferro-molybdenum, molybdenum powders, unwrought molybdenum. China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, paras. 165-166.

⁷⁸ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, paras. 119, 121.

ore products to smelting and separating enterprises, who could process these without being inspected further.”⁷⁹ In contrast, China now claims that its domestic restrictions on tungsten and molybdenum ores and concentrates are effective without this same type of supposed enforcement mechanism being applied to further processed products.

102. To China: In its first written submission, China states that the resource tax is levied on per ton of undressed ore mined. Please indicate the reason why there is no similar domestic tax on further processed products?

57. China's response to question 102 is addressed at paragraphs 186-187 (rare earths), 241 (tungsten) and 281-282 (molybdenum) of the U.S. Second Written Submission.

103. To China: Please comment on paragraphs 261 and 294 of Japan's second written submission. Could China provide information on value-added tax (VAT) on rare earth, tungsten and molybdenum products?

58. As explained in paragraphs 261 and 294 of Japan's second written submission, China imposes restrictions on the export of lower value-added rare earth, tungsten and molybdenum products. In contrast to its policies on lower value-added products, China provides tax and export incentives through, for example, refunds of the value-added tax (“VAT”) upon the exportation of higher value-added products that use rare earths, tungsten and molybdenum, such as rare earth permanent magnets.⁸⁰ China's tax code and system of export duties, therefore, encourages the export of higher value-added products as well as the domestic consumption of the lower value-added inputs. This directly contradicts China's argument that it has a “comprehensive conservation policy” given its encouragement of domestic consumption.

59. In its answer, China does not address the inconsistency between of the structure of China's VAT system and China's assertions that its measures are aimed at conservation. Rather, China notes that the VAT refund system has not been challenged by the complainants. China's argument misses the point – the VAT refund system is another example of China's stimulation of domestic consumption and the fact that the structure of its export regime is not designed to promote conservation, but rather the production and export of value-added products.

Questions 104 and 105

104. To China: In the light of Exhibits JE-45 and CHN-8, CHN-56, CHN-57, and CHN-58, could China please explain why the export duties on rare earths were

⁷⁹ China's Answers to the Panel's Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 121.

⁸⁰ Japan's Second Written Submission, para. 171.

levied on the basis of individual elements, whereas the export quotas were imposed and allocated on the basis of the general classification of “light” and “medium/heavy” rare earths?

105. To China: In the light of Exhibits CHN-20, CHN-21, CHN-22, and CHN-23, could China please explain why the extraction quotas were imposed on the basis of “light” and “medium/heavy rare earths”, whereas the production quotas were imposed in a general way?

60. China’s answers to questions 104 and 105 are addressed at paragraphs 165-172 of the U.S. second written submission and paragraphs 56-59 of U.S. Comments on China’s Answers to the Panel’s Written Questions Subsequent to First Substantive Meeting of the Panel.

106. To China: Please comment on paragraph 23 of the first part of the executive summary of the submission of the European Union, which provides as follows:

[...] China does not provide any evidence or data on how the specific duty level that it imposes might have resulted in a decrease in demand, production and consumption of these products, and on how this had an alleged beneficial effect on health protection in China.

61. In its answer, China has still not demonstrated how its export duties on rare earths, tungsten and molybdenum make a material contribution to the cited objective of protecting health or life in general, much less how the specific duty levels relate to such an objective. Regardless of the level of export duties imposed, those duties add a cost only to exports, even though the pollution (and associated health effects) is linked to the mining and production of the good, not its exportation.⁸¹

62. China’s response sheds no further light on how its export duties are necessary to promote a health or life objective. First, and perhaps not surprisingly, China makes no attempt to explain the level of export duties imposed on tungsten and molybdenum.

63. Second, with respect to rare earths, China offers only generalizations that the duty rates on some types of products tend to be higher than others (heavy rare earths as opposed to light rare earths; metals as opposed to salts and oxides). Aside from the fact that this generalization has a number of exceptions – some light rare earths are subject to a 25 percent duty, for

⁸¹ U.S. Second Written Submission, paras. 50, 55; U.S. Opening Statement at the Second Meeting of the Panel, para. 9; U.S. Answers to Questions from the Panel to the Parties in Connection with the Second Substantive Meeting of the Panel, para. 64.

example,⁸² China’s comparison between groups of duty rates provides no information about how the duty rates that are imposed reflect supposed health or environmental costs. There is no baseline for such a comparison; the fact that the duties on some heavy rare earths are higher than the duties on some light rare earths is not supportive of China’s attempt to invoke Article XX(b) given that China has failed to explain how the duty level for either those heavy rare earths or those light rare earths relates to pollution.

108. To China: In paragraph two of its first written submission, China states that “[...] China applies in 2012 distinct conservation policies for each of these three sets of resources.” (emphasis added) In paragraph 3 of its second written submission, China states that “[...] it has very carefully used its sovereign right to establish a conservation policy that reconciles that need to preserve exhaustible natural resources [...].” (emphasis added) Could China please clarify whether it has in place specific conservation policies for tungsten and molybdenum as well as for rare earths?

64. China’s response does not answer the Panel’s question. The Panel, with reference to China’s First Written Submission, asked China questions related to China’s alleged conservation policy, specifically for tungsten and molybdenum. In response, China merely refers the Panel back to its First Written Submission – the same document referenced in the Panel’s question.⁸³ In sum, China was presented with and passed on the opportunity to supplement its attempt to satisfy the burden of fulfilling the requirements under Article XX(g) of the GATT 1994.

Questions 109 and 140

109. To China: In paragraph 164 of its first written submission, China states that its 2012 comprehensive rare earth conservation policy included both export and domestic restrictions. China explains further that that policy imposed four categories of domestic restrictions, as well as “rigorous enforcement actions to ensure compliance with these four categories of domestic restrictions”. Could China please explain why the above-mentioned enforcement actions are not mentioned in the case of tungsten and molybdenum?

140. To China: Could China please update data on tungsten and molybdenum provided in Exhibits CHN-138 and CHN-139 while addressing Panel’s questions No. 111, No. 112 and No. 115?

⁸² Neodymium, lanthanum, cerium, and praseodymium are each subject to a 25 percent duty, for example. See Exhibits JE-6, JE-45.

⁸³ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, paras. 188-189.

65. In China’s response to question 109, China asserts that the above-target extraction of tungsten and molybdenum has been curbed based on a 2013 document – *Opinions on Implementing the Rectification of Metal and Non-metal Mines According to Laws* – and a provincial document issued in late 2012 – *Program of the Rectification of Metal and Non-metal Mines in Hebei Province*.⁸⁴ However, these documents are primarily directed at worker safety, not the above-target extraction of tungsten and molybdenum resources. For example, the 2013 document states:

During the eleventh five-year period, the number of mine accidents has been decreased by 47%, and the number of deaths has been decreased by 45% nationwide. However, production safety accidents still occur frequently, and the production safety situation is still grim, because the conditions that mines are in large quantity with small scales, scattered distribution and poor foundations have not been fundamentally improved in the whole nation.⁸⁵

Accordingly, the evidence China proffered does not support China’s representation that the production of tungsten and molybdenum over and above the published production targets has been curbed.

66. The fact that China does not prevent the above-target extraction of tungsten and molybdenum is also borne out in the extraction data provided by China in response to question 140. These data show the extent of the gross over-extraction of tungsten and molybdenum in 2012:

	Tungsten ⁸⁶	Molybdenum ⁸⁷
Extraction target	89,000	194,520
Actual level of extraction	124,706	267,947
Over-target extraction as a percent of the target	40 percent	38 percent

67. Clearly, the introduction of extraction targets on tungsten and molybdenum have not served as “production restrictions” for these materials as required under Article XX(g) of the GATT 1994.

⁸⁴ Exhibits CHN-218 and CHN-220.

⁸⁵ Exhibit CHN-218, p. 2.

⁸⁶ Exhibit CHN-223.

⁸⁷ Exhibit CHN-224.

110. To China: Exhibit CHN 137 states that China’s extraction plan for 2012 was 93,800 tons of rare earth. According to Exhibit JE-105, “National Mineral Resource Plan (2008-2015)”, chapter “b. Strengthen the essential advantages of mineral protection and extraction management” (“Metallic minerals”), “The 2015 extraction controls are...rare earths (REO) at approx. 140,000 tons...” According to these figures, the planned 2015 rare earth extraction cap is higher than the 2012 quota. Could China please comment on these figures?

68. One of China’s themes over the course of this dispute is that the rare earth market from 2010 to 2012 was not a “normal market,” but a market characterized by “speculative-driven extremely high prices and distortions from the intense speculation.”⁸⁸ Based on these supposed distortions, China has asked the Panel to look at data from the rare earth market at any time but 2010 to 2012. In particular, China has invited the Panel to consider data from as far back as 2008.⁸⁹

69. However, in considering the 2008 time period and the aspirations articulated in the 2008 *National Mineral Resource Plan*, it is apparent that at that time before the global financial crisis, China planned on growing the size of its rare earth extraction and production operations to historic highs – *i.e.*, 140,000 MTs of extraction. In this context, China contends that the Panel should ignore such data in favor of documents from 2010 to 2012.

70. First, China’s internally contradictory arguments should be recognized as symptomatic of the same self-serving “slicing and dicing” of data the United States observed in the comment to China’s answer to question 73 and should, accordingly, be rejected.

71. Second, the United States notes that in reality, the 2008 *National Mineral Resource Plan* shows that, but for the financial crisis, China would have continued to extract more and more rare earths at an accelerated pace. This is wholly contrary to China’s assertions that it has a comprehensive conservation regime for rare earths and further shows that China does not have actual restrictions on the domestic production or consumption of rare earths within the meaning of Article XX(g) of the GATT 1994.

111. To China: According to Exhibit CHN 138 on “Tungsten Data (1999-2012)”, the actual level of export of products subject to quota (in gross weight) in 2003, 2005, 2006, 2007, 2008, 2010, 2011, and 2012 was higher than the export quotas set for these years. Could China please comment on these figures?

⁸⁸ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 46.

⁸⁹ *See, e.g.*, China’s Second Written Submission, para. 146.

72. As previously noted by the United States, China’s industrial policy of “two resources, two markets” is a shorthand reference for the strategy of leveraging China’s reserves in rare earths and other raw materials to obtain advantages for China’s manufacturers of downstream products. With respect to raw materials, such as rare earths, tungsten and molybdenum, this can be realized through, *inter alia*, using export restraints to create two markets (one domestic and one international) for the supply and demand of the raw materials, resulting in benefits to the development and exports for China’s industries involved in processing and higher value-added manufacturing related to these raw materials.⁹⁰

73. In China’s response to the first set of Panel questions, China asserted that the United States was incorrect in its description of “two resources, two markets.” According to China, “two resources, two markets calls for a mutually beneficial and complementary outcome in globalization, creating a diversified multi-supplier system for resources.”⁹¹ China’s response to question 111 demonstrates the accuracy of the U.S. description of what “two resources, two markets” means in terms of China’s industrial policy principles.

74. In its answer to question 111, China outlines the legal regime of “processing trade” whereby China imports raw material concentrates, further processes the concentrates, and then exports the products without subjecting such exports (which include intermediate products) to the export quota on rare earths, tungsten or molybdenum. This is a typical example of the “two resources, two markets” industrial policy – for the domestic market, China’s processing trade encourages the import of raw materials and the export of value-added products; for the international market, China’s export restrictions discourage the export of raw materials and the import of value-added products. Thus, processing trade and export restrictions are part and parcel of the same industrial policies that encourage Chinese companies to import or retain raw materials and to produce and to export higher value-added products.

75. China’s export restrictions (and processing trade) on rare earths, tungsten and molybdenum are a perfect tool to achieve the goals of the “two resources, two markets” regime. As the United States has noted consistently throughout this dispute, this regime, and the export restrictions that it uses, have nothing to do with conservation and everything to do with industrial policy.

Questions 112 and 115

⁹⁰ U.S. Comments on China’s Answers to the Panel’s Written Questions Subsequent to First Substantive Meeting of the Panel, para. 65.

⁹¹ China’s Answers to the Panel’s Written Questions Subsequent to the First Substantive Meeting with the Parties, para. 125.

112. To China: According to Exhibit CHN 138 on “Tungsten Data (1999-2012)”, China’s extraction quotas increased between 2003 and 2012. A similar situation is observed with respect to the actual level of extraction of tungsten concentrate, as well as with respect to domestic consumption, i.e. levels rose between 2003 and 2012. Could China please comment on these figures?

115. To China: The figures in Exhibit CHN 139 on “Molybdenum Data (1999-2012)” show that the actual levels of extraction and domestic consumption of molybdenum concentrate have increased during the period 1999-2012. Could China please comment on these figures?

76. The tungsten export, extraction and consumption data provided by China in Exhibit CHN-223 (which updates data provided in Exhibit CHN-138) confirm that, since the introduction of the export quota and extraction target in 2002, the following have occurred:

- (1) The export quota volume has fallen;
- (2) Actual exports have stagnated;
- (3) The extraction target has more than doubled;
- (4) Actual extraction, which consistently exceeds the target, has nearly doubled; and
- (5) Domestic consumption has also more than doubled.

77. Likewise, the molybdenum export, extraction and consumption data provided by China in Exhibit CHN-224 (which updates Exhibit CHN-139) show a similar pattern since the 2010 initiation of production targets on molybdenum:

- (1) The export quota volume has fallen;
- (2) Actual exports have fallen;
- (3) The production target has risen;
- (4) Actual production, which consistently exceeds the target, has risen; and
- (5) Domestic consumption has also grown.

78. These data unequivocally show that China’s export quotas have had no impact whatsoever on the pace of extraction of tungsten and molybdenum and, therefore, do not “relate to” conservation. Moreover, these data also show that the export quotas are not “made effective in conjunction with domestic production or consumption restrictions” on these products as required under Article XX(g) of the GATT 1994 because China does not have actual restrictions on domestic production or consumption. Lastly, the vastly different access to tungsten and

molybdenum resources afforded to Chinese consumers as compared to foreign consumers clearly indicates a lack of even-handedness in the application of China’s measures under Article XX(g) and would also constitute arbitrary and unjustifiable discrimination under the *chapeau* of Article XX.

117. To China: Could China please comment on paragraph 98 of the Comments of the United States of March 25, 2013 on China’s “Answers to the Panel’s Written Questions Subsequent to the First Substantive Meeting of the Panel with the Parties”?

79. In commenting on China’s answer to question 117, the United States refers to paragraphs 36-42 of the U.S. answers to questions from the Panel to the parties in connection with the second Panel meeting.

Questions 118 and 119

118. To China: Could China please comment on paragraph 166 of the European Union’s second written submission?

119. To China: Could China please comment on paragraphs 120 and 121 of Japan’s second written submission?

80. Question 118 is based on Exhibit JE-114 – the *Rare Earth Industry Adjustment and Improvement Special Fund* (“the Fund”). According to China, the purpose of the Fund is to “stimulate compliance with [China’s] environmental regulations [applicable to rare earths].”⁹² China’s assertion conveniently ignores the fact that the Fund is also geared towards further stimulating China’s downstream rare earth industry.

81. In particular, one of the four stated purposes of the Fund is to support the development and industrialization of downstream rare earth products, such as rare earth magnets and rare earth catalysts.⁹³ Support under this program can be as high as 50 percent of the research and development expenses associated with bringing to market a new rare earth containing product.⁹⁴ Clearly, such support encourages the production of downstream rare earth containing products and, consequently, increases domestic demand and consumption of rare earths. Thus, it is wholly inconsistent with China’s assertion that it has a “comprehensive conservation regime” for rare earths.

⁹² China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 223.

⁹³ Exhibit JE-114, Art. 5(4).

⁹⁴ *Id.*, Art. 9.

82. Similarly, in China’s response to question 119, China argues that a number of additional documents that – on their face – show China’s policy of encouraging the increased production of downstream products instead involve a different policy. According to China, these documents show that China is attempting to divert rare earths from one sector to another:

[w]hile the application of rare earths in new materials industries, represented by permanent magnets, polishing powders, catalysts, hydrogen storage materials and fluorescent materials, are identified as a priority, this was at the expense of the traditional rare earth consuming downstream industries (glass and ceramic, agriculture textile, petrochemical, metallurgical machinery) which consumed considerably less rare earths.⁹⁵

83. China’s argument fails for a number of reasons. First, China is continuing to stimulate “traditional” rare earth consuming industries. This is shown by the Fund, which provides money to an illustrative list of rare earth applications, including traditional rare earth consuming industries like ceramics.⁹⁶ In addition, the Eggert report clearly shows continuing growth in “traditional” rare earth consuming industries such as glass and ceramics and metallurgy, which has nearly tripled in its use of rare earths since 2001.⁹⁷ This is not surprising as China has provided no documentation that shows that it is attempting to limit downstream consumption of rare earths in traditional rare earth consuming industries. Nor, more generally, has China provided any basis for believing that China has adopted such a policy.

84. Lastly, China asks the Panel to ignore statements by Zhang Zhong, the president of the Inner Mongolia Baotou Steel Rare-Earth (Group) Hi-Tech Co., the largest Chinese producer of rare earths, who noted that local governments encourage rare earth producers to expand production beyond the central government’s production targets.⁹⁸ According to China, the Panel should ignore comments “from a company that was engaged in a conflict of interest with the local government.”⁹⁹

85. China does not elaborate on how the company at issue was “engaged in a conflict of interest with the local government.” In any event, while the source of any statement introduced

⁹⁵ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 234 (emphasis added).

⁹⁶ Exhibit JE-114, Art. 5(4).

⁹⁷ Eggert Report, p. 14 (Table 4.6) (Exhibit JE-129).

⁹⁸ WantChinaTimes.com, Central and local authorities clash over Baotou’s rare earth (February 25, 2013) (Exhibit JE-113); China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 238.

⁹⁹ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 238.

in a proceeding is one factor that may be considered an objective assessment of the matter, China has presented no basis for asking the Panel to ignore this or any other evidence submitted by the complainants in this proceeding. And, in considering the source of the statement, the United States would note that this company has been described by China in this dispute as one that is "Subject to the Control of the Central Government."¹⁰⁰ This circumstance does not support China's contention that statements by Zhang Zhong should be given less evidentiary weight than other evidence on the record in this dispute.

120. To all 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?

86. The United States addressed the points raised in China's response to this question in the U.S. response to questions 97 and 98.

Questions 123 and 124

123. To all 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

¹⁰⁰ China's Opening Statement at the First Meeting of the Panel, Annex.

paragraph 123 of European Union’s second written submission and paragraph 11 of Japan’s opening oral statement at the second Panel meeting?

124. To China: Could China comment on the alternative means of preventing smuggling suggested by the European Union in paragraph 123 of its second written submission and by Japan in paragraph 99 of its second written submission?

87. As the United States explained in its Second Written Submission, China has failed to show that its export duties on rare earths, tungsten and molybdenum fall within the range of policies designed to protect life or health, or make any contribution (much less a material one) to such an objective.¹⁰¹ As such, they are not “necessary” within the meaning of Article XX(b). The United States and the other co-complainants in turn identified a number of alternatives that might serve China’s asserted health or environmental goals without presenting the same issues of WTO consistency.

88. In its response, China rejects the identified alternatives because it claims it already has them in place. To the extent that China maintains such alternatives, that demonstrates that they are available to China.¹⁰²

89. China claims that the identified alternatives should not be considered in light of the Appellate Body’s finding in *Brazil – Retreaded Tyres* that “[s]ubstituting one element of this comprehensive policy for another would weaken the policy by reducing the synergies between its components, as well as its total effect.”¹⁰³ China’s argument, however, is premised on the existence of a comprehensive policy, and synergies between the components of that policy. However, as the United States has noted previously, China has not demonstrated either a comprehensive policy or synergies between its export duties and the other elements it identifies as part of a supposed comprehensive environmental policy.¹⁰⁴ In particular, China has never explained why it needs to impose supposed environmental costs only on foreign consumers. Not only has China failed to explain how its export duties contribute to the ends of this policy, but it has also failed to address the potential that those duties have to undermine this policy (in particular, by stimulating domestic consumption).¹⁰⁵

¹⁰¹ U.S. Second Written Submission, paras. 45-65.

¹⁰² *China – Raw Materials (Panel)*, paras. 7.568, 7.584-7.590.

¹⁰³ China’s Answers to the Panel’s Written Questions after the Second Substantive Meeting of the Panel with the Parties, para. 245 (citing *Brazil – Retreaded Tyres (AB)*).

¹⁰⁴ U.S. Second Written Submission, paras. 47-53, 55, 66-71.

¹⁰⁵ *China – Raw Materials (Panel)*, para. 7.586.

90. China merely reiterates in its response that export duties ensure that prices reflect environmental costs. But as China has conceded earlier, export duties only increase costs for foreign consumers.¹⁰⁶ China has not explained how such duties add anything to its asserted comprehensive environmental policy other than an element of discrimination. This is not sufficient to establish an Article XX(b) defense.

91. Regarding Article XX(g) and in its response to question 124, China argues that the existence of alternatives is irrelevant in the Article XX(g) analysis.¹⁰⁷ This is incorrect. Examples by the complainants about what China could have done in lieu of export quotas illustrate how these particular 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.

92. China further asserts that it needs an export quota in addition to export licensing to police against smuggling. China’s makes the odd argument that export quotas prevent sales of illegally (*i.e.*, above-target) produced rare earths in the domestic market.¹⁰⁸ Clearly, there are more direct and less attenuated mechanisms to address illegal sales in the Chinese market. Such measures would also not be so broad as to capture legally produced rare earths, as is the case with the export quotas.¹⁰⁹

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?

93. In its response to question 127, China asserts that it does not desire to control the location of rare earth consumption (as such location is irrelevant from the perspective of conservation),

¹⁰⁶ China’s Answers to Panel’s Written Questions Subsequent to the First Substantive Meeting of the Panel with the Parties, paras. 206-207.

¹⁰⁷ China’s Answers to Panel’s Written Questions Subsequent to the First Substantive Meeting of the Panel with the Parties, para. 251.

¹⁰⁸ China’s Answers to Panel’s Written Questions Subsequent to the First Substantive Meeting of the Panel with the Parties, para. 255.

¹⁰⁹ *U.S. – Shrimp (AB)*, para. 141 (examining whether a measure is overbroad in determining if it relates to conservation).

but rather to control the pace of extraction.¹¹⁰ While China has attempted to distinguish the export quotas on rare earths, tungsten and molybdenum from those at issue in *China – Raw Materials*, it has failed to address one of the key observations by the *China – Raw Materials* panel – *i.e.*, that export quotas simply do not speak to the pace of extraction.¹¹¹

94. Simply put, China has given no reason for this Panel to question the findings by the panel in *China – Raw Materials*, particularly as they relate to the inability of an export quota to speak to the pace of extraction of exhaustible natural resources. Given that China has clarified that pace of extraction is the relevant conservation objective at issue here, there is no reason for this Panel to reach a different result from the one reached in *China – Raw Materials*.

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”?¹¹² 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?

95. The United States has addressed the points raised by China in its answer to question 129 in paragraphs 68-71 of the U.S. Answers to Questions from the Panel to the Parties in Connection with the Second Substantive Meeting of the Panel.

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)?

96. The United States has addressed the points raised by China in its answer to question 130 in paragraphs 72-74 of the U.S. Answers to Questions from the Panel to the Parties in Connection with the Second Substantive Meeting of the Panel.

132. To the parties: Paragraph 13 of China’s second written submission provides that “[i]t is hardly surprising that the rare earth export quotas cover the rare earth products that are traded within China and outside China, *i.e.* rare earth oxides,

¹¹⁰ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 277.

¹¹¹ *China – Raw Materials (Panel)*, para. 7.428.

¹¹² U.S. Second Written Submission, para. 149; *see also* Japan’s Second Written Submission, paras. 55-57.

metals, salts and alloys. These are the products that relate to the conservation of these exhaustible natural resources”. Could China please specify which forms of tungsten and molybdenum products it also considers “relate to the conservation of these exhaustible natural resources”? Why does China consider that these particular forms but not others “relate to” conservation?

97. The United States addressed China’s answers in its response to question 100(f).

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?

98. China’s response simply reconfirms that China imposes a prior export experience or performance requirement on rare earths and molybdenum.¹¹³ In other words, notwithstanding the commitments in Paragraph 5.1 of China’s Accession Protocol and Paragraphs 83 and 84 of the Working Party Report, an exporter does not have the right to trade in rare earths and molybdenum unless it satisfies that prior export requirement. While China asserts in its response that any level of prior export performance is sufficient, China admits that some level is nonetheless required. In addition, the quota allocation depends upon the amount exported in the past.¹¹⁴ China’s response simply further confirms that China imposes a prior export performance requirement with respect to rare earths and molybdenum, in breach of its commitments in Paragraph 5.1 and Paragraphs 83 and 84.

141. To China: The Panel would appreciate clarification from China on the product scope of China’s export quotas, production quotas, extraction quotas and resource taxes.

a) In paragraph 37 of its second written submission, China indicates that “the Directive Production Plan controls the production by rare earth smelting and separating enterprises of rare earth oxides and salts.” (footnote omitted) Annex 1 of China’s second written submission provides that “smelting and separating companies in China can produce rare earth salts, rare earth oxides and rare earth metals”. Could China explain why rare earth metals are excluded from its production quotas? How does China control production of rare earth metal in order to avoid illegal production? For example, how does China determine whether metals manufactured with oxides are produced legally? Why is there a need for an export quota

¹¹³ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 283 (“These measures specify that, as a criterion for obtaining a share of the 2012 export quota, candidate exporters must show *export performance* from 2008 to 2010.”).

¹¹⁴ See Exhibits JE-61, JE-63.

on rare earth metals if there is no need to control production of rare earth metals?

- b) In response to the Panel's question at the second meeting, China argues that it does not need a production quota on rare earth metals because the production quotas on oxides suffices given that rare earth metals are produced from rare earth oxides. Mutatis mutandis, could China please explain why it needs to control production of rare earth oxides and salts, if it controls production of rare earth concentrates?
- c) China in its first written submission refers to its resource taxes on rare earth, tungsten, molybdenum products (paras. 27, 28 329, 371 and footnotes 492 and 547 of China's first written submission). Are any of the rare earth, tungsten and molybdenum products listed in Annex 1 of Announcement No.98 [2011] of the Ministry of Commerce and the General Administration of Customs on the Catalogue of Goods Subject to the Export Licensing Administration in 2012 (Exhibits JE-48, CHN-8) directly subject to China's resource taxes? Please list all rare earth, tungsten and molybdenum products with their corresponding Chinese Commodity Codes that are subject to China's resource taxes or any other taxes.
- d) Could China please explain why there is no extraction quota for molybdenum, similar to those for tungsten and rare earths?
- e) Are crude ores of rare earths, tungsten and molybdenum covered by Annex 1 of Announcement No.98 [2011]?
- f) Could China please indicate the relevant Customs Codes for the tungsten products listed in Annex 2 of Exhibit CHN-99, similar to those for molybdenum?
- g) In Exhibit CHN-137 (updated by Exhibit CHN-191), China refers to "smelted and separated products" for
 - (i) "production plan of smelted and separated products",
 - (ii) "actual level of production of smelted and separated products" and
 - (iii) "actual level of export of smelted and separated products".

Please clarify what products (i.e. salts, oxides or metals?) are covered by the term "smelted and separated products" for (i) (ii) (iii).

- h) In paragraph 186 of its first written submission, China submits that:

“The 2012 total production quota for smelted and separated rare earth products was set at 90,400 REO tons. Of this total production volume, the Ministries decided to allocate 24,000 REO tons for exports, by means of export quota. Hence, 66,400 REO tons of the 2012 production of smelted and separated rare earth products would be available for domestic consumption in 2012”. (footnotes omitted)

Can China confirm that in order to calculate the amount available for domestic consumption of smelted and separated rare earth products, it deducts from the production quotas on rare earth oxides and salts, the export quotas on rare earth ores, concentrates, oxides, salts, metals and alloys? How does China calculate the amount available for domestic consumption of rare earth metals if there is no production quota on rare earth metals?

- i) In light of Exhibits JE-3, JE-48, JE -45, CHN-8, could China please explain why products, such as NdFeB magnet film, other NeFeB alloys and other ferroalloy (Chinese HS No. 7202.9911, 7202.9919, 7202.9999), other tungstates, ferro-tungsten, ferro-silico-tungsten (Chinese HS No. 2841.8090, 7202.8010, 7202.8020) are subject to export duties but not export quotas?

99. In China’s response to question 141, China clarifies that the production targets on rare earths do not apply to rare earth metals and alloys, notwithstanding the fact that the export quotas apply to rare earth metals and alloys.¹¹⁵ This is the second clarification in China’s answers to the second set of Panel questions relating to a set of products that is covered by the export quotas, but not covered by any domestic restrictions – *i.e.*, stockpiles¹¹⁶ and now rare earth metals and alloys. The fact that these two sets of products are subject to export quotas that are not applied in conjunction with any purported domestic restrictions further shows that the export quotas on rare earths are not even-handed and do not fulfill the requirements of the *chapeau* to Article XX.

100. For example, rare earth metals and alloys that are made from stockpiled or imported rare earth oxides are not subject to any domestic production restrictions, including at previous stages of production. Accordingly, Chinese consumers have unlimited access to such products. In contrast, foreign consumers’ demand for such products is subject to the export quotas on rare earths. This result lacks even-handedness and is blatantly discriminatory.

¹¹⁵ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, paras. 293-296.

¹¹⁶ *Id.*, para. 289

101. According to China, a domestic production target on rare earth metals and alloys is unnecessary because China controls the extraction of rare earth ores as well as the production of rare earth oxides and salts, which are the inputs into the production of rare earth metals and alloys.¹¹⁷ Perhaps in anticipation of the need to address the question of why China needs export quotas on rare earth metals and alloys, China further clarifies that the export quotas on rare earths are not about enforcement of China’s domestic extraction targets, but rather are about allocation.¹¹⁸

102. While China’s assertion helps clarify its core argument in this dispute (and the core disagreement between China and the complainants) – *i.e.*, that allocation of resources is not conservation of resources – it must be noted that China’s clarification runs directly contrary to China’s previous arguments that the export quotas on rare earths help to enforce the (alleged) domestic production restrictions. Compare China’s current response to its response in its First Written Submission:

	First Written Submission	China’s Answers to the Panel’s Second Set of Written Questions
Justification of the export quotas on rare earths	As established below, the 2012 export quotas, working together with the many restrictions on the domestic production and consumption on rare earths: constitute an integral part of the set of enforcement tools China has adopted in order to ensure compliance with China’s production restrictions. ¹¹⁹	China recalls that the export quota fulfills a different role than the production quota. While the production quota constitutes an additional volume control to secure compliance with the extraction quota, China relies on the export quota to manage the total supply [<i>i.e.</i> , to allocate] of the entire volume of rare earths that can be produced on the basis of the extraction quota. ¹²⁰

¹¹⁷ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 294.

¹¹⁸ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 298.

¹¹⁹ China First Written Submission, para. 132.

¹²⁰ China’s Answers to the Panel’s Written Questions After the Second Substantive Meeting of the Panel with the Parties, para. 298.

Questions 143 and 144

143. To China: According to China’s first written submission (paragraphs 136, 137, referring to Exhibit CHN-38: Public Notice of the Application Standards and Application Procedures for the 2012 Rare Earths Export Quotas), it appears that the export quota system requires, as application criteria, that candidate exporters source rare earth materials and products from qualified enterprises and provide documentation to prove the legal source. (emphasis added) Could China please indicate whether exporters are required to provide documentation as to the legal sourcing of their rare earths, tungsten, and/or molybdenum when passing through customs? Could China also comment on the extract below of paragraph 11 of Japan’s opening oral statement at the second substantive meeting of the Panel with parties?

“In other words, while the official recipient of an export quota may certify that rare earths to be exported are lawfully acquired, another entity entirely may conduct the actual exportation if the quota rights have been sold or transferred.”

144. To China: 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.

103. The United States makes two observations related to China’s responses to questions 143 and 144. First, China completely fails to address the question of documentation on export sales for tungsten and molybdenum, notwithstanding the Panel’s request to do so. As has been the case throughout this dispute, China fails to offer much in the way of a defense for its export quota regime on tungsten and molybdenum or its export duties on rare earths, tungsten and molybdenum. Indeed, China has failed to provide responses relating to tungsten and molybdenum even when prodded to do so by the Panel.

104. Second, China’s argument ignores the evidence set forth in Exhibits JE-170 and JE-171 showing that China allows the re-sale of export quota rights for rare earths, which has driven up the price of rare earths by 400,000 to 500,000 yuan per ton and contributed to the lack of quota fill.¹²¹ According to these reports from Chinese sources, the ability to re-sell quota rights is an “open secret” in the rare earths industry.¹²² The reports provided by complainants at Exhibits JE-170 and JE-171 discuss how the Chinese government does not attempt to police the vibrant and distortive market for rare earths export quota rights.¹²³

¹²¹ Exhibit JE-171.

¹²² *Id.*

¹²³ *Id.*

105. The large and growing market for rare earth export quota rights is relevant in this dispute because it shows how the export quotas do not serve an enforcement function vis-à-vis the domestic production targets (although China’s response to question 141 shows that it has abandoned that argument at this late stage in the dispute). Even assuming that the numerical limits on exports were theoretically relevant to enforcement of domestic targets, which they are not, the fact that export quota rights can be sold from a company that produced in a manner consistent with the domestic production targets to a company that produced above-target negates any contribution by the quotas to the enforcement of the targets. This is why, *inter alia*, the export quotas do not relate to conservation under Article XX(g) of the GATT 1994.

146. To China: In Exhibit JE-164, the complainants argue that an under-filled export quota affects prices and consumption in the foreign markets. Could China comment?

106. In China’s response to question 146, China submits a report by Professor de Melo that attempts to rebut Professor Grossman’s argument as to how an under-filled export quota affects prices and consumption in a foreign market.¹²⁴ As shown by the response of Professor Grossman (Exhibit JE-197), Professor de Melo failed to address properly a number of arguments set forth by Professor Grossman.

107. In particular, Professor de Melo argues that the export duties on rare earths alone cannot account for the under-fulfillment of the quota. Professor Grossman does not disagree, but rather notes that the export duty is a contributing factor.¹²⁵ This is supported by other data put on the record by the complainants, which show that the high prices for some rare earths reduced foreign demand.¹²⁶ Such high prices are driven by, in part, the export duties (some of which are as high as 25 percent *ad valorem*) and other factors related to the export quotas (such as the cost of purchasing a re-sold export quota license).¹²⁷

108. Professor de Melo also incorrectly understands Professor Grossman to argue that an under-filled export quota can have an impact on foreign consumers only in one particular type of imperfect competition – *i.e.*, a duopoly. What Professor Grossman actually stated is that an under-filled export quota can impact the market not just in a duopoly, but also in an oligopoly, which is characteristic of the rare earths market given the limited number of companies that are

¹²⁴ Exhibit CHN-206.

¹²⁵ Exhibit JE-197.

¹²⁶ Exhibit JE-109 (noting that high prices contributed to the lack of quota fill).

¹²⁷ See U.S. Response to Question 144.

allowed to export rare earths and the limited number of companies that produce certain rare earth products, such as those derived from heavy rare earths.

147. To China: In Exhibit JE-166, the complainants criticize the statistical methodology in Cheng Jiazuo’s “The Status of Development of the Rare Earth Industry” (Exhibit CHN-154-B). Could China comment?

109. In its Second Written Submission, China presented a statistical analysis by Cheng Jiazuo in order to support its assertion that the dramatic 2012 price gaps between foreign and domestic rare earth prices were not caused by the export quotas.¹²⁸ In response, Professor Watson, an expert in statistics and econometrics, noted that Cheng Jiazuo’s analysis is characterized by foundational and rudimentary methodological flaws and, consequently, should be rejected by the Panel.¹²⁹

110. Given the opportunity to defend its expert report, China has declined, notwithstanding the fact that China put such data on the record for consideration by the Panel in this dispute. Simply put, China’s expert report is indefensible. (In this connection, throughout this dispute the United States likewise has noted major deficiencies in the other reports submitted by China.)

¹²⁸ China Second Written Submission, para. 151, fn. 284.

¹²⁹ Exhibit JE-166.