Unfair Trade

The United States just won a big trade battle with China over materials used in iPhones and missiles, but it might be a Pyrrhic victory.

By Keith Johnson

The World Trade Organization ruled Wednesday that China broke trade rules by limiting the export of rare-earth metals in recent years, handing a victory to the United States, Japan, and other countries that have long accused Beijing of giving Chinese firms a powerful advantage over their foreign rivals by hoarding minerals essential to the manufacture of smartphones, solar panels, and batteries for hybrid and electric cars.

In making formal a ruling that was first hinted at last fall, the WTO brushed aside China's claims that environmental concerns had forced it to restrict the sales of materials such as lithium and tungsten. The ruling will cheer lawmakers and free-trade advocates in the United States, who have for years warned that China's decision to keep many of the minerals for itself was threatening American businesses and national security by raising manufacturing costs and imperiling access to materials vital to the defense industry.

But the WTO ruling, by slapping down limits on raw-material exports, could also have profound implications for the debate over whether or not to export part of the U.S. energy bounty. That's because the WTO said that countries can't limit exports just to ensure preferential access to raw materials for domestic industries.

At issue is China's dominance in the mining, processing, and export of a class of minerals known as rare earths, which are used in everything from computer monitors to missile guidance systems. China controls more than 85 percent of the global market, down from 97 percent a few years ago.
Once a relatively obscure, if not geologically rare, group of minerals with exotic names such as neodymium and yttrium, rare earths became increasingly important in recent years due to the massive growth of consumer electronics, advanced defense applications, and clean-energy products. Each advanced wind turbine today, for example, uses about 650 kilograms of neodymium; the roller-coaster in supply and demand for neodymium has sent prices skyrocketing and reeling in recent years.

The WTO ruled today on complaints filed by the United States, European Union, and Japan in 2012. The complaints alleged that Chinese export duties and export quotas amounted to unfair trading practices by essentially subsidizing Chinese manufacturers at the expense of American, European, and Japanese rivals. China had argued that it was entitled, under WTO rules, to limit the production and export of rare earths on environmental grounds and in order to preserve a limited resource.

Not so, said the WTO, which ruled that "China's export quotas were designed to achieve industrial policy goals rather than conservation."

China's Ministry of Commerce, in a statement emailed to a variety of Western news organizations, said it was "currently assessing the panel report and will follow the WTO dispute settlement procedures to settle this dispute." According to WTO rules, Beijing has 60 days to decide if it wants to proceed with an appeal.

The Obama administration, by contrast, was quick to cheer the ruling. Michael Froman, the U.S. trade representative, said Washington "will continue to defend American manufacturers and workers, especially when it comes to leveling the playing field and ensuring that American manufacturers can get the materials they need at a fair market price."
The White House might want to hold off on the champagne, though. The trade organization ruled that countries cannot restrict the export of globally-important commodities, especially if that involves a deliberate policy of making life easier for domestic firms that rely on those materials while disadvantaging foreign rivals.

In the Chinese rare earths case, the WTO found that "the overall effect of the foreign and domestic restrictions is to encourage domestic extraction and secure preferential use of those materials by Chinese manufacturers," in apparent violation of Article XX(g) of the 1994 General Agreement on Tariffs and Trade, the precursor to the trade organization. That could be a double-edged sword for the U.S.

Substitute "natural gas" for rare earth minerals, and "U.S. manufacturers" for Chinese manufacturers, and Washington's could find itself subject to trade complaints of its own, and with a weakened ability to go after trading partners that break the rules.

Under current U.S. law, companies seeking to export natural gas to countries with which the United States does not have a free trade agreement require several layers of government approval, a cumbersome and time-consuming process that limits the potential scope of gas exports. Manufacturers who benefit from cheap and abundant supplies of natural gas at home, notably Dow Chemical, have lobbied against exports.

Michael Levi, an energy expert at the Council on Foreign Relations, pointed to the Chinese trade dispute to underscore that export restrictions fall afoul of the United States' traditional free-trade stance.
"In the last two years, the United States has challenged Chinese restrictions on raw materials exports at the WTO," he told a House foreign affairs panel examining the geopolitical implications of U.S. energy exports. "If the United States were to block exports, or restrict them only to friends or NATO allies, that would undermine its ability to challenge other countries' restrictions and to uphold a global, open trading system."

The current dispute dates back to 2008, when China first started limiting the amount of rare earth minerals that it exported. Between 2007 and 2011, China's rare earth exports fell in half, from about 60,000 metric tons to about 30,000 tons. At times, the restrictions were particularly targeted: During a dispute with Japan, China halted all rare-earth exports for a few months in the fall of 2010.

The export restrictions shined a spotlight on advanced economies' reliance on a handful of imported minerals vital for critical sectors -- and raised fears that Chinese dominance could undermine U.S. industry and defense. The irony was acute: Until the 1980s, the United States was the largest producer of rare earths, but environmental concerns and slumping mineral prices kneecapped the domestic industry just as China's production of rare earths was picking up speed. Studies in recent years, such as a major one by the Center for a New American Security, have warned about the country's reliance on a handful of critical minerals. The Pentagon's own studies downplay the supply threat for rare earth minerals, but do acknowledge the need to bolster stockpiles of other vital raw materials.

Alarmed by China's market dominance and restrictive trade behavior, lawmakers in recent years have introduced a spate of bills that would jumpstart critical mineral production and stockpiling in the United States. Last fall, the Senate introduced a critical minerals bill meant to unify a scattered governmental approach to critical minerals and make it easier to mine for rare earth ores.
Sen. Lisa Murkowski (R-Alaska), one of the co-sponsors of the Senate bill, applauded the ruling but urged greater U.S. production of rare earth minerals. "We can file trade complaint after trade complaint, but there is no substitute for the steps that we know we must take to reconstitute our own domestic supply chain," she said.

Chinese behavior, and the fear it has sparked, has already done more to undermine its dominance than the WTO decision likely will. While China dominates the current production of rare earths, global reserves are spread more widely. New mining projects coming online in the U.S., Australia, Canada, Brazil, and other countries in Asia could soon erode China's current position. Japan earlier this year announced a massive rare earth find on the sea floor that could supply hundreds of years of domestic needs. New finds in Greenland could potentially yield one-quarter of global supplies.

Molycorp, a U.S. firm, is one of the most ambitious players, having invested in recent years to refurbish the Mountain Pass mine in California that was once the mainstay of U.S. rare earth production. Molycorp is also trying to build capacity to turn rare earth ores into the higher value, finished products such as permanent magnets, which are actually used in advanced manufacturing.

At the same time, some industries have responded to the threat by seeking alternatives for the materials dominated by Beijing. One manufacturer specifically touts its neodymium-free wind turbines. And energy researchers are working on new types of magnets for wind-turbine generators that could increase efficiency and lower costs while reducing reliance on Chinese-dominated minerals.

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