

BRIEFING

The WTO rules against China on measures limiting export of rare earths

Author: Roberto BENDINI

Abstract

On 26 March 2014, the World Trade Organisation (WTO) circulated a report on the dispute about China's rules on the exports of rare earths. The dispute had been initiated by complaints from the EU and Japan, with another 16 countries participating as third parties in the proceedings. In the report, a WTO dispute settlement panel concluded that Beijing had breached international trade rules by applying restrictions on its exports of various forms of rare earths, tungsten and molybdenum. Rare earths are a set of strategic minerals necessary to produce modern smartphones, cameras and hybrid cars.

The WTO ruling is not definitive, and China has 60 days to appeal. It is, however, unlikely that the organisation's Appellate Body will reverse the decision taken by the dispute settlement panel. If Beijing does not comply, this may pave the way to imposing retaliatory measures against products exported by China.

This paper is an initiative of the Policy Department, DG EXPO

AUTHOR:

Roberto BENDINI
Directorate-General for External Policies of the Union
Policy Department
WIB 06 M 55
rue Wiertz 60
B-1047 Brussels

Editorial Assistant: Jakub PRZETACZNIK

CONTACT:

Feedback of all kinds is welcome. Please write to:

roberto.bendini@europarl.europa.eu.

To obtain paper copies, please send a request by e-mail to:

poldep-expo@europarl.europa.eu.

PUBLICATION:

English-language manuscript completed on 31 March 2014.

© European Union, 2014

Printed in Belgium

This paper is available on the intranet site of the Directorate-General for External Policies, in the [Regions and countries](#) or [Policy Areas](#) section.

DISCLAIMER:

Any opinions expressed in this document are the sole responsibility of the author and do not necessarily represent the official position of the European Parliament.

Reproduction and translation, except for commercial purposes, are authorised, provided the source is acknowledged and provided the publisher is given prior notice and supplied with a copy of the publication.

Table of contents

1	Beijing judged in breach by the WTO	4
2	China's rare earths	4
3	The case	6
4	The WTO ruling	7
5	Reactions	8

1 Beijing judged in breach by the WTO

On 26 March 2014, the World Trade Organisation (WTO) circulated a report on the dispute about China’s rules on the exports of rare earths. The dispute had been initiated by complaints from the EU and Japan, with another 16 countries participating as third parties in the proceedings. In the report, a WTO dispute settlement panel concluded that Beijing had breached international trade rules by applying restrictions on its exports of various forms of rare earths, tungsten and molybdenum. Rare earths are a set of strategic minerals necessary to produce modern smartphones, cameras and hybrid cars.

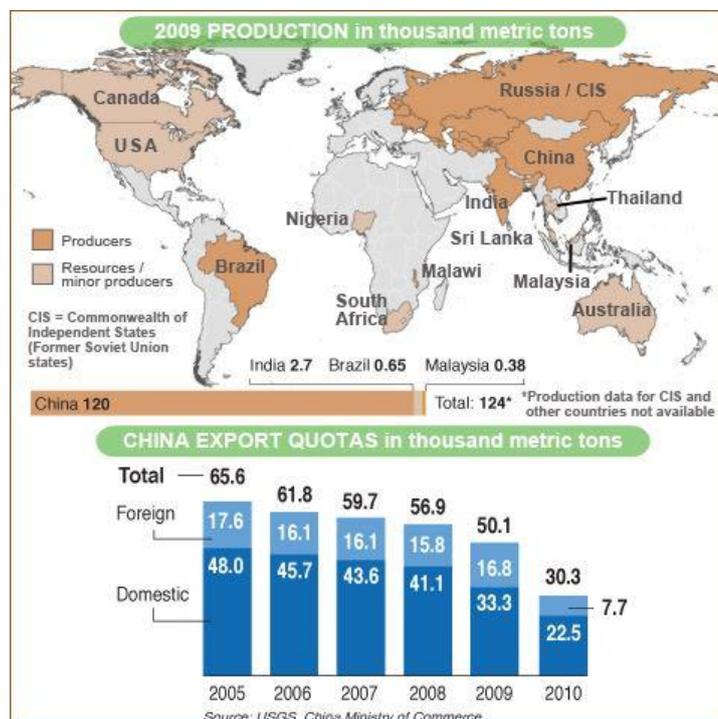
The WTO ruling is not definitive, and China has 60 days to appeal. It is, however, unlikely that the organisation’s Appellate Body will reverse the decision taken by the dispute settlement panel. If Beijing does not comply, this may pave the way to imposing retaliatory measures against products exported by China.

2 China’s rare earths

China accounts for more than 90% of the world’s rare earth production annually.

China is the world's biggest producer of rare earths, producing more than 90 % of the world’s rare earths each year (see picture below). Over the past decade, the demand for rare earths has increased three-fold, reaching nearly 125 000 tonnes a year. According to some estimates, the figure could exceed 200 000 tons in 2014¹.

Figure 1:
Production of rare earths



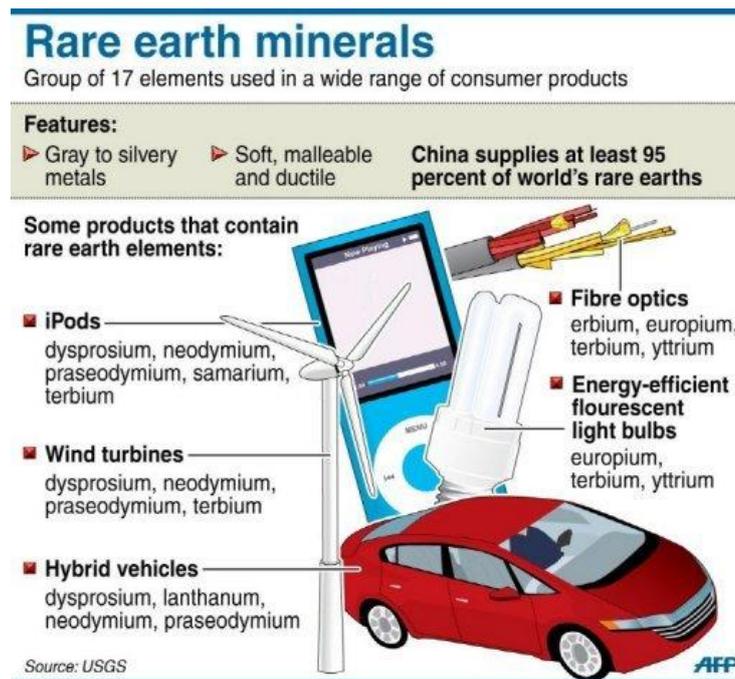
Rare earths are used widely in high-tech and clean energy products because they have special properties of magnetism, luminescence, and strength.

¹ The BBC, [WTO: China rare earth caps 'break rules'](#) (26 March 2014)

Those properties also make rare earths valuable in weapon systems.

The 15 lanthanide elements – lanthanum, cerium, praseodymium, neodymium, promethium, samarium, europium, gadolinium, terbium, dysprosium, holmium, erbium, thulium, ytterbium, and lutetium (atomic numbers 57–71) – were originally known as rare earths because they occurred in oxide mixtures. More recently, some researchers have included two other elements – scandium and yttrium – in their definition of rare earths². There are currently no known alternatives to rare earths in the production of a growing number of high tech goods.

Figure 2:
Characteristics and uses
of rare earths



Mining and processing these elements generates toxic waste and severely impacts the environment. In the past years, many countries with rare earth resources have imposed restrictions on mining them, leading China to become the foremost supplier. Beijing has also begun to impose its own set of limits on the sector, citing similar concerns.

In 2010 China introduced an extensive set of protectionist measures to reduce the exports of rare earths produced domestically.

In 2010, China severely restricted exports of rare earths on the grounds that limits would help clean up its domestic industry and improve their otherwise disastrous environmental profile. Beijing imposed three distinct types of restrictions on the exports of rare earths, tungsten, and molybdenum:

- duties (taxes) on the export of various forms of those materials,
- an export quota on the amount of those materials that could be exported in a given period,
- limits on which enterprises were permitted to export the materials.

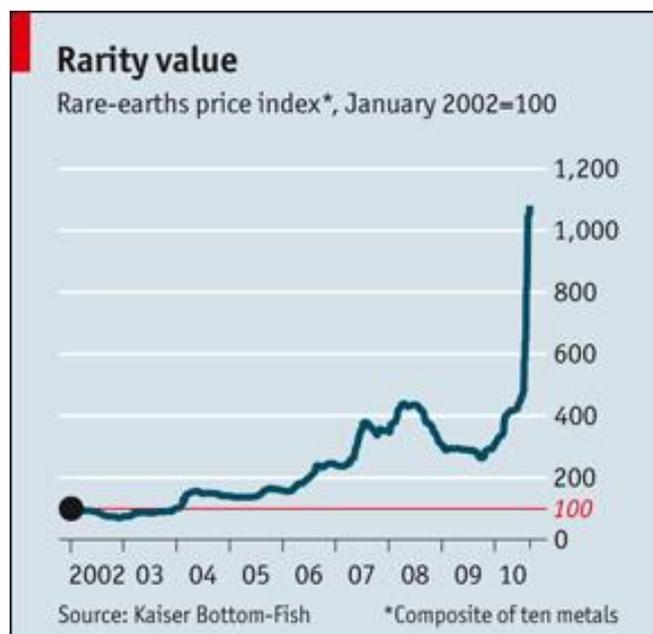
Abroad, some critics argued that the Chinese decision was only partly inspired by environmental concerns, and that Beijing's underlying motivation

² United States Geological Service, [China's Rare-Earth Industry](#) (2011)

was a desire to provide domestic industry with an unfair advantage.

As a result of the Chinese measures, the price of rare earths soared – increasing more than ten times in five years – and serious doubts were raised about the future availability of rare earths. Industrial countries (such as EU states, Japan and the United States) faced shrinking supplies and higher prices, which meant that their companies lost market positions to the Chinese competitors.

Figure 3:
Evolution of rare earth prices, 2002-2010



Source: *the Economist*

3 The case

The EU, US and Japan complained about the Chinese measures to the World Trade Organisation (WTO). Several other countries requested third-party status in the proceedings.

On 13 March 2012, the European Union initiated a case before the WTO by requesting consultations on China's measure related to various forms of rare earths, tungsten and molybdenum. The request covered a number of Chinese measures – both published and unpublished – that, when applied separately or collectively, the EU believed constituted export restrictions. The measures included export duties, export quotas, minimum export price requirements and export licensing requirements, as well as various requirements and procedures applied in connection with the quantitative restrictions³.

The EU alleged that the Chinese measures were in breach with Articles VII, VIII, X and XI of the General Agreement on Tariffs and Trade (the 1994 GATT) and that they were inconsistent with China's obligations under Part I of the country's accession protocol to the WTO (2001)⁴. The EU allegations were similar to those made by the US and Japan in two distinct but related requests for consultations.

On 27 June 2012, the European Union requested the establishment of a

³ WTO, China — [Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum](#) (WT/DS/432)

⁴ See reference at [GATT 1994](#), China's [Protocol of Accession](#) to the WTO (2001)

dispute settlement panel. This was established on 24 September 2012.

During the panel proceedings, China argued that the restrictions challenged by the EU related to the conservation of its limited natural resources, and were necessary to reduce pollution caused by mining. The complainants disagreed, arguing that the restrictions were designed to provide Chinese industries with protected, preferential access to materials.

On 26 March 2014, the panel report was circulated among the parties.

4 The WTO ruling

The WTO dispute settlement panel rejected nearly all China's arguments, concluding that Beijing's measures were intended to provide Chinese domestic industry with an unfair advantage.

The WTO panel essentially upheld the EU's and other complainants' allegations and dismissed most of China's arguments. According to the panel, 'the overall effect of the foreign and domestic restrictions is to encourage domestic extraction and secure preferential use of those materials by Chinese manufacturers'.

More specifically, the panel reached the following conclusions:

- **Export duties**

The panel found China's imposition of the export duties in question to be inconsistent with the country's WTO obligations. In its accession protocol, China agreed to remove all export duties, except for those on a number of products listed in Annex 6 to China's protocol. The panel found that none of the products at issue were listed in Annex 6, and that China was therefore not entitled to impose export duties on them.

China acknowledged that the duties had been imposed on products not included in Annex 6, but tried to justify the duties on the basis of the 'General Exceptions' provision in Article XX of the GATT. This article describes 'General Exceptions' allowing WTO members to derogate from the general rule if the measures are necessary to 'protect human, animal or plant life or health'.

The panel dismissed the Chinese argument, writing 'these exceptions are not available to justify breaches of China's obligation to eliminate export duties contained in China's Accession Protocol and that, in any event, China's export duties were not necessary for the protection of human, animal or plant life or health'⁵.

- **Export Quotas**

China argued that export quotas were justified by Article XX(g) of the GATT, since they relate to the conservation of a limited (exhaustible) natural resource. The panel did not agree and found that China's export quotas were designed to achieve Beijing's industrial policy goals rather than to conserve resources.

- **Trading Rights**

China's restrictions on the right of businesses to export rare earths and molybdenum were also found in breach of WTO rules, because China

⁵ Ibid footnote 3

had failed to demonstrate that its restrictions were necessary to conserve limited natural resources.

5 Reactions

In a response to the WTO ruling, China's trade ministry expressed disappointment and reiterated Beijing's position: 'these regulatory measures are perfectly consistent with the objective of sustainable development promoted by the WTO.' He also noted that 'the Chinese government has been reinforcing and improving its comprehensive regulation on high-polluting, high-energy-consuming and resource-consuming products in recent years'.

Both the EU and the US welcomed the WTO decision.

EU Trade Commissioner Karel De Gucht declared that 'today's ruling by the WTO on rare earth shows that no one country can hoard its raw materials from the global market place at the expense of its other WTO partners'⁶.

A statement by US Trade Representative Michael Froman adopted the same position : 'China's decision to promote its own industry and discriminate against U.S. companies has caused U.S. manufacturers to pay as much as three times more than what their Chinese competitors pay for the exact same rare earths.'

While China will almost certainly appeal the decision, the Appellate Body is not likely to reverse the panel's decision.

It is almost certain that China will appeal the WTO ruling. Although the organisation's Appellate Body has the power to reverse previous panel decisions, the ruling on rare earths appears to be well justified and based on a solid set of precedents. If the panel's decision is upheld on appeal, China would either have to comply 'within a reasonable period of time' agreed among the parties or face retaliatory measures; these would be applied on Chinese goods with an equivalent value. An unjustified refusal to comply with the WTO decision may resuscitate latent trade disputes between the People's Republic and the EU (and US). The year 2013 had involved a number of prickly issues, including the EU's imposition of duties on Chinese solar panels and China's retaliatory antidumping measures on EU wines⁷ While it seemed, at the beginning of 2014, that these belonged to the past, the WTO's ruling may stir up their memory, as well as create fresh grievances.

⁶ Reuters, Update 3-[China loses trade dispute over rare earth exports](#) (26 March 2014)

⁷ The EU and China found an agreement on solar panels imported from the PRC by negotiating a minimum import price (undertaking), while China recently terminated without the imposition of measures its AD investigation on European wines.