

# Ukraine crisis pushing Russia to form rare earths alliance with China

☒ In 1986, Deng Xiaoping, launched the “863 program”, aimed to gain control of the rare earths market in the sector saying: “The Arab countries have oil, China has rare earths.” The 15 “rare elements” along with yttrium, scandium (‘15+2’), have the characteristic of retaining a strong magnetic property, resistant even at high temperatures. They are essential for the production of hard drives, satellites, lasers, digital cameras, wind turbines, fluorescent lights, electric motors, hybrid, mobile phones, guided projectiles, new generation radar and many other items that are of special military interest. In truth, these elements are not as “rare” as the name would suggest, but, their extraction and treatment requires expensive technology, because these elements are not found in nature in its pure state and they must be refined. Their abundance betrays the fact that most are found in deposits at low concentration, making it economically unwise to extract. China is the country with the largest reserves of rare metals (between 35 and 45%) and, since 1986, has made the greatest effort to support technological research in the field. Taking advantage of the significant economies of scale, low labor costs and minimal regulatory impediments, it has been able to optimize the supply chain in order to offer prices that have eliminated all competitors. Russia has the largest reserves after China – about 20% of the world’s known reserves – but recently there have been new discoveries in the region of Murmansk and the Kola Peninsula. In addition, while the known North American, South African, Australians, Indian and Brazilian rare earth deposits do not ensure a supply of the full range of “15 + 2”, it is virtually certain that the Russian deposits would be able to provide the entire series.

Russia has every incentive to exploit these resources and the recent tensions with the West and NATO over Ukraine, have generated even more interest, given their demand in industrialized countries and their importance to military technology. And, in fact, the fall in the supply of China (which has been discussed extensively in InvestorIntel) has left Russia a serendipitous opportunity to enter the rare earths market. In late 2013, the IST group, founded by Aleksandr Nesis, has formed a joint venture with the state-owned company Rostekh, and a large investment fund in order to invest at least a billion dollars, by 2018, to exploit of an area of about 250 square kilometers in the Yacuzia region in hopes of expectation of extracting 154 million tons of elements such as yttrium, niobium, scandium and terbium. The plant is expected to be finished by 2017, to enter into full swing only in the following year. ICT's plans have gained stronger momentum as a result of the tensions resulting from the political and military crisis in Ukraine. The United States has never quite warmed up to the EU's reliance on Russia for gas supplies (and for capital), always finding ways to disrupt the South Stream project – a pipeline bringing Russian to Europe via Bulgaria, avoiding Ukraine).

The IST rare earths supply from Russia would clearly tempt the EU in the same way that Russian gas has been doing with South Stream, promoting closer ties between many existing and potential NATO members and Russia – a perspective that most American foreign policy makers, especially on the neo-conservative side, regard with concern if not horror. If Russia cannot consider the EU as a reliable market because of geopolitics (European industrial powers needing rare earths will be hard pressed to promote sanctions against Russia), Moscow can still such outlets as Japan and the BRICS (Brazil, Russia, India, China, South Africa). Taking a page from the potash industry, where Russia had an alliance and pricing cartel mechanism with neighbor Belarus, Russian rare earth producers could establish a rare earths cartel of convenience

with China. Last May, Russia and China (which are already linked by the "Shanghai Pact") decided to increase their gas trade. A Sino-Russian rare earths cartel would be far more powerful than the gas one, being able to dictate world prices. Secondly, Russia could obtain the technology required to undertake a cost-effective exploitation of its resources. China, would gain deeper trade penetration toward Western Europe linking it to Germany more directly, potentially weakening the links with the United States. China and Russia would also have all the materials needed to expand their military, thanks to the materials to advance new generation weapons from lasers to drones.

The Ukraine crisis – and China's rare earths industrial consolidation and reform – has given Russia an unprecedented incentive to develop a rare earths mining industry, which, in addition to its hydrocarbons, would give it further huge bargaining power on the world economy. It does not have the know-how, technology, refining plants yet but China can offer these. Rare earths are essential to the production of directed energy weapons: absolutely innovative systems that, instead of hitting a target with a bullet, invade it with electromagnetic radiation, plasma or high energy laser beams. They are weapons of power, precision and speed, offering much lower operating costs than conventional weapons. Now, the United States is at the forefront in the development of these systems, but for some years now, it has suffered projects delays, due to the difficulty of overcoming the supply problem. The US Department of Defense has launched some inquiries and legislative proposals to address the rare earths supply issue and the findings were discouraging.