China said it is ready to defend its limits on rare-earth exports, warning the U.S., the European Union and Japan that escalating a trade dispute over those limits risks a backlash.

The comments came as Washington, the European Commission and Tokyo challenged China's export restrictions on raw materials, including rare-earth minerals, before the World Trade Organization.

Rare-earth minerals are a critical ingredient in high-tech manufacturing used in products from iPhones to hybrid cars to missiles. China, which produces more than 95% of the world's rare-earth minerals, imposes export quotas and other measures that limit supplies, contributing to a price surge in recent years.

In Washington, President Barack Obama announced the U.S. trade action saying the U.S. will not allow other countries to "skirting the rules." The U.S., he said, can compete as long as the playing field is level. Mr. Obama said China is "preventing that from happening and they go against the very rules that China agreed to follow."

"If China would simply let the market work on its own, we'd have no objections," Mr. Obama said. "But their policies currently are preventing that from happening, and they go against the very rules that China agreed to follow."

EU and Japanese officials echoed the sentiment. EU Trade Commissioner Karel De Gucht said in a statement, "China's restrictions on rare earths and other products violate international trade rules and must be removed."

In a commentary on Tuesday directed at the U.S., China's state-run Xinhua news agency said trade action could "trigger a backlash from China instead of settling the rift." Arguing that the WTO permits countries to take steps to protect resources and the environment,
Xinhua said the move "may hurt economic relations between the world's largest and second-largest economies."

"Past experiences have shown that policy makers in Washington should treat such issues with more prudence, because maintaining sound China-U.S. trade relations is in the fundamental interests of both sides," it said.

Senior officials sounded less strident tones. China Minister of Industry and Information Technology Miao Wei told Xinhua on Tuesday, before news that the complaint was formally filed, that Chinese officials "are actively preparing to defend ourselves and will explain the case if they bring the complaint against us."

At the same time, the trade action also comes as cracks show in China's hold on the production and the processing of the metals. Prices have been easing for months, though they remain historically high.

China has sought to tighten control over its rare-earth industry in recent years, citing environmental concerns and a desire to make the industry more sustainable. Export controls had been part of that effort. In July 2010, the country's Commerce Ministry shocked the rare-earth industry with a 40% reduction in the amounts that could be exported.

Solid rare-earth pricing data is hard to come by because the minerals are mined in small quantities and sales are generally private. Australian rare-earths miner Lynas Corp. estimates that lanthanum oxide, which is used for applications such as polishing glass, shot up to more than $110 per kilogram in the second half of 2011 from an average of $4.88 in 2009. The U.S. Defense Department estimates that rare-earth prices surged between four and 49 times compared with their values in current dollars in 2001.

But prices have come down in recent months as a number of companies look for ways to reduce or eliminate use of rare earths, while international efforts to find new supplies have gathered steam.

In 2009, the U.S. and European Union launched a case against China at the WTO related to other industrial raw materials, such as magnesium and zinc, maintaining that China limited exports in order to boost prices and help domestic producers. The WTO ruled against China in that case in January, leading lawmakers and trade officials around the world to press for a similar action related to the 17 rare-earth metals.

The latest U.S. move, part of an effort by the Obama administration to show American corporations and union workers that it is confronting the world's largest exporter this election year, follows years of unsuccessful efforts to press China directly on the issue.

Mr. Obama faces mounting pressure from GOP presidential candidates, and members of his own party, to get tougher on what some see as a Chinese violation of international trade rules. Even as Mr. Obama made his announcement Tuesday, some lawmakers were already pressing him to go even further.

"This is a worthwhile step, but more must be done to stop China's hoarding of rare earth minerals," said Sen. Charles Schumer (D., N.Y.) "There are faster ways to assert leverage on China than relying on the WTO, which could take years to resolve the case."

Mr. Schumer has called on the U.S. to use its leverage at the World Bank to block financing for Chinese mining projects and for the administration to halt Chinese-funded mining projects inside the U.S. "These two steps would get China's attention right away and force them to reconsider their unfair practices," he said.

The international move against China marks an escalation that could signal other multilateral steps ahead against the country, said Eswar Prasad, a Cornell University professor of trade policy.
"Beijing is likely to be preparing a fierce counterpunch, especially since China is in the midst of its own leadership transition and can ill afford to be seen as caving in to international pressure," Mr. Prasad said. "This elevates the risk of a serious escalation of global trade tensions."

China in December said its quotas for this year will likely be the same as last year, in part because last year's quota wasn't fully used. Major consumers of rare earths, such as Toyota Motor Corp. and Renault SA, have said they are reducing use of parts that have rare-earth elements in their cars.

China also unveiled new export rules that would give it greater control of its industry. It said its quota system for this year would exclude companies that met environmental standards, while it set up a pending-approval list for those that don't. It also split its quotas into light and medium-to-heavy categories. In the past, quotas didn't differentiate, leading to imbalances in production that favored more valuable minerals.

Meanwhile, production elsewhere is ramping up. Gareth Hatch, an analyst at research firm Technology Metals Research, counts more than 419 rare-earth projects in 36 countries.

Lynas last month received a temporary, conditional license to operate a rare-earth refinery in eastern Malaysia, though it faces continued opposition from environmental groups. Lynas, which hopes to process minerals it mines in Western Australia, says the project could account for up to one-sixth of global rare-earth production. On Tuesday its Sydney-traded shares rose 3.9% to 1.22 Australian dollars.

Molycorp Inc. of the U.S. continues to increase production at a California mine that was once the world's largest, which it estimates has more than 20 million tons of ore.

The importance of rare earths to China is reflected in a saying attributed to the late Chinese leader Deng Xiaoping in 1992: "There is oil in the Middle East, there is rare earth in China." In an effort to take a greater role in the market, it boosted annual output more than fourfold between 1995 and 2010 to 130,000 metric tons, according to the U.S. Geological Survey.

Meanwhile, amid rising costs and environmental concerns elsewhere, output of rare earths outside China slumped from 42,000 metric tons in 1995, or nearly 60% of global production, to virtually nothing.

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