An EU-US Critical Raw Materials Deal: Drivers & Dynamics

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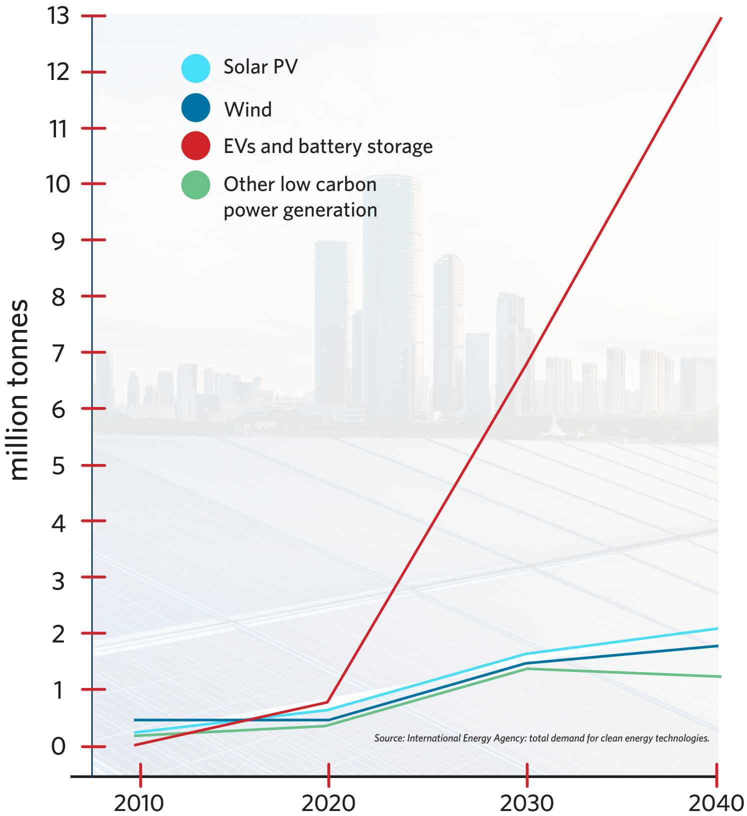
The EU and the US are negotiating an agreement on critical raw materials. The political push came during a meeting between European Commission President von der Leyen and US President Biden in March, and both sides hope to announce a deal at the next EU-US Trade and Technology meeting on 30-31 May. The stakes are high, not only for the importance that critical raw materials have for the success of the EU and US green and digital transitions, but also because the negotiations are closely linked with wider transatlantic trade dynamics.

Why the negotiations?

Critical raw materials demand is soaring globally. An example: the EU's lithium demand is projected to increase 57-fold by 2050, according to European Commission estimates. Production of raw materials is concentrated in a few countries, with China holding the lion's share of the global processing value chains. Raw material supply is subject to significant geopolitical challenges, given increasingly tense relations between the West and China, an unpredictable situation in the Taiwan Strait, and uncertain prospects for trade agreements between consuming and producing countries.

In this context, free trade agreements can bring significant strategic benefits by reducing barriers to trade, stimulating economies of scale and better pricing, as well as improving resilience against external shocks and soaring demand, ultimately resulting in more stable and reliable value chains.

Projected critical mineral demand by low carbon technology



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What is driving the EU?

The EU has made it a political priority to reduce its strategic dependency on third countries, and has set a target of 2030 to ensure that no single third country is relied on for more than 70% of strategic raw material imports.

To achieve this, the EU has proposed a Critical Raw Materials Club, a global alliance of like-minded CRM users and producers.

Building the club will require bilateral alliances. The recent EU-Chile Free Trade Agreement and the ongoing negotiations on a Memorandum of Understanding with Argentina can be read from that perspective. An agreement with the US would certainly represent a decisive step forward, establishing structured cooperation, and reducing competition, with another major CRM user. Another key element driving the EU towards an agreement with the US is the as yet unresolved spat over the US Inflation Reduction Act. The EU would like the deal to allow CRM sourced or refined in the EU to be considered as domestic products in the US, therefore qualifying for IRA subsidies.

Last but not least, we must consider the power politics ahead of next year's European Parliament elections. Many in the European Commission, including president Ursula von der Leyen, are looking for notable wins to enhance their prospects ahead of the appointment of the new Commission in 2024, as well as heads of the European Council and Parliament.

A deal with the US would be easily sellable as a political win as it would achieve multiple objectives at once: the EU no longer losing out from the IRA, the EU reducing its dependency towards China, and, perhaps most impressively, bringing the US to the table for a "trade deal" after so many years of frozen trade relations.

What is driving the US?

The U.S. approach on critical minerals has focused in large part on providing domestic incentives and subsidies, including $7 billion in grants and loans through the Bipartisan Infrastructure Law to strengthen the U.S. battery supply chain, which includes producing and recycling critical minerals.

The IRA provides tax credits up to $7,500 for clean vehicles made with domestically sourced or processed critical minerals and batteries assembled in North America.

Congress has appropriated an additional $750 million for the Defense Department to provide to U.S. or Canadian mining and processing of critical minerals under the Defense Production Act (DPA). The programs are a major part of the Biden administration's climate agenda, which has promised millions of good-paying, middle class, union jobs for Americans.

Bolstering supply chain resilience through cooperation with like-minded trading partners in one of the key elements of the Biden administration's trade policy agenda. President Biden signed Executive Order 14017 (America's Supply Chains) in 2021, directing a whole-of-government approach to assess vulnerabilities in, and strengthen the resilience of, critical U.S. supply chains. The resulting report determined that while the United States must reduce its dependence on China and other geopolitical competitors for key products, a "friend-shoring" approach that both strengthens U.S. resilience and ensures the resilience of allied and partner supply chains would be recommended.

In responding to trading partners' concerns about the discriminatory aspects of the IRA legislation, the Biden administration has shied away from the pursuit of comprehensive free trade agreements that would require Congressional approval. In lieu of a more ambitious trade liberalising agenda, USTR has pursued a "worker-centred' trade policy that emphasises labour and environmental standards, as well as equity and inclusion goals.

USTR has therefore proposed a limited negotiation on critical minerals to prevent a formal trade dispute with the EU but not fundamentally disrupt the law's goals of "de-risking" supply chains away from China.

What could the deal include?

The recent US-Japan agreement on critical raw materials may well provide the benchmark for an EU-US deal.

On that basis, the main elements of an agreement might include:

- A prohibition for both sides against putting in place bilateral export restrictions, or import duties, on critical materials.
- Transparency requirements when it comes to traceability, responsible sourcing, environmental regulations and labour laws in supply chains.
- Cooperation on international standards.
- Information sharing mechanisms and coordination on foreign investment screening, addressing non-market practices from third parties (read China) as well as supply chain disruptions.
- Potentially making EU companies eligible for IRA tax incentives related to component ma-

What to expect

EU Commission Executive Vice-President Valdis Dombrovskis and U.S. Trade Representative Katherine Tai are meeting on a monthly basis and hope to conclude a critical minerals arrangement "as fast as possible", potentially presenting an agreement at the upcoming TTC ministerial meeting in Sweden at the end of May.

The political desire for a deal is there from both sides. The EU probably has more to gain, given it is more vulnerable economically and politically. The main question mark is over what legal form the deal will take. A "proper" trade deal would in fact create political uncertainty both in Brussels and Washington, as it would require the approval of EU Member States and the European Parliament on one side, and of Congress on the other.

That's why the EU and US officials are understood to be working on some creative options, including "semi-binding" provisions and a limited scope, which would not need to undergo the approval and ratification process for traditional trade deals. Whether they will succeed in striking the right balance - delivering a deal with meaningful content while avoiding the many possible political pitfalls - remains to be seen.

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