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The Right Way to Deal With China? Open Up Channels for Domestic Rare Earths Production

by tberezowsky on October 5, 2011

COMMENTARY

A [recent editorial](#) in the New York Times on China and currency manipulation caught our eye, and based on the topic and the news headlines surrounding it, it certainly caught Beijing's eye as well.

The Right Way to Go About It?

The US Senate is currently debating the Currency Exchange Rate Oversight Reform bill, a blatant rebuke to China's policy of yuan under-appreciation. According to a separate [article](#), Chinese Foreign Ministry spokesman Ma Zhaoxu told Xinhua news agency that the bill "seriously violates rules of the World Trade Organization and obstructs China-U.S. trade ties." Zhaoxu also urged lawmakers to "rationally understand Sino-U.S. trade cooperation, which is mutually beneficial in nature, and stop pressuring China through domestic lawmaking."

The renminbi has only appreciated 3 percent against the dollar since the beginning of the year. Although one dollar buys about 6.4 RMB today compared with 6.8 RMB in June 2010, economists estimate that the RMB is still undervalued by about 25 percent relative to the dollar, according to the Times.

The bill calls for:

- The Treasury Department to "identify countries whose currencies were grossly misaligned", i.e. China
- Washington to stop spending federal dollars on Chinese goods, and consider the renminbi's undervaluation in antidumping cases against Chinese imports, if China is deemed a currency manipulator
- The Treasury Department to ask the Federal Reserve to consider acting in currency markets to counteract the undervaluation of China's currency.
- Increased pressure on the Commerce Department to impose tariffs on undervalued Chinese products.

Although all of these moves are (arguably) well intentioned, it all comes down to form vs. function, or the ends vs. the means, or (insert your favorite cliché here). In other words, we can't say we disagree that official action on a high level must be taken. However, this method might be the wrong way to go about it. We can't simply solve this problem with passing a bill. Especially since the bill seems to have the (perhaps harmful) one-sided focus on creating/saving more US jobs. James Dorn of the Cato Institute [writes](#) that “there is little evidence that a stronger yuan would reduce the US trade deficit with China or improve the jobs picture” and that “Washington should welcome Chinese direct investment that does not affect national security...Engagement, not destructive protectionism (under the guise of saving American jobs), is the only path to peaceful development.”

The Times takes the tack that the US should use other diplomatic channels first to apply pressure, such as working through the WTO and reaching out to the EU among others. As the editorial concludes, “Beijing is not immune to pressure. But the Senate bill is too blunt an instrument.” We would agree. (So too, apparently, does [House Speaker John Boehner](#).)

However, we would disagree with the Times' point that Chinese retaliation to US congressional maneuvering is imminent. The threat of retaliatory tariffs or VAT rebate changes could almost be seen as a non-issue. China depends on the US too much, and its investment in our debt remains a large sticking point. Political posturing and hot air are more likely.

Critical Minerals Add-On

In another twist perhaps more pertinent to our readers, Senators Lisa Murkowski of Alaska and Dean Heller of Nevada [tacked on an amendment](#) to the Currency Exchange Rate Oversight Reform bill that calls out the need for domestic production of rare earth elements (REEs), termed as “critical minerals.” The definition includes the seventeen rare earth elements, yttrium, scandium, cobalt, lithium, thorium and helium.

Murkowski proposed a similar bill back in May, called the Critical Minerals Policy Act. At the time, no action was taken to pass it, but now the amendment is more critical than ever in light of China's existing rare-earths export restrictions and the impending political tussle over its currency manipulation.

Upon reading the current amendment, we noticed that it's essentially a reworking of the May act. Its purpose is to reestablish “domestic, critical mineral designation, assessment, production, manufacturing, recycling, analysis, forecasting, workforce, education research and international capabilities in the United States.” A little over \$53 million has been appropriated for the plan.

Overall, Murkowski and Heller envision establishing an official process to assess and designate minerals as critical in terms of potential supply restrictions and importance to energy, defense and health-care applications; creating an inter-agency working group to

facilitate greater exploration and development of domestic critical minerals; and instituting critical minerals research and development programs at the Department of Energy on recycling technology and possible alternative materials, according to [their original proposal](#).

The government would work with producers, processors, trade associations and others to coordinate this effort. Coupled with news that Molycorp announced discoveries of heavy rare earths, now could be a watershed moment to begin subverting China's restrictions.

–Taras Berezowsky

If your firm buys tin, tungsten, tantalum or gold, you may wish to attend [our first Conflict Minerals webinar led by Lawrence Heim of The Elm Consulting Group](#).