

Trade Judges See Flaw in China Policies Preliminary WTO Report Finds No Case for Some of Beijing's Export Restrictions

By JOHN W. MILLER and JAMES T. AREDDY

BRUSSELS—The World Trade Organization on Friday will issue a preliminary report concluding that China has no legal right to impose export restrictions on nine raw materials, say trade diplomats and lawyers familiar with the case.

The quotas, license requirements and other measures on industrial ingredients such as zinc and coke, many vital for making steel, have been a key irritant in China's simmering trade tensions with trading partners.



A worker stirs rare-earth cauldrons in Inner Mongolia. A WTO report could pave the way for a U.S. challenge of China's rare-earth export quotas.

"This [case] is a punch against China's trade policy," says Simon Evenett, an economist at the University of St. Gallen in Switzerland. "It means you can't use protectionism as a policy tool on natural resources."

The raw-materials case, which follows a complaint filed in 2009 by Mexico, the U.S. and the European Union, doesn't concern China's politically sensitive export restrictions on 17 minerals known as rare earths, some of which are essential to the production of smart phones and other high-tech appliances. But a victory is likely to pave the way for the U.S. to file a separate WTO complaint on the rare-earths policy, trade analysts said.

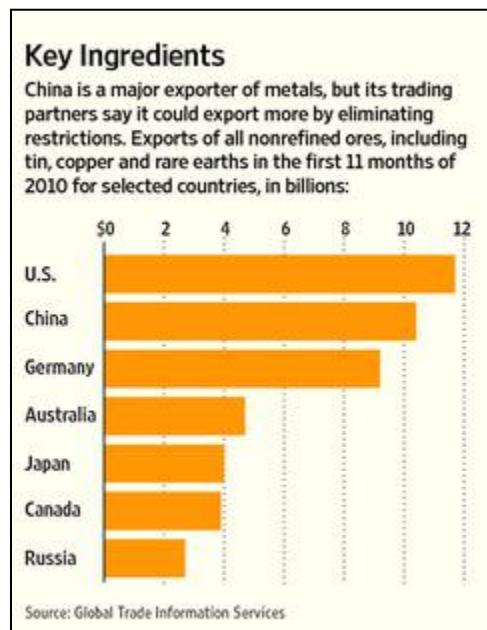
That is because at the core of the raw-materials case is whether the WTO agrees with China that the export restrictions are necessary to protect the environment, an argument China has used to justify limits on exports, including of rare-earth ores.

On Friday, the WTO is due to mail an interim report to the parties involved in the case. It won't be made public. But trade diplomats and lawyers working on the case at the WTO say its judges have concluded that China clearly lacks the legal backing for the restrictions.

The final report will be published in April. China can then appeal. If it loses it will have to remove the export controls or face retaliatory sanctions.

China's resource-management policy is a major point of contention in global trade. It is the world's top producer of cadmium, gold, indium, iron ore, lime, lead, manganese, mercury, molybdenum, phosphate, salt, tin, tungsten, vanadium and zinc. And it has taken steps to limit exports in a number of materials, often in a bid to attract more manufacturing to China. For example, as a sign of how much zinc is being retained inside the country, the amount of the metal registered as inventory on the Shanghai Metals Market has increased to more than 320,000 metric tons, from less than 80,000 two years ago, according to MetalPrices.com.

China exports almost no zinc, despite being the world's No. 1 producer. The effect has been to drive up prices and, in some cases, dry up supply abroad. "China has become the big purchaser on the scene, changing price models of the industry," says Daniel Hamilton of Johns Hopkins University.



China abandoned most export restrictions—mainly quotas, tariffs and license requirements—when it joined the WTO in 2001, but reinstated some of them late in the decade, amid a global commodities crunch and the financial crisis. In defense of its actions, the government cited "the protection of the environment and nonrenewable resources," said Tu Xinquan, deputy dean at the China Institute for WTO Studies at Beijing's University of International Business and Economics.

WTO rules permit export controls for environmental reasons, as long as "such measures are made effective in conjunction with restrictions on domestic production or consumption." Chinese officials have cited polluting mining as one reason for its stricter rare-earth controls.

The U.S. and other complainants in the raw-materials case alleged that quotas and other measures were a protectionist move that illegally keeps prices high and discriminates against other nations. Buyers of raw materials were also upset. Because of China, "they have no influence on 75% of their input cost," says Christian Obst, a Munich-based analyst at UniCredit Bank, who covers steelmakers such as ThyssenKrupp AG. China's main goal, he adds, "is self-sufficiency."

WTO representatives confirmed that the interim report was being sent out but declined to comment on its contents. The Ministry of Commerce in Beijing didn't respond to written questions. Chinese officials in Brussels didn't return calls seeking comment. The U.S. Trade Representative's office and the EU declined to comment.

If Beijing loses, "it will probably comply; China doesn't want to be perceived as a rogue," says Mr. Hamilton.

On Wednesday, China said rare-earth export quotas would stay but that it would "cooperate" more with trading partners. The State Council, China's cabinet, said the rare-earths industry will be streamlined over a five-year period. "The industry will maintain rational production and inventory control, make better use of domestic and overseas markets and resources, and have active international cooperation for a healthy and sustainable development," said Premier Wen Jiabao, according to the state-run Xinhua news agency.

Few analysts see signs that Beijing intends to slash domestic rare-earth output but China has signaled plans to stockpile rare earths. They point out that the government has reminded industries that mineral supplies will remain ample for any operations they locate in China.

Until rare earths became a hot global topic in 2010, Chinese policy makers said the quotas were meant to support prices. "Some countries bought a large amount of rare-earth metals from China at low prices in a period of time when management over rare earth in China was the most chaotic, and even now they still have a considerable stockpile," Mr. Wen said in October.

For now, however, the restrictions appear to have remained in place. For the first half of 2011, China has licensed only 32 companies to export rare earths, compared with 47 in 2006. It also cut the quota to 14,508 metric tons for the first half of 2011, down 35% from the period in 2010.