

# An era of globalization and free trade ending?

One of the most famous self-help books since the Second World War was "How to Win friends and Influence People". That Donald Trump hasn't read it seems rather obvious and indeed he seems to have adopted a policy of snarling and snapping at friends while engaging in an on-again/off-again flirtation with Russia. Ok, so the guy's erratic...

So the election in November of 2016 delivered a mandate for getting tough with trade partners that were ripping the US off. All well and good... the people had spoken. The trouble was that the most egregious example of trade imbalances, that of the US with China, has not been dealt with. In fact it seems like the Administration has retreated from its tough talk in that direction to instead go for a soft target (in Canada). Whether the new target will prove to be "soft" is yet to be proven, but Trump clearly thinks it's easier to kick sand in the face of friends than foes in a classic bully manoeuvre. The problem he has here is that not even his "base" regards Canada as kick-worthy and it will beg the question over the long-term as to why he is not doing anything about China.

## The China Syndrome

Much of the campaign period in 2016 was larded with attacks upon China and how it was stealing jobs (and technology) from the US and how its currency policies were manipulative and distortive and directed towards enhancing the shift of industries and trade in their direction. Frankly we had little to argue with the first thesis. Having been involved up close and personal with the Rare Earth industry this was a classic example of the Chinese *modus operandi*. Very little happens by chance even in areas that one might feel there is not much to

gain. So the idea of taking punitive action, for instance against Chinese steel-dumping, has quite a lot of appeal and definitely Trump's opponents were flailing around and on fragile ground when trying to arguing that China had NOT stolen US jobs. On the second thesis of China as a currency manipulator we suspect that Trump was looking at a rather out of date copy of Time in the dentist's waiting room when he proposed that thesis. That view is so totally 2007 and outmoded. China has not been finding it easy to control its currency in recent times (welcome to the rest of the world) and if anything has been trying to stem capital flight.

In any case Trump's election came as a shock to the Chinese and the sabres continued to be rattled during the interregnum leading up to the inauguration. Taiwan and South China Sea issues unsettled nerves and it looked like a serious tussle might evolve and that the new import duty regime and the tax credits linked to it (the Border Adjustment Tax) could put the US and China on a road to locking horns.

Then peace broke out. China was deemed useful for putting North Korea in its place (despite them being the main sustainers of the wayward regime for over 60 years now). Meals were partaken at *Mar a Lago* with the Chinese leader and all was well in the world, or at least in Sino-US relations.

The problem with this outcome is that it sets up the scene for appeasement on the South China Sea and will not deliver back a single job to the US. It does not deliver for "the base" in the Rust Belt who thought that some, if not all, of the lost jobs would be brought home. It does not deliver for those of us who had hoped to see a removal or lessening of China's rather sinister hidden hand in a lot of commodity pricing and trading. It does nothing for those who hope to see resource independence (read security) in the West from Chinese machinations. Essentially Trump wimped out.

**Randomness**

“Erratic” is not a critique in the Trump Administration it’s virtually a mantra. If a policy decision is consistent with something said or done before then clearly someone “didn’t get the memo”. The wild swings and roundabouts have lead to daily embarrassments (not that anyone on this crew would blush at anything they have done or said). Strangely the worst events have usually involved close allies and long-term friends. The Australian Prime Minister was insulted (and hung up on), the German Chancellor was excoriated for not paying her share of NATO, the Mexicans have been accused of bringing Biblical style plagues of misfortune upon the US and now the Canadians have been given the first taste of Trump’s new get-tough trade policy.

As a result of this there appears to be no grand plan. That Canada has been the first victim of the “trade realignment” is probably because it is perceived as a soft target for a quick news opportunity in the absence of any action on the China issue. The perception, possibly mistaken, is that Canada won’t respond. Meanwhile little consideration seems to have gone into the opinions of the US housebuilding industry where on average timber worth \$15,000 goes into each new dwelling constructed and that the new measures against Canadian timber imports might add \$1,500 to the cost of each house. That must cut into margins or increase the cost (and affordability) of new houses, or both. It is also somewhat ironic that the beneficiaries of this action are in the timber states of the US of which the two largest are Oregon and Washington that both went with the Democrats. How does this deliver for Ohio or West Virginia?

A new tone has been set here. There could very well be a slew of random tariff actions take place from now on against a range of products and countries and there are sure to be countervailing actions by those countries affected to show that they will not take this lying down.

## **Conclusion**

Trump quite likes being folksy so we might remind him of the old adage “What comes around, goes around”. Whatever the revenge that Canada exacts for the latest slap in the face it will probably be more subtle than anything the Donald might understand as “revenge”. If he has resolved on a course of trade actions against everyone EXCEPT China then the US will find itself exceedingly isolated for the rest of his term with foreign dignitaries staying at home and trade talks becoming a distant memory.

If Trump is right in one thing it is that China (and a few other nations) have gamed the WTO rules for a long while now with seeming impunity. The US has decided to join that exclusive grouping of rule-breakers. The response of those negatively impacted will be “see you in court” and the Trump approach is “bite me”. An era of globalization and free trade is ending. If the US thinks it can rule the globalized world while simultaneously dismantling it, it has a rude shock coming its way.

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## **Spratly Islands’ dispute redirects investors to Hastings heavy rare earths**

☒ China is expanding the Spratly Islands in the South China Sea in contested waters that the US is following closely. A little too closely the Chinese think. This could affect the rare earth trade that China controls. As a result, the west will be looking more closely at deposits outside of China, like the one in Australia owned by Hastings Rare Metals Ltd, (ASX: HAS).

Tensions in the Spratly Islands have sparked interest in what these events may do to the price of rare earths, and rare earth companies. The dispute is largely over potential oil reserves, but the events are reminiscent of the China-Japan dispute over the Senkaku islands in 2011 that caused China to cut off rare earth supplies to Japan. And current tensions with the US makes people wonder if China would use rare earths as a bargaining chip to get control of these islands. Finding other viable sources, especially in the Asia-Pacific area are always a concern. Hastings has a deposit of heavy rare earths that may benefit from all this in the race to supply minerals from outside of China. And maybe China knows something about deep sea mining of rare earths that the Japanese have said is unfeasible. Perhaps that would be a reason to build islands?

Regardless of why China is expanding the Spratlies and building an airport, these sorts of tensions usually push up the price of materials that are both shipped through the region, and sourced nearby. The world is hugely dependent on China for rare earths and if they experience negative repercussions from claiming islands that several countries claim, and are closest to the Philippines, then they may retaliate in a sector that all modern technology needs. The import-dependence, and the fact that China controls over 90% of the supply means that deposits in western countries like Hastings' are being examined closely as a way to lessen dependence on China.


Hastings has two deposits of heavy rare earths in Western Australia, Yangibana, and Brockman. They released a news release May 20<sup>th</sup>, regarding pre-feasibility (PFS), drilling at Yangibana. Their first target is the high neodymium mineralisation at Bald Hill South. A new target that was drilled in the 1980's will also be tested. They have also applied for a fourth mining lease, at Yangibana West, which will also be drilled as part of the PFS program. In late 2014 Hastings finished a Scoping Study of the Yangibana Project

that confirmed the economic viability of the Project. In early 2015 they commenced work on the Pre-Feasibility Study.

When the PFS is released, if it infers that this could be a producing source of these critical heavy rare earths, it may speed up the process. If tensions continue, it could spur the west to produce rare earths more quickly. What is certain is that China will continue to control the industry whether there are price or availability shocks or not. To lessen dependence on China for these minerals, the west will be looking towards the news about deposits of heavy rare earths like Hastings'.

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## **Ties between the USA and China at the lowest point of the past 40 years**

Relations between China and the United States arrived in  the worst point since 1972, when President Richard Nixon flew to China to meet Mao Tse-tung launching what would be known as 'ping pong diplomacy' (remember 'Forrest Gump'?) and a gradual improvement of relations between the two countries. Now, more than forty years later, diplomacy between the two superpowers is deteriorating because of disputes in the South China Sea and East China Sea, involving Japan and other countries of South-east Asia. East Asia is now less stable than any other period since the end of the Cold War.

The Sea of Japan (also known as East China Sea) has been at the center of a dispute between China and Japan that also, and so far indirectly, affects the United States. The situation has reached crisis level and it concerns a dispute over the Senkaku/Diaoyu islands, which intensified in 2012, when Japan

decided to formally annex the territory. China maintains that it is willing to compromise with Japan over the Islands, even as it has avoided any diplomatic language. China's Ministry of Foreign Affairs has insisted that it would defend "every inch of the territory that belongs to us", which means that Beijing in no way recognizes Japan's sovereignty over any part of the Islands. China is also at odds with other Asian neighbors, triggered by spats over territorial control in the South China Sea, which has caused the kind of anxiety that could break the thin rope that binds Beijing to Washington and blast cooperation on international issues such as the Middle East, climate change, nuclear weapons proliferation and North Korea. The world will get a better idea of how the US and China will manage their ever more complicated relationship at the sixth annual edition of the Strategic and Economic Dialogue (SED) summit between the two powers to be held in Beijing this week.

Since last May, the Government of Vietnam warned its citizens that China is preparing to launch a war – albeit, an economic one – as demonstrated by the fact that it entered unilaterally in Vietnamese territorial waters in order to install a massive oil drilling rig. In fact, China wants to ensure it increases its control natural resources and disputed sea areas and waterways in its 'sphere of influence'. The violation of Vietnam's maritime sovereignty has produced an underground climate war among the people on the streets. Many men have responded to the call for arms, many are ready to fight against what they see as the enemy, China. In fact, the unexpected intensification of the crisis has led to an extensive militarization of the area with dozens of Chinese vessels, repeated attacks on Vietnamese fishing vessels (the sinking of a fishing vessel May 26). However, the whole world is affected, as it happens that the South China Sea, affected by China's encroachment where is also the stretch of sea where over 80% of global maritime traffic moves. The question, of course, is not a problem exclusive to the Hanoi government, nor is it just a regional agenda topic. The issue was the

chief concern at the Summit on the security of the ASEAN meeting in Singapore in early June (Shangri-La Dialogue).

Whatever the reasons for China's apparent impromptu unilateral actions in Vietnam, they seem to serve the purpose of diverting domestic and increasingly frequent demonstrations of workers against the conditions of employment in their country, the presence of a dynamic urban middle class, largely inspired by Western models, has to confront a much poorer rural reality and the growing inequalities of today's Vietnam. The World Bank now places Vietnam among the middle-income countries (middle income countries), which means exclusion from many international development cooperation mechanisms.

China, meanwhile, announced – in the wake of more tensions in the Island dispute with Japan – that it would increase its military budget 12.2% in 2014. China's military budget has increased six fold since 1992. China's neighbors and critics say that reducing the U.S. military budget could leave it weakened against the potential of the Chinese threat. China has been known to have conducted military exercises in the fall of 2013 aimed at destroying the Japanese fleet in the East China Sea with the ultimate goal of capturing the Senkaku/Diaoyu islands. China has established an air defense zone in the East China Sea. Any non-Chinese passenger and military aircraft must identify themselves and follow the instructions of the Chinese Air Force when flying over the area. There are no international tools or provisions to stop China. The UN Security Council is powerless, meanwhile, because China can count on Russia's full support in matters related to Beijing's territorial claims and interests. Therefore, the US, NATO or any other Western power would be powerless to enforce meaningful sanctions under the auspices of the UN Security Council.

If China adds defense concerns and military prestige to its already intense plans for economic domination, it will generate a serious risk to global growth. The current



geopolitical climate suggests that superpowers and emerging powers will be fighting over these resources.

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## **Australia and Japan to sign Free Trade Deal – what this means for rare earths and resource sector?**

Japan's Prime Minister Shinzo Abe has arrived in Australia, after stops in New Zealand and Papua New Guinea, to sign a free trade and, perhaps more importantly, a defense cooperation agreement with his Australian counterpart Tony Abbott. Abe will be the first Japanese prime minister to address parliament in Canberra while he will be meeting Tony Abbott for the second in a matter of months. This is no coincidence, the Japanese government is seeking closer ties to Australia at all levels, given that Tokyo's relations with Beijing or Seoul have deteriorated since he was elected in 2012. Japan, meanwhile, has reorganized its military, and is now seeking support in Australia and other regions for policies aimed at limiting, or managing, Beijing's growing power and influence in the Asia-Pacific region. China and South Korea have established closer ties, due to their shared concerns over a renewal of Japanese nationalism under Abe; however, Australia has backed Abe's defense policies and Australia may just be Japan's closest ally in the Asia-Pacific region. Japan is now seeking new partners to for international support, fearing the possibility of remaining isolated.

The excuse, then, might be the signing of a historic trade

agreement – or Economic Partnership Agreement (EPA) as Japan calls it – on July 8, but much more is at stake. Australians will see the cost of their Japanese drop while Japanese consumer will get more high quality beef from Australia. Abe will address Parliament in Canberra and this is the highest level Japanese visit to Australia since 2002. The cars and the beef are, nevertheless, a bit of a side show to what appears to be a more strategic partnership taking shape between Australia and Japan. Abe has quietly relaxed Japan's regulations governing the export of military equipment while pushing a resolution to revise its pacifist doctrine as defined by Article 9 of its pacifist constitution, adopted after the Second World War under American pressure, prohibiting it to participate in military operations outside its borders.

Japan has strong self-defense forces, 250,000 men and an annual budget of some USD 50 billion. Abe's changes to Japan's defense policy, dubbed "collective self-defense", will enable Japanese forces to be deployed in a theater of operations even if Japanese territory has not suffered a direct attack from an external power as long as there have been threats against Japanese territory, danger for its inhabitants presenting no alternative solution other than a military one. "Japan will not be involved in a war to defend a foreign country, it is out of the question," insisted Shinzo Abe (though Japan has participated in NATO and UN sanctioned international peacekeeping operations). This is a historic turning point that reflects the current evolution of the regional geostrategic context.

Japan has territorial disputes with China, particularly, but not exclusively, where the Senkaku Islands are concerned. Japan also has claims over the now Russian controlled Kuril Islands, while being in the range of – admittedly risibly effective – North Korean ballistic missiles. Relations with Beijing have deteriorated hand in hand with Tokyo's approval

of double-digit military budget increases. In this context, Japan and Australia, both close allies of the United States, have agreed to strengthen their military ties, especially in terms of equipment. In June, ahead of tomorrow's signing ceremony, Japan's Minister of Defense Itsunori Onodera said that a cooperation agreement was to be signed dealing with equipment and defense technology. His Australian counterpart, David Johnston, meanwhile explained that Australia and Japan are "natural partners" who are changing their "strong relationship in a special relationship." One of the main beneficiaries of the agreement may well be a series of new submarines for the Royal Australian Navy (RAN), which is to be assembled in Australia with significant transfer of Japanese technology. Japan has expertise in submarine conventional propulsion. Newer models belong to the Soryu class. The first copy was commissioned in 2007. Overall, the Japanese Navy expects nine units. These submarines are built by Mitsubishi Heavy Industries and Kawasaki Shipbuilding Corporation among others. Joint F-35 fighter jet exercises are also being planned between Japan and Tokyo. Japan and Australia are both concerned by the rise of Chinese military capabilities, as well as Beijing's territorial claims in the East China Sea.

Japan's defense sector buildup contrasts with its needs to secure reliable supplies of Chinese rare earths, given that it is the main importer of these elements from China. Undoubtedly, and beyond the dubious headlines of rare earths being extracted from mud in Jamaica or from under the seabed off the deep end of the Pacific (no pun intended), Japan's militarism will force it to find new rare earth sources and processing facilities. China, meanwhile, can retaliate by treating its rare earths as strategic. Submarine hulls may use difficult scarce metals in the alloys, but the electronic equipment that will control every aspect of its weapon delivery systems from guidance to lasers, to actuators, to electric motors, need actual 'rare earth' magnets. Surely, Japanese industry will become ever more interested in

Australia's rare earth producing potential and companies such as Alkane Resources (ASX: ALK | OTCQX: ANLKY) have already formed close partnerships with Japanese end users and magnet producers such as Shin-Etsu. Japan's highly influential trading houses 'Soshas' such as Marubeni and Mitsui have invested heavily in Australian mining resources in general. However, in so doing, they have also met competition from the Chinese, who are also eager to secure access to Australia's resources. While Alkane is dealing with Japan, Arafura Resources (ASX: ARU) has attracted interest from Chinese magnet producers and there is no sign that Australia will restrict Chinese investment or trade, despite the defense and trade agreements with Japan.

Asian trade is a complex web of resource, technology and manpower exchanges, and no country wants nationalist or geostrategic disputes to interfere with trade. In the rare earths sphere, this means that signs brandished by mobs in front of Japanese consulates in China, urging Beijing to cut off rare earth supplies to Japan do not have a great chance of being acted upon officially. Any cuts to exports will be adopted more because of Beijing's efforts to restrain the industry and illegal exporters than to nationalism. China is concerned about its own supply of rare earths, especially heavy rare earths such as dysprosium, which are truly rare, accounting for 2-3% of an ore's composition. The Senkaku problem and the expectation that China would cut off rare earths supplies to Japan, the world's largest importer of these minerals, has merely highlighted this fact. Indeed, it has highlighted the fact that for all the arguments of low demand and low prices, rare earths remain a compelling proposition. China itself would benefit from increased rare earth production in other parts of the world. Japan, has tried to reduce its dependency on Chinese rare earth supplies, given its experience with the 2010 edition of the Senkaku dispute. China, for one, will not allow fickle and fast burning nationalism to turn away good business.

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# The geopolitics of missing Malaysian Airlines flight MH 370

✘ The investigation into the disappearance of the Malaysia Airlines Boeing 777, flight MH 370, continues and none of the theories, whether leaning towards foul play or malfunction, have yielded any results. All that is certain is that flight MH370 departed Kuala Lumpur with 239 people on board – two thirds of whom Chinese – took off at 00:41 hrs on March 8. Notions that the pilots, or one of the pilots, deliberately disabled the Boeing's communication systems have not been conclusive; indeed, they have been as inconclusive as all other theories, which, as any internet search will show, include UFO and Bermuda Triangle like plots as well. It is natural and necessary to speculate over what may have happened to MH 370 – this author has his own theory of possible sudden depressurization causing the plane to keep flying with nobody at the controls – nevertheless, only the facts and the evidence will reveal what has become a mystery.

The problem of speculation, however, is that it only raises the hopes of the family members of the passengers and crew of MH 370. The uncertainty and constant barrage of suppositions and assumptions has taken its toll on the families. Furious relatives of the Chinese interrupted a press conference by a minister demanding answers before he was able to utter a word. "They say different things every day. Where is the plane now?" This article does not intend to speculate over that question – there are plenty of others that do that. Rather, there are some actual unintended developments surrounding the missing Boeing. The search has brought together 26 countries, which

have been forced to share some security information, manage adverse interests under chaotic coordination in a region full of geopolitical tensions. Regardless of when or even if the fate of MH 370 is revealed, the region will emerge a little different – perhaps better or perhaps worse.

China and its neighbors compete economically with and among each other as well as strategically over sovereignty of the South China Sea. In the midst of the regional tensions, the United States have made the Asia-Pacific a “pivot” of their geostrategic policy. The search for MH 370 has been especially arduous, particularly in the crucial early days, because of the contradictory information resulting from the various states’ reluctance to share information and observations. In the first 24 hours, the search focused on an area between Malaysia and Vietnam. The next day, without explanation, Malaysia announced that the flight might have changed course after about an hour’s flight towards the west, re-directing the search toward Central Asia and the area south of the Indian Ocean. Malaysia revealed that its military radar had identified the aircraft while explaining that no action had been taken because it did not seem “hostile”. Five days later, Thailand has also implicitly recognized a failure in radar recognition on March 8, excusing it by claiming that “the aircraft was not in Thai airspace and was not a threat to Thailand”.

The tensions in the region have kept countries quiet about their capabilities. It seems they are reluctant to disclose the limits of their technology and military capacity. This has made coordination and disclosure difficult. It has also prompted a ‘pot calling the kettle black’ accusation from China. Indeed, the ever cryptic China has slammed Malaysia for its lack of transparency after the disappearance of flight MH370. Beijing’s indignation contrasts heavily with its well documented tendency to obfuscate disasters on its own territory. For instance, after the 2008 earthquake in Sichuan,

where the collapse of schools had caused the death of thousands of children, activists were asked about the poor quality of school buildings. Those curious citizens were either beaten or arrested. China is definitely one of those countries where curiosity will hurt if not kill the cat.

This small matter has not deterred Chinese Premier Li Keqiang from curtly demanding that his Malaysian counterpart provide information with "punctuality, accuracy and completeness" over MH 370. Chinese state media have even accused Malaysia (a far more democratic and transparent country than the People's Republic) for their lack of transparency. Yet China has hardly been transparent, entirely excluding even the chance that MH 370 entered its airspace. How could they be so sure?

Beijing's silence results from the same sensitive geopolitical character that has delayed important details about radar and other detections from being revealed by all the other countries involved in the search. The search operation by military vessels in the South China Sea have been much like a massive military exercise, revealing the strengths, but even more the vulnerabilities, of those same countries' defense systems.

National self interest has prevailed over the search for MH 370. Malaysia has underlined the importance of outside help in scouring two land and sea corridors equivalent in size to the entire land mass of Australia. Yet, Indonesia was late in granting surveillance clearance to aircraft from Australia, Japan, the United Arab Emirates and Malaysia to overfly its territory, blaming the delay on 'awaiting' instructions from Kuala Lumpur and 'protocol'.

MH 370 has uncovered the lack of cooperation and mistrust that exists in the South China Sea region. Many of the countries involved are not used to such close cooperation as required, given the need to share sensitive radar data. One positive development has come from Japan. Even though, there are no

Japanese citizens aboard MH370 and despite the tensions with China over the Senkaku/Diayou Islands, Japan was not even asked to join the rescue/search operation. But it has. Japan, the one major NATO power in the region also has the most advanced technology and trained personnel in the entire Asia-Pacific region. Japan's collaboration may well help to resolve the deadlock in Sino-Japanese relations, or at least bring the two countries to discuss the Islands dispute, which will have evident economic and business repercussions, not the least of which will concern the rare earths market.

Both China and Japan have increased military spending and military naval exercises; the MH 370 incident may be the catalyst for a respite and possible diplomatic overture. Nevertheless, the heavy presence of Chinese ships in the South China Sea, in an area over which it claims sovereignty at the expense of Malaysia may cause tensions to rise in South East Asia, where many countries have grown more concerned about China's rising power status and ambition. China is Malaysia's largest trading partner. Perhaps, Malaysia will be seeking more opportunities with its equally concerned neighbors. Or, logic will win the day, as the various countries in the region will start to trust each other more in a greater climate of trust. Either way, MH 370 will have much deeper consequences and effects than the fate of its passengers.