Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

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# Rare earths in a political theatre



Economic security is top of mind for governments around the world. But it is mostly the largest economies, especially the European Union and the United States, that are implementing concrete measures aimed at bolstering it, whether by forcing their economic partners to alter their behavior or finding alternatives.

For smaller economies, the only real option for reducing vulnerability to bullying and coercion is diversification.

In 2020, when Australia called for an international inquiry into the origins of COVID-19, China punished it with import restrictions. Australia has since diversified its export markets.

Today, Canada is facing the wrath of the US, its largest trading partner, after refusing to bow to President Donald Trump's trade demands.

While Canada is feeling the pain, it is working doggedly to shift its exports to alternative markets.

But when it comes to certain goods—in particular, rare-earth minerals—even the world's largest economies are finding that their options are limited.

Rare earths are critical inputs in a number of high-tech products, including some of the most advanced weapons (like America's F-35 fighter jet), as well as in the permanent magnets used in electric vehicles and wind turbines.

But global supplies of rare earths, and the permanent magnets that are made from them, are highly concentrated, with China enjoying overwhelming dominance.

In the EU and the US, where policymakers have made securing access to these goods a high economic and security priority, anxiety over Chinese dominance was compounded early last year, when China introduced an export-licensing regime for these products.

While China imposed neither a formal quota nor a general embargo, export shipments declined sharply while applications were processed.

The impact was immediately felt by European and US automakers, which maintained very low inventories—a reflection of the just-in-time supply-chain strategy that globalization had made possible.

To be sure, exports soon resumed, and Chinese rare-earth exports ultimately increased in 2025, compared to the previous year.

## Political theatre

Today, China continues to supply Western customers with these vital inputs. But the very existence of the export-licensing regime is a signal to American and European policymakers that China could interrupt supplies at any time.

This is, to a significant extent, political theater. In the rare-earths "option game," China has escalation dominance: it could inflict a high cost on Western economies by cutting supplies of rare earths.

But it has little incentive to exercise this option, because an embargo is a one-shot weapon with limited effects.

When China sharply curtailed rare-earth exports through general quotas in 2010, prices surged.

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But users quickly found ways to minimize the impact, such as by redesigning products and processes to reduce their rare-earth needs and finding alternative supplies. Prices

eventually returned to normal.

Today, the EU and the US are already investing in alternative supplies, and China seems to understand that the escalation option created by the licensing regime remains valuable only as long as it is not exercised fully.

Nonetheless, the specter of a possible Chinese escalation looms large in the West, where the media heighten the drama by breathlessly reporting on any supply disruption or price spike, but giving far less attention to the resumption of supplies or the return of prices to the previous level.

## New mining projects are not profitable

But the EU and the US have been gradually realizing that building alternative rare-earth supplies is a slow and expensive process, because as long as there is no Chinese escalation, new mining projects are not profitable.

In Europe, the quest to develop alternative supplies has so far gone nowhere, though EU leaders like German Chancellor Friedrich Merz are calling for increased investment in such projects.

The US has invested more, but what progress has been made has come at a high cost.

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Stockpiles—which the US has been building, and leaders like Merz are touting in the EU—offer a cheaper option.

For example, since 1983, Japan's rare-metal reserves have enabled the country to weather supply shocks. And while China is trying to prevent rare-earth stockpiling, its ability to do so is limited.

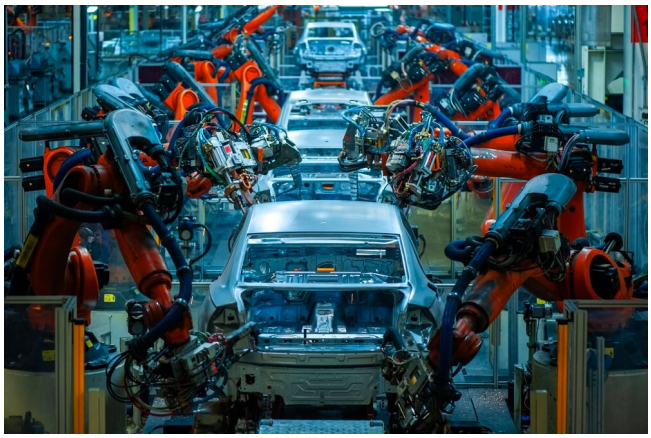
Even if the Chinese customs authorities increase scrutiny of large requests, they cannot monitor what part of the rare-earth demand by hundreds of thousands of Western firms is needed for current production or for inventories.

Moreover, Western official stockpiles could be sourced from available non-Chinese sources.

## How much insurance is worth buying against a temporary disruption?

In any case, both sides will probably continue to prefer conspicuous preparation to actual conflict.

China will probably not impose an embargo, though it will keep the specter of one alive.



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Consistent with this, China extended in November a previous suspension of additional rare-earth export controls for another 2 months.

The West will probably not achieve self-sufficiency, but it will keep seeking to reduce its vulnerability to a supply shock.

The likely result will be an uneasy equilibrium, in which China continues to license most civilian exports while retaining the ability to delay selected shipments.

This will force Western governments to bear the extra costs of maintaining inventories and building up a limited amount of non-Chinese capacity.

The relevant policy question is not whether dependence on China can be eliminated, but how much insurance is worth buying against a temporary disruption—and how to prevent that insurance from becoming an open-ended subsidy for every industry claiming strategic importance.

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