

PRESENTATION

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Working Group 2.2: “TOOLS—How to address the issue of measures restricting exports of raw materials?”

In his opening remarks at this conference, David O'Sullivan, Director General, DG Trade, stated somewhat plaintively that the EU stood “virtually alone” in its concern regarding the deleterious effects of the increasing use of restrictive measure on the export of raw materials (defined in the wider sense of not only primary resources such as metals and commodities but also secondary products such as wood, hides, chemicals, ceramics or agricultural goods). His candid confession mirrored my own reaction when I was asked to make a presentation on potential trade tools for a strategy regarding the export of raw materials. Though I follow international trade policy quite closely, I—and I think this is true of most U.S. trade analysts—was only dimly aware of the scope and magnitude of the emerging problems. And that indeed constitutes the starting point for this presentation: having checked with U.S. public officials and representatives from the private sector, I think it is clear that these issues have yet to attain a high priority in the United States (though this may change soon). But as Mr. O'Sullivan also stated: the EU

has its work cut out for it in building a coalition to combat the distortive impacts of raw material export restrictions.

The balance of my presentation will consist of the following sections: (1) an explanation of why the most important strategy must be to convince exporting nations (particularly developing countries) that the unintended, negative consequences from the imposition of export restriction will often outweigh short-term gains; (2) why some suggested trade tools by developed countries, in turn, will result of negative, unintended consequences; and (3) a review of less disruptive trade tools that could be utilized.

An Economic Critique of Trade Restrictions on Raw Materials.

Because I believe that many suggested trade tools will be ineffective or ultimately damage the multilateral trading system, my first point is that the EU and its allies in combating raw material exports should concentrate their resources and strategy on analyzing and explaining the frequent negative consequences for the exporting nation of introducing export restrictions—and the failure often of such restrictions to achieve intended goals.

Admittedly, the effects of raw material export restrictions are complex and to some degree fact (and nation) dependent. But recent economic research has demonstrated that for some of the important goals—to nurture infant industry, to control inflation, to underpin social policy and income distribution, and to buttress government revenue—export restrictions are less than reliable and must overcome important pitfalls. For instance, without flexible financial markets, efficient and non-corrupt tax systems,

and carefully crafted social reforms, developing nations will find it difficult to direct the income from export taxes into socially coherent programs. Further, regarding the infant industry motive, there is the danger (a circumstance often encountered) that the subsidies will result in the maintenance of inefficient companies whose owners are better at rent-seeking from government bureaucrats than constructing an efficient manufacturing process. Finally, given the highly unstable nature of commodity prices and the potential inefficiencies of customs administration, the use of export taxes as a major source of public revenue is risky as a long-term policy.

The Limitations of the WTO Dispute Settlement System as a Tool for Combating Export Restrictions

There have been suggestions from various quarters that the main line of defense against increased use of raw materials export restrictions should be the WTO dispute settlement system through alleged violation of existing rules. For the most part, I would argue that this will be an unproductive—even dangerous—route to take.

First, it should be acknowledged that the entire GATT/WTO system as presently constituted is ill-equipped to deal with export restrictions. The system is based upon a benign mercantilist political economy (exports are good; imports are bad) that concentrates on import restrictions and by and large does not contemplate that the member states would enact restrictions on exports.

Thus, export taxes are not prohibited per se by the WTO, though such taxes must be non-discriminatory and transparent under Articles I and X of the GATT. In addition,

Article XI prohibits import or export restrictions “other than duties, taxes, or other charges;” but Article XI.2 also provides a number of exemptions from that prohibition such as temporary restrictions to prevent or relieve critical shortages. Finally, very few WTO member states have bound export tax commitments. In 2004, about one-third of all WTO members imposed export restrictions on some products.

Among the specific suggestions that have been advanced regarding use of the DSU to combat raw material export restrictions—particular the use of VAT rebates as instruments of industrial policy—is to attack these policies as subsidies in violation of the WTO Agreement on Subsidies and Countervailing Measures (the “SCM Agreement”). Specifically, a number of countries use differentiated VAT rebate rates to promote downstream industries, including aluminum foil by China, processed foods by Argentina and textiles by India. For instance, the PRC, which has traditionally provided a 15 percent rebate on the export of primary aluminum products, recently phased out the rebate for primary aluminum products and even instituted a 15 percent tax on such products. Meanwhile, it continues to maintain a 13 percent rebate on manufactured aluminum foil and other aluminum products, thus inducing Chinese manufacturers to shift to the production of these more advanced products.

While these policies should be countered through negotiations, I would argue (without getting into the dense WTO legalese) that there are two major problems with attacking through the Dispute Settlement System. First, given that one-third of WTO members impose some form of export restrictions (and most of these are developing countries), a wholesale attack through means of alleged violations of existing rules

would deepen the already wide divide between the North and the South in the WTO.

Further, while such a defense is still over the horizon, claims by developing countries that the export restrictions have an environmental purpose will further complicate and muddle this trade policy area.

Second, as noted above the GATT/WTO rules system does not really adequately cover—and the rules did not foresee—conflicts relating to restrictions on exports. Thus, attempts to expand or twist the definitions of subsidies are based upon weak or dubious interpretations of the SCM agreement. There is already division and conflict on these issues within the WTO. In 2006, the WTO Secretariat, in the Trade Policy Review for China, directly criticized China's use of export tax rebates as an industrial policy tool, arguing that this was an implicit subsidy.

On the other hand, a WTO dispute settlement panel (*U.S.—Measures Treating Export Restraints as Subsidies* (DSU194)) stated explicitly that export restraints could not be challenged as subsidies. Advocates of the legality of the “implicit subsidy” theory, however, point to another case (*U.S.—Countervailing Duties Investigation on Dynamic Random Access Memory Semiconductors from Korea*(DSU296)), where the WTO Appellate Body held that the Korean government acted in complicity with private banks to subsidize Hynix Semiconductor Inc through signals that the banks in effect would be carrying out government policy with subsidized loans. The present author would hold that applying the rationale in the Hynix case to the VAT manipulation is a stretch—but the bottom line is that the legal precedent is murky at best; and thus in attacking export restrictions the DSU should not form the first line of attack. There is also the practical

question of timing—the legal route would take years to resolve in individual cases, given the possibility of appeal and the ability of the losing party to tweak the export restriction slightly to achieve the same result.

More Viable Trade Tools and other Strategies

As noted above, the argument advanced here is that there should be a concerted effort first to educate developing countries to the counterproductive consequences of export restrictions and to the fact that such policies often backfire and do not advance either the economic or social goals for which they are intended.

Beyond this effort, there are alternative trade policy tools that would be less politically disruptive to the multilateral trading system.

1. **Bilateral and Regional Agreements:** Both the EU and the United States have negotiated and will continue to negotiate bilateral and regional trade agreements to complement their efforts in the WTO. Both should continue their current policies of introducing prohibitions against exports restrictions into these agreements. Though this route is less efficient than multilateral negotiations, over time it will produce significant changes that can later feed back into WTO negotiations.
2. **Future WTO Negotiations:** Though the EU has attempted to introduce export restrictions into the Doha Round NAMA negotiations, it did not find great support from other member states. And given the precarious state of Doha negotiations

and the dim prospects for success, it would be futile to attempt at this late date to re-visit the issue. In addition, undoubtedly some developing nations would argue that export restrictions were not part of either the original Doha mandate or subsequent additions to that mandate. The bottom line is that the most fruitful strategy for the foreseeable future in the WTO is to begin to build a coalition to change future rules in the next round.

3. OECD: As another longer range measure, the EU should lead an effort (the US and Japan would certainly be supportive) to commission the OECD to take up the issues related to export restrictions and over the next few years bring out credible studies demonstrating with considerable depth the negative consequences of export restrictions both on the international trading system and on nations undertaking such policies.
4. GSP: I would endorse the first three future policy options. It has also been suggested that the US, EU and other developed countries demand that export restrictions be abolished as a condition of continued GSP support. I would oppose this strong-arm tactic: as a general rule, I think that using GSP to blackmail developing countries into adopting policies beyond those they are willing to negotiate either multilaterally or bilaterally violates the spirit of reciprocity-based WTO rules and negotiations.

In conclusion, I think that over time the damaging consequences of export restrictions can be contained—but without distorting existing WTO rules or bullying developing countries.

Sources:

1. William Deese and John Reeder, "Export Taxes on Agricultural Products: Recent History and Economic Modeling of Soybean Exports Taxes on Argentina," *Journal of International Commerce & Economics*, Vol. 1, August 2008, 185-213.
2. Roberta Piermartini, "The Role of Export Taxes in the Field of Primary Commodities," World Trade Organization, Geneva, Switzerland, September 2004.
3. Julio Nogues, "The Domestic Impact of Export Restrictions: The Case of Argentina," IPC Position Paper, International Food and Agricultural Trade Policy Council, Washington, D.C., July 2008.
4. *Inside US Trade* (various issues).