MORNING NOTES Friday July 8, 2011
Michael A. Berry, Ph.D.

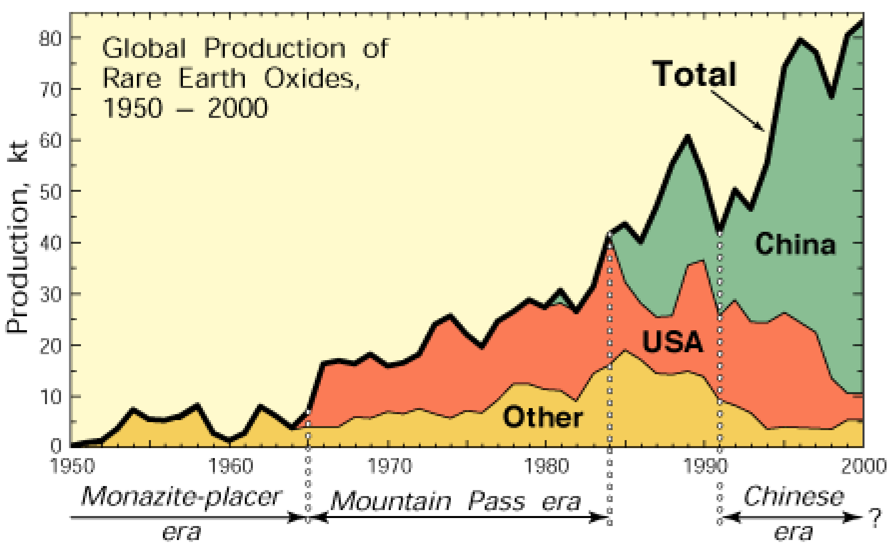
Today's Notes:

1. The Coming Resource Wars

The Coming Resource Wars

The WTO ruled against China this week, regarding China's increasing practice of restricting exports of raw materials. This ruling came as a result of the tight rare earth (REE) supply situation in 2009 and 2010. China's mineral export policies seem to be the only issue, other than $4 per gallon gasoline and the debt ceiling, which has captured the attention of Washington.

Our leaders, both Republicans and Democrats, have looked the other way for years as assets such as Mountain Pass (now owned by Molycorp, formerly the world's major supplier of REEs till closed in 2002) were mothballed or left undeveloped. As a result China gained domination of the extraction and fabrication of these important ("critical") metals.



Last year the E.U., U.S. and Mexico complained that China had unfairly imposed export duties and quotas on 9 metals as well as rare earths. This week the WTO judicial panel ruled China's export restrictions were illegal.

The US Senate finally focused on the rare earth issue. Senator Murkowski's (R Alaska) Critical Metals Bill will begin, but only begin, to address this issue domestically. The bi-partisan Murkowski bill identifies thorium, potash, rare earths, lead, natural gas and a number of other materials. There are three bills circulating in Washington that have become known in insider circles as “Bills to Address the Coming Resource Wars.” Daniel McGroarty a former Defense Department official says,

“But the Rare Earths are just one part of the larger picture of near-total U.S. dependency on a range of technology metals - a dependency deepened by the fact that the U.S. is home to known deposits of many of these materials.”[i]

Few Americans (and fewer Congressional reps) realize that today there are no manganese mines, no vanadium mines and no graphite mines in the US and that we import most of our uranium from Russia. We are dependent upon China and other countries for these critical materials. Wake up Washington! There are no mines, in part, because it takes years to jump through all the hoops (legal obstructions) that the well-funded environmentalist lobby has constructed. We are about to pay the price in terms of a bankrupt supply chain strategy and a lower quality of life as the resource wars gain full force. China has also restricted exports of molybdenum, tungsten, antimony with more natural resource restrictions to follow.

Even the journalists at the FT this AM missed the crux of the issue. The U.S. government, under pressure from this Administration’s Departments of the Interior, Energy, EPA, numerous environmentalist organizations and, in many cases, industries who covet the “cheap” materials from China, has looked the other way as strategic materials processing facilities have gone offshore. Over a period of decades our critical supply chains have also gone offshore and the supporting IP has become obsolete. TDK, a Japanese company headquartered in Oklahoma that produces rare earth magnets, is a prime example.

Domestic supply chain development is now crucial to the United States and the West. It is not only jobs that emanate from a vigorous supply chain incubator, it is also ongoing Intellectual property and a supporting and revised educational platform. This all sounds easy. But of course it is not easy. It will take awareness, time, tender loving care and focus by our leaders to nurture a new national supply chain incubator. This is what happens when leaders ignore natural resource policy and its relationship to industrial policy for so many decades.

Regarding the rare earth issue which we believe is the lightning rod and tip of the iceberg coming extractive resource war, Karel de Gucht, Europe’s trade commissioner, said the WTO verdict would help to create a more level playing field for raw materials.

"I expect that China will now bring its export regime in line with international rules. Furthermore, in the light of this result China should ensure free and fair access to rare earth supplies."

Does anyone really believe that China will ignore its new industrial advantages and needs because the WTO rules so? Of course not. China will appeal this WTO decision and draw out the process. The Resource Wars are now officially joined and they are joined on more than supply issues.

Ron Kirk, US trade representative, complained on Tuesday:

"China's policies provide substantial competitive advantages for downstream Chinese industries."

The export restrictions ***"have also caused massive distortions and harmful disruptions in supply chains throughout the global marketplace."***

Beijing's restrictions meant their prices on world markets were 100% or more of those paid by China's domestic manufacturers, according to EU officials.

It is not only the U.S. that has concerns about this growing class of critical metals. Out of more than 40 metals that were analyzed by EU experts, the 14 commodities they consider critical for the region's industry are: antimony, beryllium, cobalt, fluorspar, gallium, germanium, graphite, indium, magnesium, niobium, the platinum group metals, rare earths, tantalum and tungsten.

Today even zinc and copper are taking on special roles in terms of demand and pricing. In Indonesia workers at Freeport's mines are striking. This will not have an immediate effect on copper prices but if long lived it will be significant. Similar unrest affects Chilean copper resources and Peru's newly elected Leftist government cannot bode well for ongoing cheap production of metals. Just ask the management of Bear Creek Mining.

Bloomberg reports this AM that African countries are raising the cost of mining in that continent by assessing significant excise taxes. China's Minmetals and Brazil's Vale are bidding along with Western companies for access to Africa's commodity riches. Therefore commodity prices are likely to go higher and the Discovery premium will also increase.

Indeed the global Resource Wars are just beginning to heat up. Canadian Nobel Laureate Dr. Michael Spence has written an article in Foreign Affairs ***(Globalization and Unemployment)*** and a book ***(The Next Convergence: The Future of Economic Growth***

in a Multispeed World) in which he outlines the coming convergence of lifestyles in the rest of the world. This will heighten the need for discovery and the level of competition in the Resource Wars. Both writings are required reading if you want to understand the extent of the coming resource wars.

Dr. Spence claims,

"More and more developing countries have been experiencing sustained growth rates of 7-10 percent; 13 countries, including China, have grown by more than 7 percent per year for 25 years or more. Although this was unclear at the outset, the world now finds itself just past the midpoint in a century-long process in which income levels in developing countries have been converging toward those in developed countries. Now, the emerging economies' impact on the global economy and the advanced economies is rising rapidly."

We emphasize his words, ***"Just past the midpoint!"***

Dr. Spence strongly advocates that this commodity supercycle and the changing relationships (the convergence) have more decades to last. This is clearly now the time to become a Discovery Investor and to embrace a suitable allocation for discovery in your portfolio.

[i] http://www.realclearworld.com/articles/2011/05/03/bellwether_bills_in_the_resource_wars_99504.html