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COMMISSION OF THE EUROPEAN COMMUNITIES

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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE
EUROPEAN PARLIAMENT**
**TACKLING THE CHALLENGES IN COMMODITY MARKETS AND ON RAW
MATERIALS**

1. INTRODUCTION

Commodity markets have displayed increased volatility and unprecedented movements of prices in recent years. Prices in all major commodity markets, including energy, metals and minerals, agriculture and food, increased sharply in 2007 to reach a peak in 2008, declined strongly from the second half 2008 onwards and seem to have been on an increasing trend again since the summer of 2009. To varying degrees, these price swings have also been reflected in consumer prices, at times leading to social unrest and deprivation.

At the heart of current developments lies a series of changes in global supply and demand patterns as well as short term shocks in key commodity and raw material markets. The years 2002 to 2008 were marked by a major surge in demand for raw materials, driven by strong global economic growth, particularly in emerging countries such as China. This increase in demand will be reinforced by the further rapid industrialisation and urbanisation in countries such as China, India and Brazil. China is already the largest consumer of metals in the world – its share of copper consumption, for example, has risen from 12% to about 40% over the last 10 years¹. Price movement has been exacerbated by various structural problems in the supply and distribution chains of different commodities.

In addition, markets are experiencing the growing impact of finance, with a significant increase in financial investment flows into commodity derivative markets in recent years. Between 2003 and 2008, for example, institutional investors increased their investments in commodities markets from \$15 billion in 2003 to between \$250 and \$300 billion in 2008. While the financial crisis interrupted the upward trend, financial positions approached or even exceeded their 2008 peaks on many markets in 2010 and investment by index traders in particular has increased strongly.

These developments have led to increased calls for policy responses to mitigate the negative effects of such movements on both producers and consumers, especially the most vulnerable ones, generating attention at the highest political level, including the latest G20 summits. While the debate on the relative importance of the multiple factors influencing commodities prices is still open, it is clear that price movements across different commodity markets have become more closely related, and that commodities markets have become more closely linked to financial markets². This makes the analysis more complex.

The European Commission drew attention to the strategic importance of defining appropriate policies for raw materials by launching the raw materials initiative in 2008³. It also began an in-depth reflection on developments on commodities market in general and on food prices and

¹ World Metals Statistics Bureau – 2009 Yearbook

² CFTC "Staff report on commodity swap dealers and index traders with Commission recommendations", Washington, 2008. American Economic Review, 99; 2008 Commission Communication COM(2008) 821 final "Food prices in Europe" and its accompanying staff working document SEC(2008)2971 "Task force on the role of speculation in agricultural commodities price movements - Is there a speculative bubble in commodity markets?"

³ COM(699)2008 "The raw materials initiative - meeting our critical needs for growth and jobs in Europe"

food security in particular⁴. In response to the financial crisis, it has also launched a range of measures to improve the regulation, integrity and transparency of financial markets.

This Communication presents an overview of what has been achieved in each of these areas and of the steps which are planned to take the work forward. It will feed into the work of the G20 which agreed at the Pittsburgh summit "to improve the regulation, functioning, and transparency of financial and commodity markets to address excessive commodity price volatility."⁵ This commitment was reinforced in November 2010 by the G20 summit in Seoul which pledged to address food market volatility and excessive fossil fuel price volatility.⁶

2. DEVELOPMENTS ON GLOBAL COMMODITIES MARKETS

Fundamentals, including unexpected changes in global economic conditions linked to the strong demand growth of emerging market economies have played a key role in driving developments on commodity markets⁷. Other factors that have also played a role are supply shortfalls and monetary policy, and in recent years, various ad hoc policy interventions. Export restrictions, border measures, and shifts in storage policies had an impact on food prices in the run up of the 2008 food price crisis. Increased use of agricultural land for the production of renewable energy has strengthened the link between developments in agricultural and energy prices. Price dislocations have also been exacerbated by various structural problems in the supply and distribution chains of different commodities⁸.

Each commodity market functions differently depending on the nature of the commodity, the needs of traders and historical developments. There is no single model for the organisation of commodity markets and hence of how prices evolve. Some commodity trading exhibits a high degree of standardisation, while on other markets the way in which trades are done may change according to the particular needs of individual market participants. Derivative markets⁹ based on commodities have existed for a long time and play a role in the hedging of exposures of both producers and users of various commodities. Just as the underlying commodities can be traded in different ways, derivatives can be traded on a bilateral basis, generally called over the counter or OTC, or using organised exchanges. The following sections examine specific developments on the markets for energy and agricultural commodities and the increasing financialisation of commodities markets.

2.1. Developments on the physical markets

2.1.1. Energy (oil, electricity gas)

Oil and petroleum markets are integrated, liquid and global, and are widely considered to be driven by economic fundamentals, geopolitical considerations, the role of the Organization of the Petroleum Exporting Countries (OPEC), and by non-physical trades. There have been significant developments in terms of financial and derivative investment instruments and trading technologies. The G20 at the Seoul summit has highlighted the importance of well-

⁴ COM(2009) 591 "A Better Functioning Food Supply Chain in Europe", COM(2009) 591

⁵ See <http://www.pittsburghsummit.gov/mediacenter/129639.htm>

⁶ See http://www.g20.org/Documents2010/11/seoulsummit_declaration.pdf

⁷ See for example, IOSCO, Task Force on Commodity Futures, Report to the G20. November 2010

⁸ COM(2009) 591 "A Better Functioning Food Supply Chain in Europe",

⁹ A derivative can be defined as a financial asset, generally a contract between two or more parties, that derives its value from other assets, securities or even indices.

functioning and transparent energy markets for economic growth. It has been working on physical market transparency, fossil fuel price volatility, and the phasing out of inefficient fossil fuel subsidies

The gas market, which is increasingly influenced by the development of non-conventional sources, has traditionally been based on long-term over-the-counter (OTC) contracts. As a result of the proliferation of Liquefied Natural Gas (LNG), gas is also increasingly traded on a global and liquid market which is being commoditized. Electricity is the least global energy market as its transport over long distances is restricted for physical reasons of non-storability and energy loss. The geographic scope of the market is therefore smaller than for other energy commodities.

EU electricity (and gas) markets are increasingly integrated as a result of the internal market. They have seen the development of energy exchanges or other organised markets and broker facilitated OTC markets which can be used both for physical delivery and hedging. It remains the case that market prices are highly sensitive to the availability of actual and expected generation as electricity cannot be stored on an industrial scale.

2.1.2. Agriculture and food security

Most agricultural commodities, in particular crops, are subject to strong seasonal production patterns, and their supply cannot always adjust rapidly to changes in demand. This means that agricultural markets are characterised by a certain degree of variability.

However, both the level and the volatility of prices of agricultural commodities have recently increased to levels beyond what has been considered normal. This is the case both on the EU and international markets, and on spot and futures markets. Within the EU, successive reforms of the Common Agricultural Policy (CAP) have significantly reduced support prices and related measures. As a result, commodity producers and traders are more exposed to market price developments, and thus are more prone to use futures markets to hedge risks. Trade in options and in over-the counter derivatives is also growing. These factors explain to some extent the increased activity on European-based exchanges and raise two issues in particular: food security and the need for increased transparency on agricultural markets.

Food security has been identified as one of the main drivers for future reform in the CAP¹⁰. A strong agricultural sector is vital for the highly competitive food industry to remain an important part of the EU economy and trade and a major contributor to international markets. This is why, in the context of the Doha Development Round the EU has agreed to steep reductions in the ceiling on EU trade-distorting support, and reductions of EU border protection, with a minimum average cut to EU tariffs of 54% and full elimination of EU export subsidies by 2013, conditional to reaching an overall and balanced agreement.

Excessive volatility of food prices also has serious effects on food security for food importing developing countries. During food price spikes – such as in 2007-08 - many of the poor in developing countries reduced their food intake¹¹. The 2010 food price increases may lead to another increase in malnutrition in the world. Paradoxically, many of the malnourished live in rural areas where agriculture is the mainstay of the economy. While in theory, higher global prices could stimulate agricultural production, price transmission mechanisms are often

¹⁰ The CAP towards 2020, COM(2010) 672 final,

¹¹ FAO, WFP, The State of Food Insecurity in the World, October 2010.

imperfect. In many developing countries' commodity markets are often disconnected from world markets, or, at best, world price signals are transmitted to domestic markets with considerable lags.

Several analyses by FAO, OECD, Commission and others have focused on the combination of supply and demand developments, exacerbated by short-term economic and policy factors (among which are restrictions on exports) that explain part of the observed extreme price volatility, including factors specific to financial markets that may have amplified price changes.

Despite remaining uncertainties, based on the outlook for agricultural commodities established by several organisations, including the latest DG AGRI medium term projections, three conclusions are clear for agricultural commodities:

- (1) Agricultural commodity prices are expected to stay higher than their historical averages, seemingly reversing their long-term downward trend, at least for the foreseeable future.
- (2) Price volatility is also expected to remain high, although uncertainties with respect to its causes and duration persist.
- (3) The level of input prices used in agriculture is also likely to remain higher than its historical trends.

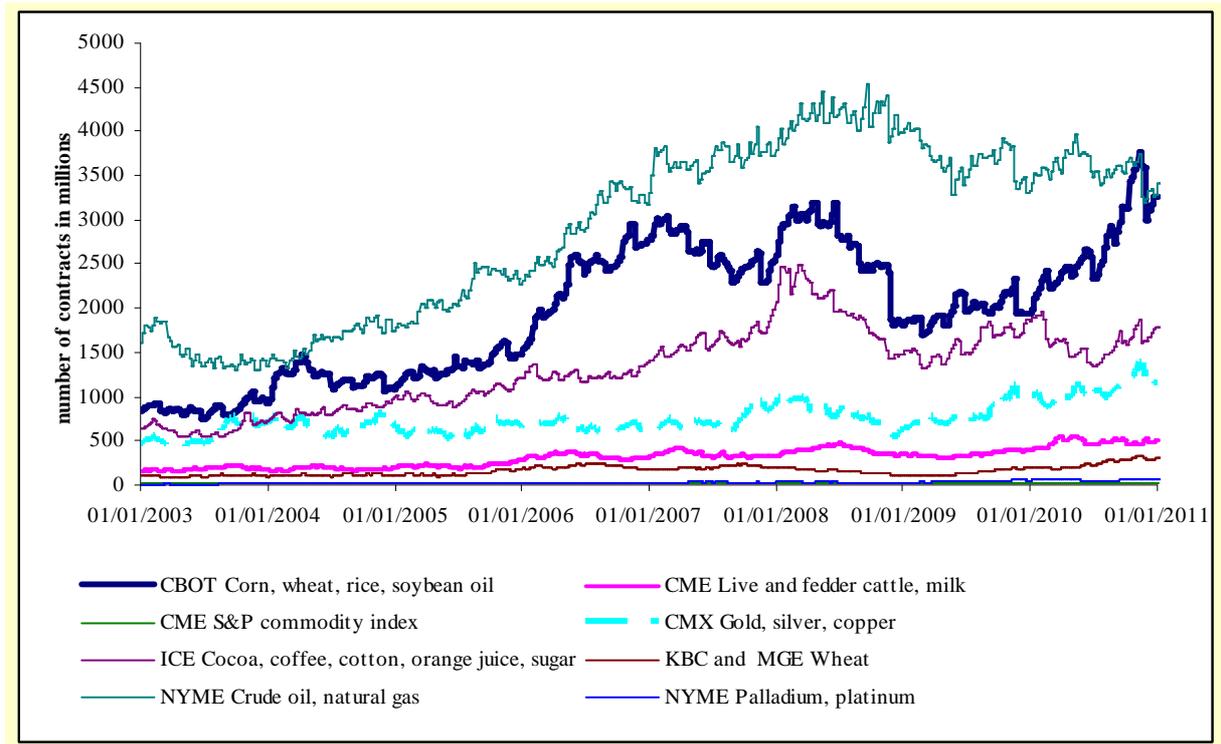
The combination of the above factors implies that higher prices for agricultural commodities will not necessarily result in higher income for farmers, especially if their margins are squeezed by increased costs. In addition, potential problems for net food importing countries and more generally for the most vulnerable consumers are evident, stemming from price impacts on food inflation. While a certain degree of variability is an intrinsic part of agricultural markets, excessive volatility does not benefit producers neither users.

2.2. The financialisation of commodities markets

Financial investment flows into commodity derivative markets have grown significantly in recent years (see graph 1). Commodity derivatives allow producers and users to hedge the risks associated with physical production and price uncertainty. But they are also increasingly seen purely as financial assets.

Commodity and financial markets are increasingly intertwined, sharing a growing number of participants in search of risk management and investment opportunities. The liquidity, efficiency and accessibility of spot markets is strengthened by well-functioning derivative markets, and vice versa. Adequate and reliable information on market fundamentals such as volumes of production and consumption, network and pipeline capacity etc, as well as the amount of trading that takes place in the commodity is necessary for transparent and orderly price formation both on the spot and derivative markets. Derivative markets are not only used by commercial companies for risk management purposes. In addition prices of commodity futures (i.e. derivatives listed on organised trading venues) often serve as benchmarks for example influencing retail energy and food prices for EU consumers.

Graph 1: Transactions on commodity derivative markets (Total open interest of futures and options)



Source: U.S. Commodity Futures Trading Commission. (via Reuters Ecowin)

The prices of commodity derivatives and underlying physical commodities are interlinked, but it is not simple to identify which way causation flows in the interaction between financial and physical markets. Commodity derivatives markets therefore cannot be regarded in isolation from commodity markets or *vice versa*. At this stage, there is little evidence that the price formation process on commodity markets has changed in recent years with the growing importance of derivatives markets. Empirical studies do not find any systematic evidence of a correlation between the substantial increase in index fund positions and commodity futures prices. Similarly, while there is a strong correlation between positions on derivative markets and spot prices, there is no conclusive evidence on the causality between speculation in derivatives markets and excessive volatility and prices increases in the underlying physical markets.

Significant further work is necessary to understand fully these developments, but three issues can already be identified. First, with a widening of the investor base, be it temporary or lasting, the transparency and easily accessible information on the physical markets becomes more important to allow new investors to make informed decisions and thus contribute to the price finding process. Secondly, the recent price volatility has shown that for physical market actors the possibilities to hedge their price risks must be maintained. Thirdly, the high volatility shows that a close monitoring of market developments is necessary.

3. EU POLICY RESPONSE TO DEVELOPMENTS ON COMMODITIES MARKETS

At EU level, there has been an initiative to increase oversight, integrity and transparency of trading in energy markets¹². It has taken a number of initiatives to improve the functioning of the food chain and transparency on agricultural commodities markets. As part of the ongoing reforms of the regulatory framework for financial markets, it has also identified measures to increase the integrity and transparency of commodity derivatives markets.

3.1. Physical markets

3.1.1. Energy (oil, electricity gas)

The Commission has also shown its readiness to act to ensure the orderly functioning of energy markets in its proposal to establish clear rules prohibiting market abuse on wholesale electricity and gas markets backed up by an EU wide market monitoring framework and new enforcement powers for energy regulators. This approach will help to ensure that the benefits of the internal market are realised for Europe's businesses and citizens, and provides a good model for how to address the challenges resulting from the financialisation of commodity markets. The proposed Regulation on Energy market Integrity and Transparency¹³, reflects the readiness of the Commission to proactively address the challenges of integrated markets combined with the increased importance of financial markets. It will provide European and national authorities with the tools to identify instances of market abuse in electricity and gas commodity derivative markets and in the underlying markets:

- The European Agency for the Cooperation of Energy Regulators (ACER) Market will be responsible for monitoring to uncover possible cases of abuse.
- Traders will be prohibited from using inside information to benefit from their transactions or manipulate the market by artificially causing prices to be higher than would be justified by the availability, production cost or capacity to store or transport energy.
- Cooperation will be enhanced between physical (ACER) and financial (ESMA) market regulators.
- The Commission is committed to ensuring that transparency requirements for fundamental data in gas and electricity markets are effective and meet market needs.

3.1.2. Agriculture and food security

The food price spikes have highlighted the underinvestment in agriculture in many developing countries in recent decades¹⁴. EU development policy has recognised the need to reverse this trend. The Commission has adopted a policy framework on food security¹⁵, indicating that the EU and Member States should contribute to improved food market functioning at global,

¹² The market in allowances within the carbon Emissions Trading System for the EU is not dealt with in this section as the allowances are not commodities in the generally understood sense.

¹³ Proposal for a Regulation of the European Parliament and of the Council on energy market integrity and transparency COM(2010) 726

¹⁴ Fewer than ten African States meet the Maputo target set in 2003 of ten percent of public investment to agriculture.

¹⁵ COM(2010)127 – An EU Policy Framework to assist developing countries in addressing food security challenges

regional and national levels, including through improved market transparency. This would entail support in developing countries to strengthening of farmer's organisations, to improving price transparency, and to developing and applying regulatory frameworks. Developing agricultural production will increase resilience and adaptability to food shocks.

Yet with the causes of price volatility multiple, there is no single and simple solution to the identified problems. This is more so since, despite some common factors appear to be at play across and beyond commodity markets, the specificity of agricultural production (linkage to food security, the environment, and the latter including the dependency of agricultural production on life cycles, weather and seasons, sanitary and pest conditions) complicates the potential impact of policy options further.

The G-20 has requested the "World Bank to work with other relevant international agencies to develop measures to improve information on national and regional food stocks and food production projections" and this is work which the Commission will fully support.

The agricultural sector benefits from a wealth of information on agricultural production, consumption and stocks from public sources (WB, FAO/OECD, USDA, EU, ABARE) or commodity bodies (especially the International Grains Council) that is in clear contrast to information in commodities such as metals, minerals and energy, where market information is proprietary and available by industry. However, information could be improved further especially on national and regional food stocks and food production projections.

Given the increasing market orientation of its Common Agricultural Policy, information and transparency on commodity market developments have become key features in efforts to ensure the proper functioning of the agri-food chain:

- Member States regularly communicate a wide range of data to the Commission which is published on the internet¹⁶ and discussed with advisory committees of stakeholders.
- A food price monitoring tool has been set up by the Statistical Office of the Commission to increase price transparency and ¹⁷discussions are on-going on how to improve this tool.
- The Commission services regularly produce and publish a medium-term outlook for major agricultural commodity markets¹⁸.

The Commission has established a High Level Forum for a better functioning Food Supply Chain¹⁹. While it does not deal with price volatility as such, it addresses the transmission of price developments throughout the supply chain, examining business to business relations, the competitiveness of the food industry, agri-food logistics and the food price monitoring tool.

¹⁶ See for instance http://ec.europa.eu/agriculture/markets/prices/monthly_en.pdf

¹⁷ See http://epp.eurostat.ec.europa.eu/portal/page/portal/hicp/methodology/prices_data_for_market_monitoring

¹⁸ http://ec.europa.eu/agriculture/publi/caprep/prospects2010/index_en.htm

¹⁹ See http://ec.europa.eu/enterprise/sectors/food/competitiveness/forum_food/index_en.htm

3.2. Regulation of financial markets

There is a broad agreement that it is desirable to increase the integrity and transparency of commodity derivatives market. In line with G20 principles and conclusions, the Commission has launched a number of initiatives to do so:

- It has adopted a proposal for a regulation on OTC derivatives trading,²⁰ which aims to reduce systemic risk and improve transparency for regulators in all derivatives, including commodity derivatives.
- The review of the Market Abuse Directive²¹ in spring 2011 will aim to clarify what trading in commodity markets constitutes abuse, and to ensure that all venues and transactions where abusive practices can occur are properly covered under pan-EU rules.
- The review of the Packaged Retail Investment Products (PRIIPS)²² will require additional rigour and enhanced quality of information when retail investors are offered structured commodity investment products.
- The Alternative Investment Fund Management Directive²³ will increase transparency of these funds for investors and national supervisors, and give a better insight of the impact of these funds on the markets for commodity derivatives.
- The review of the Markets in Financial Instruments Directive²⁴ in spring 2011, will aim to improve further the transparency of trades and prices in commodity derivatives by setting conditions for when commodity derivative products should trade exclusively on organised trading venues. It will also require more systematic and detailed information on the trading activities of different types of market participants in commodity derivatives, and require regulators to assert comprehensive oversight over commodity derivative positions.
- Finally the creation of the European Securities Markets Authority (ESMA) will ensure consistency of technical rules applicable to these markets and be instrumental in strengthening collaboration with regulators of the underlying physical markets²⁵.

These measures will help to ensure that increasing investment flows are more transparent, are better accounted for, and are less able to distort the functioning of commodity markets. However the Commission acknowledges that a better understanding of the interaction between physical and financial commodities markets is needed.

Against this background, the Commission will:

²⁰ COM(2010) 484 final, 15.9.2010

²¹ Directive 2003/6/EC, OJ L 96, 12.4.2003

²² A public consultation on PRIIPS was launched on 26th November 2010, http://ec.europa.eu/internal_market/finservices-retail/investment_products_en.htm#consultation

²³ COM(2009) final, 30.04.2009

²⁴ Directive 2004/39/EC, OJ L 145, 30.04.2004

²⁵ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority, amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2010, p.84

- carry out further analysis of developments on financial and physical commodities markets to improve understanding of the relationships between them, and will feed this analysis into the preparation of a G20 conference later this year.
- examine the extent to which further improvements are necessary on the transparency and accessibility of information on the physical commodity markets.

4. THE EUROPEAN RAW MATERIALS INITIATIVE

Beyond developments related to price volatility and the interaction between physical and financial commodities markets, the question of physical supplies of raw materials remains essential. In 2008 the Commission launched the "Raw Materials Initiative"²⁶ (RMI) which established an integrated strategy in response to the different challenges related to access to non-energy raw materials.

The RMI is based on three pillars: ensuring a level playing field in access to resources in third countries; fostering sustainable supply of raw materials from European sources, and boosting resource efficiency and promoting recycling. This section examines key results to date on identifying critical raw materials, and in the areas of trade, development, research, and resource efficiency and recycling. Section 5 looks at next steps.

4.1. Identifying critical raw materials

The Commission has identified 14 critical raw materials at EU level (see annex 6), with Member States and stakeholders, and has developed a transparent, innovative and pragmatic methodological approach to defining "criticality"²⁷.

Critical raw materials are those which display a particularly high risk of supply shortage in the next 10 years and which are particularly important for the value chain. The supply risk is linked to the concentration of production in a handful of countries, and the low political-economic stability of the suppliers. This risk is in many cases compounded by low substitutability and low recycling rates. In many cases, a stable supply is important for climate policy objectives and for technological innovation. For example, rare earths are essential for high performance permanent magnets in wind turbines or electric vehicles, catalytic converters for cars, printed circuit boards, optical fibres, and high temperature superconductors. The EU is completely dependent on imports, with China accounting for 97% of world production in 2009 (see annex 7). China's own demand for rare earths is expected to exceed its domestic supply in 2012. At the same time, no recovery processes relevant to rare earths are currently commercially viable and available substitutes currently show a loss of performance in their applications, thus requiring more research.

The work on identifying critical raw materials also revealed the need for better data and knowledge, and on the need to update the list of raw materials every 5 years to take into account market developments, technological developments, or new information on the environmental impact of a material. It further concluded that policy actions should not be limited to critical raw materials exclusively.

²⁶ COM(699)2008 Communication "The raw materials initiative - meeting our critical needs for growth and jobs in Europe"

²⁷ "Critical raw materials for the EU". Report of the RMSG Ad-hoc working group on defining critical raw materials June 2010.

4.2. Implementing the EU trade strategy for raw materials

There have been a number of achievements under the trade policy chapter since 2008. An EU trade strategy for raw materials has been defined and the first annual report presents the main results until 2009 in the three main areas²⁸:

- the EU proposed trade disciplines on export restrictions (including bans, quotas, duties and non-automatic export licences) in all relevant negotiations, bilateral or multilateral (for example in the Free Trade Agreement with Korea and in provisions on export duties on a series of raw materials, including wood, in the context of Russia's WTO accession).
- regarding enforcement, the Commission continued to tackle barriers primarily through dialogue, but when no progress was registered was ready to use other tools including WTO dispute settlement.
- In terms of outreach, the Commission has addressed the raw materials issue in various bilateral dialogues and in the OECD. Following the co-organisation of a workshop dedicated to the issue at the end of 2009, the topic was put on the OECD's work programme for 2011-2012.

4.3. Development instruments

Actions have been launched under the 10th EDF mainly within the good governance approach ("strengthening states"). Projects were also financed by the EU-Africa Infrastructure Fund, through the EIB lending to mining projects or the research framework programme 7 for geological surveys. The Commission is also supporting a sound investment climate through initiatives such as country-specific technical assistance for greater revenue transparency through the Extractive Industries Transparency Initiative, and work to promote good governance in tax matters²⁹.

4.4. New research, innovation and skills opportunities

The EU has taken steps to improve its knowledge base on actual and future deposits of many important raw materials and to stimulate the extractive industry to deliver new products to the manufacturing industry through the Seventh Framework Programme for Research and Development. The project ProMine, launched in 2009 with a €17 million budget, will develop the first pan-European satellite-based mineral resources database and a 4D computer modelling system to help to assess the value of European mineral resources. Funding has been provided to projects on advanced underground technologies for intelligent mining, on substitution of critical raw materials such as rare earths and platinum group metals, and on coordination of activities in Member States in the area of industrial handling of raw materials through ERA-NET. Support has been provided for the development of the bio-refinery concept, that will contribute to provide new high value added products, and the European Technology Platforms on Sustainable Mineral Resources and Forest-Based Sector Technology are important drivers of new research efforts in relation to raw materials.

²⁸ DG Trade - Raw materials policy - 2009 annual report (<http://ec.europa.eu/trade/creating-opportunities/trade-topics/raw-materials/>)

²⁹ COM (2010)163, "Co-operating with Developing Countries on Promoting Good Governance in Tax Matters"

The European Regional Development Fund also provides funding for research, innovation and business support measures for raw material exploration and extraction, while the Erasmus Mundus Minerals and Environmental Programme (2009-2013) supports the generation of new skills in the area of raw materials.

4.5. Guidelines on the implementation of Natura 2000 legislation

In the context of the RMI concerns have been raised about the sometimes competing objectives of protecting Natura 2000 areas such as ensuring a high level of environmental protection, and the development of competitive extractive activities. The Commission has developed guidelines on this issue underlining, for example, that there is no automatic exclusion of non-energy extraction activities in or near Natura 2000 areas³⁰. The Commission has also provided guidance that presents examples of good practice for exploiting wood resources while ensuring sustainable forest management³¹.

4.6. Increased resource efficiency and improved conditions for recycling

The concept of sustainable use of natural resources is increasingly being mainstreamed into EU policy initiatives to promote growth and competitiveness. Member States have implemented various policies and practical instruments to improve resource efficiency. A major policy issue is the need for legal clarity for defining when reprocessed waste can be reclassified as a product. The Commission under the Waste Framework Directive is developing 'End-of-Waste' criteria for specific waste streams, and work is advancing on rules for ferrous metals and aluminium, copper, recovered paper and glass.

Since 2008, the Commission has worked to prevent illegal export, or dumping, of waste by supporting Member States in implementing the Waste Shipment Regulation. It is considering guidelines for the shipment of used and waste vehicles. Concerning the stream of waste from electrical and electronic equipment (WEEE), the Commission has proposed an ambitious new collection target which would ensure that 85% of the WEEE stream would be available for the recovery of valuable raw materials contained, instead of being lost through improper treatment. In addition it has proposed stricter rules for the categorisation for shipment of 'used' electronics and electrical goods which will require exporters of such equipment to provide proof of functionality for every item exported for re-use.

5. FUTURE ORIENTATIONS OF THE RAW MATERIALS INITIATIVE

While significant progress has been made in implementing the RMI, further improvements are necessary. An integrated approach based on the three pillars is essential, as each contributes to the objective of ensuring a fair and sustainable supply of raw materials to the EU.

5.1. Monitoring critical raw materials

Securing supplies of raw materials is essentially the task of companies and the role of public authorities is to ensure the right framework conditions to allow companies to carry out this task. The Commission intends to explore with the extractive, recycling and user industries the potential for targeted actions, notably with regard to recycling. It is also ready to examine with Member States and industry, the added value and feasibility of a possible stockpiling

³⁰ http://ec.europa.eu/environment/nature/natura2000/management/guidance_en.htm

³¹ Good practice guidance on the sustainable mobilisation of wood in Europe. European Commission, Forest Europe, FAO. 2010

programme of raw materials. At EU level, the stockpiling programme for oil aims to protect public security for Member States and EU³². The Commission will:

- Monitor the issues of critical raw materials to identify priority actions, and will examine this with Member States and stakeholders.
- Update the list of critical raw materials every 5 years.

5.2. Fair and sustainable supply of raw materials from global markets (pillar 1)

5.2.1. A trade strategy

The Commission intends to reinforce the Raw Materials Trade Strategy³³ as set out in section 3.2 in line with development and good governance objectives. The Commission considers that the EU should:

- further embed raw materials issues, such as export restrictions and investment aspects, in ongoing and future EU trade negotiations in bilateral, plurilateral and multilateral frameworks.
- pursue the establishment of a monitoring mechanism for export restrictions that hamper the sustainable supply of raw materials, and will continue to tackle barriers distorting the raw materials or downstream markets with dialogue as the preferred approach, but using dispute settlement where justified.
- continue to develop bilateral thematic raw materials dialogues with all relevant partners, and strengthen ongoing debates in pluri – and multilateral fora (including e.g. G20, UNCTAD, WTO, OECD). Further studies could provide a better understanding of the impact of export restrictions on raw materials markets, and foster a debate about their use as a policy tool.
- In OECD, the EU will encourage the inclusion of relevant non-OECD members in the work on raw materials, and will further explore multilateral and plurilateral disciplines including consideration of best practices.
- use competition policy instruments to ensure that supply of raw materials is not distorted by anti-competitive agreements, mergers or unilateral actions on the side of the companies involved.
- The Commission intends to move forward the above mentioned actions, further analyse raw materials priorities with third countries through bilateral and multilateral frameworks and dialogue, and continue to pursue the consistency of the EU's general trade policy with regard to these priorities.

5.2.2. Sustainable supply of raw materials and development needs

Sustainable mining can and should contribute to sustainable development. However, many developing countries – especially in Africa – have not been able to translate their resource wealth into sustainable and inclusive growth, often because of governance issues related to

³² Council Directive 2009/119/EC of 14 September 2009

³³ DG Trade - Raw materials policy - 2009 annual report

regulatory frameworks or taxation. Enhancing governance, transparency and investment climate in the raw materials sector is essential for achieving inclusive growth and sustainable development in resource rich countries. Development policies can play a crucial role in creating win-win situations where both developed and developing countries benefit from the sustainable supply of raw materials, and in using domestic financial resources from the mining sector for sustainable development to support the objectives of respective growth and poverty reduction strategies.

The Commission will consider further these issues in the context of the Green Paper consultation processes on the future of EU development policy and budget support as well as in its public consultation on country-by-country reporting³⁴. The EU will encourage partner governments to develop comprehensive reform programmes that clearly identify objectives such as improving mining taxation regimes or enhancing revenue and contract transparency, or enhancing the capacity for using revenues to support development objectives. Greater transparency will help society at large and national supervisory bodies to hold governments and companies to account for revenue payments and receipts, and thus decrease fraud and corruption and ensure a more predictable investment climate.

In Addis Ababa in June 2010 the Commission agreed with the African Union Commission (AUC) to establish bilateral co-operation on raw materials and development issues based on the RMI and the AUC's policy on mining and minerals, i.e. the 2009 'African Mining Vision'. This co-operation will focus on three areas: governance, investment and geological knowledge/skills. Under the Africa-EU Joint Strategy 2011-2013, agreed at the Africa-EU Summit held in November 2010, actions on raw materials are foreseen under the Trade, Regional Economic Integration and Infrastructure Partnership. The EU and its Member States will work jointly on these issues. The Commission proposes to:

- enhance European financial and political support for the Extractive Industries Transparency Initiative (EITI), and help developing countries to implement it;
- share best practice with international organisations such as the World Bank, IMF, and the African Development Bank on the basis of the EU standards
- examine ways to improve transparency throughout the supply chain and tackle in co-ordination with key trade partners situations where revenues from extractive industries could be used to fund wars or internal conflicts;
- assess the feasibility of promoting more disclosure of financial information for the extractive industry, including the possible adoption of a country-by-country reporting requirement. The Commission will take into account progress made by the International Accounting Standards Boards on an International Financing Reporting Standard for extractive industries, as well as the current status of legislation third countries active in the region³⁵.
- promote the application of EU standards by EU companies operating in the developing countries and the application of the Best Available Technique Reference document and by developing a code of conduct of EU companies operating in third countries; and

³⁴ http://ec.europa.eu/internal_market/consultations/2010/financial-reporting_en.htm

³⁵ For example (ass ref to US Dodd-Frank Wall Street Reform and Consumer Protection Act)

- support the work by the OECD on due diligence in the mining sector.

Resource-rich developing countries often suffer from a lack of transport, energy and environmental infrastructure which limits their ability to harness their mineral wealth. The European Commission and European Investment Bank (EIB), in co-operation with African countries, will continue to assess how to promote the most appropriate infrastructure, and related governance issues, that can contribute to the sustainable use of the resources of these countries and facilitate raw materials supply, using respective sector dialogues to steer this process. The existing EU-Africa Infrastructure Trust Fund³⁶ could assist African countries in this task. Networks of EU delegations can play a lead role in the dialogue process on sectors relevant to provide the enabling infrastructure environment.

To increase the funding opportunities for such projects, the Commission will liaise with the EIB (a) to explore the feasibility to increase lending to mining and refining projects and (b) investigate the possibility to promote financial guarantee instruments that reduce risk for operators, and in particular work together with the EIB and private banks to facilitate the provision of loans on the basis of guarantees provided by the European Development Fund. Eventually the EIB could also provide transaction advice for investments in mining.

Development policy should also target the creation of linkages from the extractive industry towards local industry, by improving the value chain and maximising diversification. Therefore, an enabling business capacity building should be fostered and trade agreements should include the necessary flexibility to achieve this aim. The EU can also help developing countries increase their geological knowledge³⁷ to allow them to better estimate national mineral reserves, better plan budgets based on expected revenues from these reserves and give increased bargaining power vis-à-vis mining firms.

The Commission – in co-operation with African countries – is assessing the feasibility of assisting further co-operation between both continents' geological surveys and is promoting co-operation in this area in multilateral fora such as UNESCO's Geosciences Programme.

5.3. Fostering sustainable supply within the EU (pillar 2)

The Europe 2020 Strategy underlines the need to promote technologies that increase investment in the EU's natural assets. Extractive industries fall under this category but its development is hindered by a heavy regulatory framework and competition with other land uses. Many regulatory issues in this area are the competence of Member States. The Commission therefore acts mainly as a facilitator for the exchange of best practices.

At the same time, extraction in the EU must occur in safe conditions. This is important both for the image of the sector and as a precondition for the public acceptance. The Commission considers that the following practices³⁸ are particularly important in promoting investment in extractive industries:

³⁶ The purpose of the Trust is to benefit cross-border and regional infrastructure projects in sub-Saharan Africa.

³⁷ For example, the AEGOS project brings the EU's and Africa's geo-surveys together to improve the level and quality of resource data available for Africa.

³⁸ "Improving framework conditions for extracting minerals for the EU". Report of the RMSG Ad-hoc working group on exchanging best practices on land use planning, permitting and geological knowledge sharing. June 2010.

- defining a National Minerals Policy, to ensure that mineral resources are exploited in an economically viable way, harmonised with other national policies, based on sustainable development principles and including a commitment to provide an appropriate legal and information framework;
- setting up a land use planning policy for minerals that comprises a digital geological knowledge base, a transparent methodology for identifying mineral resources, long term estimates for regional and local demand and identifying and safeguarding mineral resources (taking into account other land uses);
- putting in place a process to authorise minerals exploration and extraction which is clear, understandable, provides certainty and helps to streamline the administrative process (e.g. the introduction of lead times, permit applications in parallel, and one-stop-shop).

The Commission proposes to assess with the Member States, in full respect of the subsidiarity principle, the feasibility of establishing a mechanism to monitor actions by Member States in the above area, including the development of indicators.

It is also important to further enhance the knowledge base necessary for an efficient raw materials strategy. In the short term the Commission proposes to assess with the Member States the scope for increased synergies between national geological surveys, that would allow for economies of scale, reduced costs and increased potential to engage in joint projects (e.g. harmonised minerals database, European Raw Materials Yearbook). In the medium term, any synergies should contribute to an improved European raw materials knowledge base in a co-ordinated way, in particular taking into account future opportunities within the GMES programme. For some raw materials, such as wood, the growing demand for renewable energy continues to increase competition for them. Increased demand is not always matched by a corresponding supply increase, thereby leading to higher prices.

The Commission intends to:

- promote the work of UNECE in the area of standardisation concerning reporting of reserves and resources at EU-level.
- carry out an appropriate analysis on the availability of wood and recovered paper taking into account the potential demand from both the forest based industries and the renewable energy sector (biomass).
- continue to support the creation of sectoral skills' councils at European level when an initiative comes from stakeholders such as social partners or the relevant observatories.
- assess whether there is a case for launching a Innovation Partnership on raw Materials for a modern society within the Europe 2020 Flagship on Innovation Union³⁹

5.4. Boosting resource efficiency and promoting recycling (pillar 3)

As worldwide demand for raw materials is increasing at a faster rate than the supply of recyclable material, recycling will not satisfy all of the EU's raw material demands. In the framework of the Europe 2020 flagship initiative on resource efficiency, the Commission will

³⁹ COM(2010)546

present in 2011 an EU roadmap for a low-carbon economy by 2050. It will set out a vision of structural and technological changes required to move to a low carbon, resource efficient and climate resilient economy by 2050 and how we can make this transition happen through policies delivering most benefits for the EU's growth, jobs and energy security.

'Urban mining', which is the process of extracting useful materials from urban waste, is one of the main sources of metals and minerals for European industry. The use of secondary raw materials contributes to resource efficiency, to the reduction of greenhouse gas emissions and to the preservation of the environment. However, the full potential of many of these resources is not being exploited and although recycling of municipal waste in the EU has doubled in 10 years, there are large differences in the situation in the Member States. Given pressures to reduce carbon emissions, protect human health and reduce external dependence, the barriers to prevention and recycling need to be further addressed. The Commission considers that these barriers fall into three broad categories: 'leakage' of waste to sub-standard treatment inside or outside the EU; obstacles to the development of the recycling industry; and inadequate innovation in recycling.

Better implementation and enforcement of existing EU waste legislation is essential for promoting a more resource-efficient Europe. The Commission proposes therefore to:

- publish a review of the Thematic Strategy on waste prevention and recycling in 2012. It will assess possibilities to develop best practices in the area of collection and treatment of key waste streams, in particular those which contain raw materials which have a negative impact on the environment. When necessary, the availability of recycling statistics will be improved.
- support research and pilot actions on resource efficiency and economic incentives for recycling or refund systems.
- carry out an ex-post evaluation of the EU waste acquis, including an assessment of areas where legislation in the various waste streams could be aligned to improve coherence. This would include the effectiveness of deterrents and penalties for breaches of EU waste rules.
- review the action plan on sustainable consumption and production in 2012 to identify what additional initiatives are necessary in this area.
- analyse the feasibility of developing ecodesign instruments to foster more efficient use of raw materials, ensure the recyclability and durability of products and promote the use of secondary raw materials (minimum content of recycled materials) in products, notably in the context of the Ecodesign Directive.

The problem of environmental dumping of waste products also occurs in cases of illegal shipment of waste to third countries. To further strengthen the enforcement of the Waste Shipment Regulation, the Commission proposes to:

- ensure precise and workable inspection standards for waste across the EU in 2011. This will include provisions to facilitate the control of shipments by customs authorities;
- consider using FP7 research funding to help improve technologies for detection, identification, tracking and location of illegal shipments;

- examine the feasibility of applying a global certification scheme for recycling facilities to the export of waste streams, building on environmentally-sound management criteria;
- building on IMPEL, work with Member States to assess the feasibility of a formal EU-level mechanism for the enforcement of the EU acquis; and
- develop new initiatives to improve the competitiveness of EU recycling industries notably by introducing new market based instruments favouring secondary raw materials.

6. WAY FORWARD

Access to commodities and raw materials is essential to maintaining the productive capacity of the economy and securing the well being of citizens. These commodities and raw materials are sourced from across the globe as well as from within Europe. The challenge is to ensure that commodity and raw materials needs are met in a way which supports wider goals for development in source countries, environmental protection, open trade and stable markets which do not pose risks to the wider economy.

Across all classes of commodities and raw materials, there has been an increase in financial activity. Ensuring that this development supports and does not undermine access to commodities and raw materials or destabilise the European economy or the economies of developing countries is therefore a key policy concern at European level and international level. These markets must continue to serve the real economy by helping price formation and allowing the hedging of market risk.

The prices of commodity derivatives and underlying physical commodities are interlinked. Their dynamics are challenging established paradigms and understanding commodity prices is becoming increasingly difficult. The Commission considers there is a need to promote greater understanding of these developments.

Given that the sustainable supply of raw materials is a major on-going challenge, the Commission also intends to reinforce implementation of its raw materials initiative in an integrated strategy based on its three pillars. Furthermore, the Commission will hold regular public discussion through an annual thematic event that would promote the awareness of the challenges ahead and take stock of the progress made.

Lastly, the Commission intends to take forward discussions on these issues at international level and in the framework of the G20, and will host a conference to discuss them before the G20 Summit this year.