

# **The challenge of raw materials**

## **Speech by Peter Mandelson at the Trade and Raw Materials Conference**

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I'd like to say how I see the question of raw materials fitting into the wider political and economic approach that this Commission has taken to globalisation and the European economy. And – partly because I have just come back from high level contacts with China and India – I'd like to offer some thoughts about what we are up against politically outside of the EU when we make the case for open and transparent trade in commodities.

When I set out the EU's Global Europe strategy back in 2006 I based it on a simple argument about globalisation and the structure of the modern European economy. Europe is a supply chain economy. The materials that power our manufacturing industries are sourced from every part of the world. Between 70-80% of our primary resources are imported. In 2007 about 70% of all imports to the EU were not finished consumer products but intermediate goods headed for the transformation industries here. The fundamental reason why Europe's foreign economic policy has to be based on openness is because we depend on it. We don't produce goods here from scratch and just sell them across borders: we produce across borders. In a very real sense, Europe needs to import in order to export.

To a greater or lesser degree this reality applies to every economy on earth. Industrial self-sufficiency is simply not possible for a modern economy – the costs in inefficiency would be crippling. That's an important fact to bear in mind when we consider the changes that the emerging economies are already imposing on the basic global economic order.

This is especially true of the booming growth of China and India. This change is resource-intensive, and it is on an enormous scale. It is why the next phase of globalisation will be defined by pressure for access to basic resources. We are in a race and I believe one of the biggest challenges we face at the global level is managing that race to mutual benefit. It will be, I believe, one of the two or three defining issues of our strategic long term economic relationship with China, for example. The case against resource nationalism is a strong one, and I want to remake it today. I also want to set out the long term strategy behind Global Europe's commitment to open global trade in raw materials.

### **The raw material problem**

Most people are aware that over the last two years global commodity prices have risen sharply. What is less well known is that these rising prices have been tracked by a proliferation of export restrictions for commodities. We now count at least 450 export restrictions on raw materials across the global economy, and I am absolutely certain that this is an underestimate. We find restrictions on the export of metals, wood, leather, ceramics, chemicals, textiles and energy, everything from high volume products to highly specialised rare materials.

Russia, for example, now imposes an export duty of 50% on scrap aluminium that has all but wiped out trade in this metal. Argentina's export taxes on raw hides and skins are now as high as 40%. India taxes iron ore exports at 50 rupees a ton, which is one of the main reasons why its biggest customer, China, is now looking to secure supply in Gabon at source. China itself recently imposed an export tax of 120% on yellow phosphorous and increased export duties on coke to 40%.

Our competitive advantage is already acutely sensitive to the supply and the costs of these inputs. On average, raw material costs make up around a sixth of the costs of manufactured goods in the EU. In industries like plastics, chemicals and paper the costs of raw materials can be easily as much as a third or more. The imposition of an export tax can price a European company out of the market overnight.

The costs to EU companies that rely on these raw materials *and compete with producers in these countries* is obvious. If it costs more just to *export*, say, phosphorus, from China than it costs a Chinese company to buy it domestically *and transform it*, then European industry can't compete – in Europe, in China, or anywhere else in the global market. The export duty acts like an indirect subsidy.

Unfortunately, sixty years of global liberalisation in trade in goods has made little impact on this kind of practice. The WTO states that still use them have effectively kept the issue off the table in the Doha negotiations.

### **Can we afford a world of resource nationalism?**

Why are these things out there? Governments impose export restrictions for a range of reasons. They can be an attempt to shield domestic consumers from high international commodity prices and price inflation. Or to capture raw materials for their own producers. They also allow governments to turn high commodity prices into a windfall tax on their own exporters – assuming that the export duties do not suppress exports altogether.

Argentina's export taxes on wheat in the spring were intended to hold down the cost of wheat in Argentina by pumping up local supply to keep local prices down. Russia's export taxes on wood are intended to hand the same kind of captive supply to the Russian timber processing industry. China's duties on coke exports are a prop for its steel industry.

These sound like significant political and economic strategies, so it is important to understand why their costs can outweigh their benefits. Export restrictions run one huge long term risk in a global economy: they switch off the international price signals that encourage companies to be more productive and more competitive. A subsidy at the top of the supply chain in the form of artificially cheap raw materials will transmit that inefficiency and poor productivity down the line to downstream producers as well. This prompts a slide in production and diverts resources away from other potentially more competitive industries. Any initial benefits are often cancelled out by the loss in foreign market share and foreign currency income.

Often the public policy problems cited as the justification for export restrictions - like the strengthening of infant industry, or ensuring a stream of government revenue from commodity exports, or even restricting trade in environmentally sensitive goods like timber – can be better addressed through more focussed measures. In economic terms an export restriction is a policy sledgehammer rather than a scalpel.

But there is another set of problems. In a globalised economy export restrictions can also pose a systemic risk. When they drive up world prices and cut off supplies of raw materials, beggar-thy-neighbour export restrictions invite a cycle of retaliation that is as economically counterproductive as it is politically hard to resist. Because the pressure on global resources is only going to grow, policymakers cannot afford to ignore the knock-on effects of closing down or politicizing markets for supply.

### **The EU's raw materials strategy**

So, the goal of the EU's trade policy is, and will remain, an open global market completely free of all distortions on trade in energy and raw materials. The question is: how do we get there? What is certain is that there are no short-term or quick-fix solutions. There is no global

framework for managing export restrictions and no real global appetite to create one. For that reason, since we refocused on the raw materials question in Global Europe, we have been working at a number of different levels.

The first is by writing commitments on free trade in raw materials into all our bilateral trade agreements, where they are clear and enforceable. We have done this in the latest agreements we have concluded with Mexico and Chile. We have in the last few months discussed such provisions in our FTA negotiations with Korea. I will be making the same case to the Indians and to our other negotiating partners over the next few months.

The second is by using WTO accession negotiations to secure the same commitments to bind or prohibit export duties and to begin to build some global jurisprudence on these commitments in the WTO. The Russian plan to increase export duties on ferrous and non-ferrous scrap goes against the commitments it made to the EU in its WTO accession negotiations in 2004, and is the subject of current discussions between us.

China also must expect to be held to the commitments it made on export restrictions in its own WTO accession agreements. I have raised this issue repeatedly in Beijing – most recently just last week. You will have read reports about a possible US WTO case against Chinese restrictions on raw material exports. I certainly cannot rule out that the EU would use the WTO in the same way to enforce Chinese commitments. Countries that use export duties to subsidise domestic industries and subsequently dump products on European markets must also expect to attract the scrutiny of our trade defence system.

Finally, we will continue to build support for the elimination of export restrictions and an open market in raw materials as a basic principle of a global economy that is defined above all by interdependence. We will continue to raise awareness of the problem in the G8, the OECD and in strengthened strategic dialogues on export restrictions with the US and Japan. In our investment dialogues we will continue to push for more open and more transparent conditions for EU investors in the raw materials sector. I will raise the question of raw materials in every meeting I have with every trade minister from every country that restricts European imports.

I believe that the question of trade in raw materials will become one of the defining issues of our trade and economic dialogue with China, and I have placed it on the agenda of the High Level Trade Mechanism and of other dialogues. While we can and should reinforce commitments through arbitration where necessary, this is not a policy that can be conducted solely in a WTO courtroom. At the end of the day raw materials is an area where China and the EU will need to work together constructively and for the long term.

Globalisation forces us to see the big picture on raw materials. Transparent, open markets for commodities are the only way to manage the intense pressure that global economic growth is already exerting on supply. Resource nationalism not only makes this system more politically unstable, it *makes it less resource-efficient* – which is exactly what we do not need in the face of rising demand. We have spent six decades creating an open trading order by pushing down import duties for goods – only to have export restrictions putting those gains into reverse.

Europe's strategy on trade in raw materials doesn't include quick fixes, because there aren't any. But we have identified the leverage we do have and we are using it. It will require coherence and consistency from Europe. Establishing rules, enforcing and reinforcing them through our strategic relationships will require the efforts of industry and Member States alongside the Commission. Events like today have pushed the issue onto the agenda and we will keep it there.