

US-Chinese tensions build rising interest in rare earths

Black Friday is one of the features of the US shopping year when budding purchasers camp outside their local Walmart with a view to getting first dibs on some ultracheap piece of electrical goods. These events frequently devolve into violence and even death when sharp elbows become sharp objects and bystanders fall prey to the uncivilized. In recent days the rising tensions in the South China Sea prompted by a Chinese “land-grab” (though more of a land-build & grab) have nearly bought the US and China to blows.

As the chart below shows the Chinese have a very inflated view of what they actually own in the South China Sea.



Indeed it is like China has cordoned off the entry to Walmart at a great distance from the building and told other shoppers that they should not dare cross the line. It's all (supposed oil reserves and fishing rights being the “all”) for China and nothing for anyone else. The US, as friend/protector to the other countries around the South China Sea, has waded into

this fray to calm persecuted shoppers and restore order before the doors open. And the Chinese aren't having a bar of it.

There is very little that we can see that is "diplomatic" about the Chinese actions in recent weeks as regards the Spratly Islands. In some ways this is even worse than the fishing boat war around Japan's Senkaku Islands (some uninhabited rocky islets in the East China Sea) several years back that sent more than a frisson through REE markets when the Chinese banned exports of Rare Earths to their neighbor.

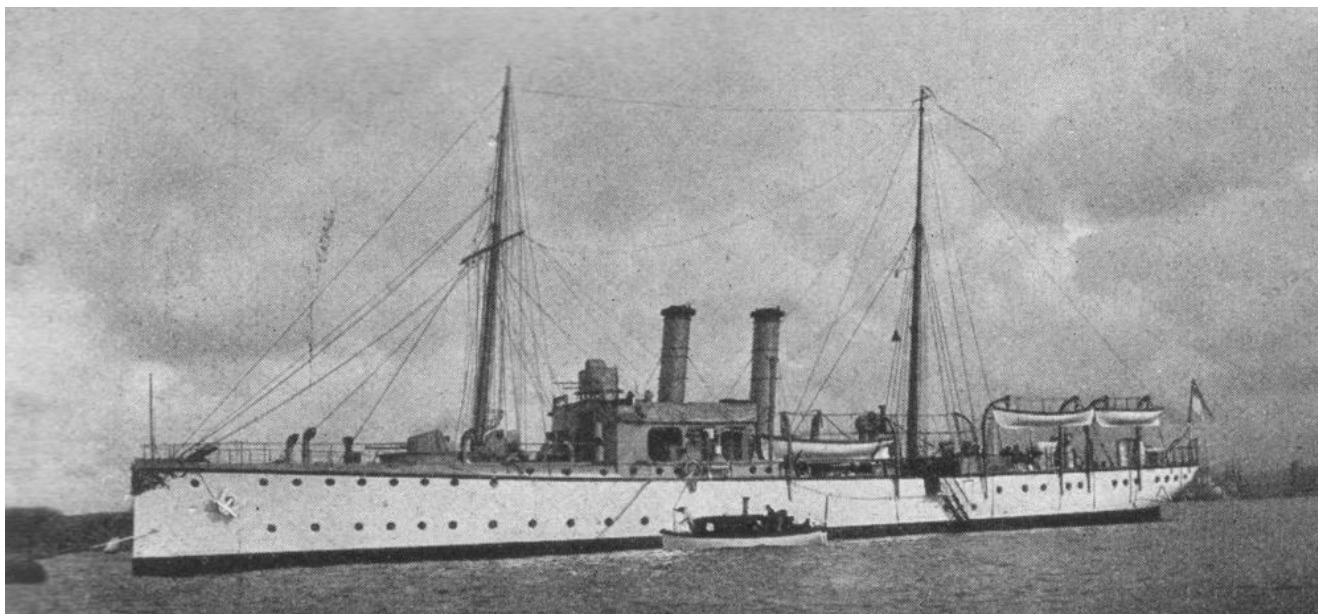
Heavy-handed might be a better word for Chinese actions. That there is no chemical relation, or otherwise, between a fishing boat and those elusive objects of desire known as Rare Earths almost goes without saying.. or at least there was not until the Chinese decided to change the game plan in its struggle with Japan over the Senkaku Islands. At the risk of sounding apocalyptic the current tussle in air-space rather than in the water has the potential to escalate and all the theorizing that pundits like ourselves have done about the West's China-dependency in specialty metals may finally be put to the test.

Agadir Parallels

While the Agadir Crisis was not the first use of gunboat diplomacy (that had originally surfaced in the 19th century largely as colonial muscle-flexing in Asia), the incident in question was one of the most portentous and essentially presaged the First World War (hence its *de rigeur* presence in all books on the theme).

The Agadir Crisis, also called the Second Moroccan Crisis, was the international tension sparked by the deployment of the German gunboat Panther (pictured below), to the Moroccan port of Agadir on July 1, 1911. This ship was sent to make a German presence felt at the time that the French were suppressing an uprising against their "client" the local Sultan. In a spiral of events the Spanish seized two ports and the British then

threw its support behind France despite having not wanted the French to send troops to help the Sultan in the first place. The British feared the Germans seizing Agadir and making it an enclave port. Such is the potted version. It was a dry run for the haggling in the weeks that preceded the First World War three years later.



For desisting the Germans were given Cameroon as a colony. So a gunboat on hand can be a useful thing! However Germany's goal was really to scare France into turning to Germany, the main result was to increase British fear and hostility and to draw Britain closer to France. British backing for France during the crisis reinforced the Entente between the two countries (and with Russia as well) and added to Anglo-German estrangement, deepening the divisions that would culminate in World War I.

Some think that it was this incident that led Winston Churchill, then Britain's Home Secretary (and shortly after made First Lord of the Admiralty), to the conclusion that the Royal Navy must convert its power source from coal to oil in order to preserve its supremacy. Commodity replacement as a strategy... sound familiar?

The Senkaku Event

The previous peak in tensions was in 2011 when a Chinese fishing boat “going about its business” was harassed by Japanese patrol boats. Some sort of altercation ensued and it “rammed” the Japanese ships and the Chinese captain ended up being arrested. The Chinese government demanded his freedom. When they didn’t get it the rhetoric was stepped up and then the Japanese claimed that REE shipments to Japan had been unofficially frozen, something which China denied, but which many traders corroborated. Much to the surprise of many, the Japanese did not tough it out (though in retrospect they probably wished they had) and instead, with rather unseemly swiftness, let the fisherman go. We had thought that they could have used intermediaries and transshipping to get REE from China through other means if they had decided to hang tough, but clearly they rushed to save their REE supply before thinking of saving face.

The Chinese, still not satisfied, demanded apologies and other reparations while the Japanese said they wanted China to pay for damage to their vessels by the fishing boat. The issue was allowed to fade away because the “hostage” was no longer in the middle but the real hostage was patently clear to the economic community. In various key metals the Chinese have the rest of the world over a barrel. Without stockpiles or alternative sources (or even recycling processes) the West is at the mercy of China’s mood swings and grandiose machinations.

The Spratlys

Obviously in the latest case we don’t have colonies or quasi-colonies (like Cameroon and Morocco) in contention but we do have oil (as the reefs and rocks create a zone of influence to claim suspected undersea oil reserves). All the countries around the South China Sea claim the Spratly (and Paracel) Islands to varying degrees. As the map shows the Spratly’s are much closer to the Philippines than they are to China. Never let distance stand in the way of a land-grab though. All of

these claims were rather theoretical until recently but the Chinese decision to turn what was a shipping hazard into a military base by importing sand, rocks and cement and building some sort of a runway has made a technical claim into a reality under the old saw that "possession is nine-tenths of the law". The Chinese have not only become squatters on this remote outpost but have also claimed the airspace and quite literally told the US Air Force to "buzz off".

The Senkaku dispute got very close to becoming a shooting war and this was only narrowly avoided, the Spratlys may be the one to do it. If we dust off the history books, Agadir was merely a sideshow with the eventually trigger for WW1 being the assassination of Archduke Ferdinand of Austria in Sarajevo, three years later.

Conclusion

The old saying that those who do not remember history are destined to repeat it comes to mind. The Senkaku Islands events had the Chinese rankled at the Japanese and conjuring up the bogeyman of Japan's actions in the 1930s and 1940s. Ironically one lesson from that time was that the Japanese push across the region was made in the name of the Greater East Asian Co-prosperity Sphere, which many in Asia now see being revived with the Chinese having purloined the notion and doing its best to make its own version.

A few rocks in the ocean don't seem much, but provocations don't need to come in large sizes (or of Archducal status). The Nazi's invaded Poland on the pretext of a staged raid by "Polish" troops on a German radio station in August 1939. Thus rocks and reefs can have their nationalist uses.

The West seemingly has not learnt the lessons of the fishing boat incident and things are escalating up the food chain with the US now involved in the sharp elbowing over the Spratlys. This is potentially a whole different order of magnitude. The

West now has Lynas and Molycorp in production, which were not back then. The position of Heavy Rare Earths supply though is scarcely better while there has been nothing done to improve the non-Chinese production profile of a swathe of non-sexy, yet still important, technology metals which China has in its vice-like grip. At least a sound stop-gap would have been to build stockpiles, even if one wasn't going to foster producers. But no.. paying lip service won out again over action.

They say that truth is the first casualty in war.. well this time around it may be shorter in the Rare Earth space.