RSIS COMMENTARY

6 February 2026

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www.rsis.edu.sg No. 022 – 6 February 2026

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SYNOPSIS

China's 6 January 2026 "dual-use items" export controls to Japan institutionalise its rare-earth leverage within a security-framed legal regime. This framework operates through licensing and compliance procedures, which can create sudden shocks and lasting uncertainty. As Japan cannot quickly replace key rare-earth processing and downstream manufacturing steps, de-risking is likely to accelerate through third-country nodes. Southeast Asia is therefore pivotal to the next phase of supply chain reconfiguration.

COMMENTARY

On 6 January 2026, China announced export controls to Japan under a "dual-use items" framework. The measures focused on prohibiting exports for military purposes and for end uses related to enhancing military capabilities. While the language has a military focus, the specific product scope and enforcement boundaries are not fully clear.

As a result, markets are less worried about an immediate cutoff and more concerned about long-term uncertainty arising from licensing requirements, compliance reviews, and administrative discretion. Even firms producing for civilian markets may experience delayed orders.

Japan has criticised China's move as unilateral. Still, it has also stressed that existing strategic stockpiles can cushion short-term disruption, signalling that the near-term impact may be manageable even if the longer-term risks must be addressed.

Rare earth elements (REEs) and related materials can serve as geoeconomic tools because they are deeply embedded in modern industrial systems and defence production. Advanced chips, precision electronics, electric vehicle drive motors and some military systems rely on a set of REEs as material inputs.

When supply chains face institutional friction, the impact rarely stays confined to a single product. It spreads across the supply chain and can become a systemic risk for manufacturing. Japan still imports approximately 60-70 per cent of its rare earths from China. In particular, Japan's dependence is most acute for heavy rare earths, which it sources almost entirely from China.

From Grey-Zone Interruption to Institutionalised Compliance Friction

Japan is not facing a rare earth-related disruption from China for the first time. In 2010, as the sovereignty dispute over the Diaoyu/Senkaku Islands escalated, China–Japan relations deteriorated markedly, and rare earth exports to Japan declined sharply.

Unlike the language of 2026, which centres on security logic, the 2010 episode served as a deniable administrative choke point. Officials denied the existence of an "embargo" yet changes in export procedures and controls led to a sharp decline in shipments to Japan.

Although the episode was brief, it delivered a strong lesson in Japan on building supply chain resilience. In the years that followed, Japan utilised state capacity to diversify sourcing, expand strategic stockpiles, develop recycling and substitution, and spread risk through overseas investment and long-term procurement arrangements, thereby reducing excessive dependence on any single supplier.

Considering the lessons from 2010, the key to understanding the 2026 episode is not simply whether restrictions have reappeared, but how the mode of restriction and resulting form of risk has changed. The 2010 episode operated more like a short-lived, grey-zone suspension that caused immediate pressure and a supply shock, yet it was difficult to sustain within a formal institutional narrative.

By contrast, the 2026 episode looks more like an effort to place key materials within a security-framed, institutional toolbox. Even if the measures are framed as military-focused, they can spill into civilian trade through a licensing and compliance regime subject to administrative discretion, creating ongoing compliance friction.

Under this framework, risk first appears as licensing delays and compliance uncertainty. It then reshapes company behaviour, such as raising inventories, paying premiums for non-China sources, revising procurement strategies earlier, and moving key links away from single-point exposure to China.

Why De-risking Spills Over

Over the past decade, Japan has reduced its dependence on REEs from 90 per cent to 60-70 per cent, and its reliance on light rare earths has eased. However,

vulnerabilities remain in the rare-earth value chain, especially for heavy rare-earth inputs and magnet-related production.

The key bottlenecks are not only in the rare-earth mines but also in processing, metalmaking, and magnet manufacturing. These midstream and downstream links are capital- and technology-intensive and subject to strict compliance requirements.

Rebuilding heavy rare-earth chains usually requires sustained investment and policy patience across political cycles, and it is difficult to compete directly with an established supply system on cost. Japan's de-risking strategy is therefore more likely to rely on third-country nodes by extending some processing, manufacturing, and supporting capacity to reliable locations.

This strategy also reflects how export controls shift risk toward persistent compliance uncertainty rather than only temporary interruption. These export controls are shifting from temporary deterrence to tools that are replicable and adjustable. The government can apply them selectively and adjust their timing and strictness, allowing them to operate as continuing bargaining chips in external relations and industrial competition.

As other economies that also depend on China for critical minerals or key materials, this trend has its own deterrent effect. It forces companies and governments to treat compliance uncertainty as a long-term risk factor, rather than as a one-off supply interruption.

Spillovers to Southeast Asia: Two Nodes in Supply Chain Reconfiguration

In this context, Southeast Asia becomes a core region for absorbing supply chain reconfiguration not because it can immediately replace China, but because it offers usable node functions at different links. It can host relocated manufacturing, and upstream volatility can also feed back into the stability of existing systems, shifting the strategic boundaries faced by all sides.

Malaysia

Malaysia's rare-earth industry has an advantage in its ability to absorb real demand for a non-China supply chain. On the one hand, Malaysia aims to raise domestic value added by restricting the direct export of unprocessed rare-earth feedstock, thereby channelling external capital and technology into local processing and manufacturing. On the other hand, expansion around existing processing capacity, along with investment in heavy rare-earth refining, strengthens Malaysia's ability to supply midstream capabilities and heavy rare-earth–related products where countries such as Japan face the most acute gaps.

As rare earths are increasingly discussed in security terms, Malaysia's hub position becomes more contested. It can attract investment and industrial cooperation from traditional partners, while also drawing attempts by Chinese firms to work with local partners and exchange technology, market access, and resource arrangements to sustain influence. Because Malaysia is becoming a key "non-China" node and a

contested hub, Chinese state-owned firms would cooperate and share technology to avoid being excluded from emerging non-China chains, retain commercial presence and influence, and compete with alternative supplier blocs.

Myanmar

In the China rare-earth chain, part of the upstream heavy rare-earth supply has long relied on cross-border extraction and exports from northern Myanmar, where local governance and security conditions give this trade a clear grey-zone character. In this setting, Myanmar functions primarily as an upstream source of volatility. Its impact stems from how disruptions in heavy rare-earth feedstock can propagate through existing processing systems and affect broader markets.

In recent months, as instability has intensified, heavy rare-earth trade to China has declined sharply, underscoring how upstream instability can create systemic effects. When control over mining belts shifts among local armed actors, rare earths can move from ordinary commodity trade to a bargaining chip, creating openings for third-party contact and involvement. Even if third parties cannot quickly build an entire supply chain, their involvement raises transaction costs and uncertainty. At the margin, this increases the security cost of the existing system and reduces the controllability and sustainability of using economic pressure.

Conclusion

The institutionalised restrictions of 2026 shift risk from episodic disruption toward persistent compliance-driven friction. This shift pushes diversification and investment toward third-country nodes and cross-border cooperation, positioning Southeast Asia as a focal point for rare-earth processing projects.

Japan may be joined by the United States, Australia, South Korea and other related countries, while China competes for influence, partnerships, and supply chain positioning, with outcomes shaped by host-country approvals and governance capacity. Whether Southeast Asia converts this window into durable gains will depend on predictable regulatory rules, credible environmental governance capacity, and workable long-term cooperation mechanisms.

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