

## Rare Earths and the WTO: Tougher case than it looks

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The European Union, the United States and Japan have finally decided to take their case on China's rare earth export policies to the WTO. China stands accused of violating the terms of its WTO accession agreement by limiting exports of rare earths and driving an artificial wedge between prices in China and prices abroad – in essence using its resource advantage to shelter nascent high-tech industries and even to coerce the transfer of foreign expertise. Beijing, meanwhile, argues that this is a purely internal matter motivated by the need to impose environmental restrictions on a highly polluting industry. Uncontrolled production practices have indeed wrought havoc on local environments and human health in rare earth-producing regions. The Chinese authorities argue that export permits and higher prices for rare earths are needed to allow industries to adapt to higher production standards – export tariffs and quotas being a useful tool in China's eye.<sup>1</sup>

Ultimately, this issue is in dire need of adjudication and clear legal lines need to be drawn between environmental protection and resource protectionism. There has been some doubt in the last year as to whether a formal complaint would be made before the international body. Many questioned whether it was fortuitous to push China at a time when its help was needed on other pressing issues – notably the European debt crisis and the Iranian nuclear question. Some industries also worried that it might bring about repercussions in other parts of their business in China, and thus urged caution.

Despite these concerns, the rare-earth ball has finally started rolling at the WTO. Many explain the timing of this action in the context of the American political season – the Obama Administration taking heat during the Republican primary debates for not being tough enough on China, as an early-November presidential election looms overhead. But the decision to move forward now was facilitated in large part by the final outcome of a similar (yet different, see below) case on Chinese raw material policies put before the WTO by the U.S., the E.U. and Mexico

in 2009 – a case that did not include rare earths.<sup>2</sup> China used similar environmental arguments to justify export restrictions. The dispute settlement board finally ruled against China in July 2011, paving the way for rare earths in 2012.

But China's case seems stronger than in the past. They've adopted stricter environmental standards for rare earth producers and adapted their quota system as a consequence. In the end of 2011 representatives from the Ministry of Environment trekked across the country inspecting production operations and determining whether or not they had adopted the standards put in place. A direct link between respect for environmental rules and quota allocation was then included in China's export quota schedule for 2012 – a first. Those producers who met environmental standards were given "confirmed" quotas, while "provisional" quotas were allotted to those who fell short. Ultimately, if those given provisional status don't make the necessary upgrades then they could see their quotas taken away and likely reallocated elsewhere.<sup>3</sup> The question still remains whether this system was put in place to bring about improvements on environmental protection (which are sorely needed), or rather in anticipation of an eventual case at the WTO (or both).

Another drawback to the WTO track is that it will likely take time. If the 2009 case is any indication, it could take another 2 years before a final decision is made. A lot can happen in that time, including substantial industrial relocation. On the flip side, if China were to decide today to stop its export quotas it would be bad news for production outside of China. No Chinese quota system means a return of cheap Chinese rare earths to the global market. While this would mean industrial users could once again have unfettered access to Chinese rare earths, this would spell trouble for all of the mining operations struggling to come online across the globe– diversifying sources being a key to creating a security of supply for rare earths.<sup>4</sup> Dramatically lower prices would mean that these potential producers would have real trouble turning a profit, but without these producers we are back to depending on China for rare earths. Japanese consumers will be the first to point to the risks of depending completely on China, after Chinese exports were halted in the fall of 2010 during a spat over territorial issues in the East China Sea. Indeed, one ironic consequence of China's quotas – despite all of the noise they have created overseas – is that they have raised rare earth prices and paved the way for more efficient resource use, for production outside of China, and even for recycling. It's quite a corner we've backed ourselves into: Many of our industries can't live without China's rare earths so we pressure China to play by the trade rules they've signed up to, but without their export quotas we will have a hard time breaking our dependence on China's rare earths.

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<sup>1</sup> For a more complete analysis of the issue, see John Seaman, “Rare Earths and Clean Energy: Analyzing China’s Upper Hand”, *Note de l’Ifri*, September 2010, [http://www.ifri.org/index.php?page=contribution-detail&id=6204&id\\_provenance=103&provenance\\_context\\_id=4&lang=uk](http://www.ifri.org/index.php?page=contribution-detail&id=6204&id_provenance=103&provenance_context_id=4&lang=uk)

<sup>2</sup> The raw materials in question were bauxite, coke, fluorspar, manganese, magnesium, silicon carbide, silicon metal, yellow phosphorous and zinc.

<sup>3</sup> See Gareth Hatch, “The first round of Chinese rare earth export quota allocations for 2012”, Technology Metals Research, 28 December 2011, <http://www.techmetalsresearch.com/2011/12/the-first-round-of-chinese-rare-earth-export-quota-allocations-for-2012/>

<sup>4</sup> Producers of so-called “light” rare earths, – Mt. Weld in Australia, Mountain Pass in the U.S., for example – are slated to come online this year or the next, whereas “heavy” rare earth deposits cannot be expected to be brought into production before 2016.