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What’s All the Fuss About?

U.S. experts weigh in on fears over CNOOC’s now-withdrawn billion-dollar oil bid for Unocal

By MICHAEL RICE

A CNOOC worker hitches a ride to work in a harness

The proposed purchase of California-based Unocal Corp. by China’s third largest oil producer, China National Offshore Oil Corp. (CNOOC), has fueled weeks of debate between American economic analysts and politicians, the likes of which have not been seen since Japanese companies began purchasing American assets in the 1980s. Even with CNOOC’s failure to increase its $18.5 billion bid for Unocal, the ninth largest oil and gas producer in the United States, in the wake of Chevron Corp.’s $17.6 billion counter-offer, the question of whether the CNOOC offer poses a credible threat to U.S. national and economic security remains at the forefront of American dialogue.

Energy economists insist that the owner of Unocal's assets, in today's global oil market, will have little or no impact on the supply of energy in the United States. Neither, they say, will it provide them any significant strategic advantage. Those cautious of the deal warn that it's not simply a matter of energy supply and demand, or the price we pay at the pump, but a matter of positioning for dominance between the world's reigning superpower and what many see as the world's next superpower.

Jerry Taylor, Director of Natural Resource Studies at the Cato Institute in Washington, D.C., spent two and a half hours on July 13 testifying before the House Armed Services Committee on the national security implications of the possible purchase of Unocal by CNOOC. In his testimony, Taylor spoke specifically on the economic basis for a perceived threat to national security and concluded that the fears expressed by critics of the deal were "ill founded."

Taylor argued that the amount of oil Unocal contributes to the United States overall is insignificant, and, moreover, that these assets are sold at a profit to the U.S. oil market. In an interview with *Beijing Review*, Taylor also refuted the argument that China will buy or produce reserves and keep them off the world market. The vast scope and fluidity of the world oil market, Taylor said, precludes any one nation from controlling access to oil. The ease of transporting this oil means that a price increase in one country is immediately reflected in the price of oil across the globe.

"All that would be accomplished would be a general price increase in oil for all consumers including Chinese consumers," Taylor said. "And that would have more of a detrimental effect to the Chinese economy than to the U.S. economy."

Ill-founded or not, the debate over national security has become a rallying point for American politicians, special interest groups and pundits. Describing the hearing as a "bash China" session--an expression that conjures up memories of the term "Japan bashing" used to describe the sentiment of those opposed to investments and takeovers by Japanese companies in the 1980s--Taylor said the issue is being exploited as an opportunity to gain political exposure while voicing anti-Chinese sentiment.

"It brought to the surface fears of China's emerging economic strength," said Taylor. "Opposition to the merger is a manifestation of American fear and loathing toward China."

Unocal headquarters in El Segundo, California

In the American media coverage of the story, any reference to CNOOC is accompanied by the qualification that the company is 70 percent owned by the Chinese Government, and the reminder that China is a "communist state." While in the Chinese press that ideological distinction might seem irrelevant to the matter at hand, in the United States, it carries with it a significantly potent arsenal of political baggage. Irrespective of the evolution of China's economic policies over the past two decades and its emergence as a player in the global business market, the term "communism" remains a political trump card in American politics. For many Americans who continue to use the phrase "Red China" to describe the nation, China's rise to power is a credible threat, and not one to be taken lightly. The mere thought of a Chinese state-run business purchasing American industrial assets has prompted scores of bipartisan lawmakers to advise the U.S. Government to look closely before approving such a deal.

Dr. Usha Haley, Professor of International Business at the University of New Haven's School of Business and author of *The Chinese Tao of Business*, believes the Unocal deal poses a threat to U.S. national security for the simple reason that it gives China direct control of natural resources.

"Any country wants to control its access to natural resources," Haley said. "Countries have gone to war over this."

Haley, who has recently completed a thorough study of Chinese enterprises, said that while

CNOOC tries to present a "façade of good governance," its ties to the government suggest a very different reality.

"CNOOC is perceived in China as one of the most well-run state-run companies," Haley said. "But that's not saying much. We actually don't know who reports to whom in any of these companies. We certainly don't know who controls what. I would say it's almost 100 percent guaranteed that the Chinese Government controls CNOOC."

And while that may seem to be more a matter of concern for Unocal shareholders than for the U.S. Government, it is the strength of that relationship that elevates discussion of the CNOOC deal from one of free trade to one of national security.

For China, Haley said, the real gain to be had from the acquisition is not in the company's North American oil production, but in its natural gas assets. "And most of it is in Asia," Haley said. "It's in Indonesia, Thailand and Bangladesh."

But, John Tobin doesn't see how that should make any difference. Tobin is executive director of the Energy Literacy Project, a non-profit organization aimed at educating the public on the role energy plays in everyday life. He says the market for natural gas tends to be more localized because of the relative difficulty in transporting it, compared with oil.

"You have to have pipelines and refrigeration to move it to long-distance destinations," Tobin said, adding, "The Unocal natural gas resources that are in Asia are not coming to the United States at this point in time, anyhow." China's acquisition of those resources would have no effect on U.S. national security or its access to that energy source, he said.

"From a production or energy perspective, it doesn't make any difference at all who owns the production," Tobin said. "It will always go to its most logical market, whether it's owned by Unocal or Chevron-Texaco or CNOOC." He added, "Energy is a fungible commodity. Once you get a barrel of oil… nobody can tell the difference where it came from."

Tobin interprets the perceived threat to U.S. national security as what he calls "Sino-phobia."

"Where real Sino-phobia comes from is where the Chinese are getting their investment dollars," said Tobin. "When you look at how OPEC itself runs… there's not a heck of a lot of difference. I do not see a great deal of justification for the paranoia."

Haley, on the other hand, views the issue as a classic standoff between economic powers.

"China perceives itself as a world power and it sees itself as offering an alternative civilization," Haley said.

The implication here is that as China matures into an economic power to be reckoned with, it also strengthens its ability to offer that alternative.

"It's not just an economic battle between the United States and China," Haley said. "It's also a battle for civilizational dominance."

But, for Jerry Taylor, the fear of China using Unocal's assets as an "oil weapon" represents "a Victorian view of economics" that assumes resources are things that need to be tied into a nation's economy.

"I think this is a dated way of looking at resources," he said. "Unless they are going to shoot drill bits at us, I don't see it."

Timeline of Takeover Bid for Unocal (2005)

April 4 Chevron Corp., the second largest U.S. oil concern, announces its offer to buy rival

Unocal Corp., the ninth biggest U.S. oil and gas exploration and production company, for about $16.4 billion, comprising 75 percent in stock and 25 percent in cash.

June 22 CNOOC Ltd., China's third largest oil producer, announces an $18.5 billion all-cash bid to acquire Unocal, setting up a possible contest with rival bidder Chevron Corp.

June 26 Forty-one U.S. Democrat and Republican lawmakers write a letter to the U.S. Treasury Department urging the Bush administration to closely scrutinize CNOOC's offer to determine whether the proposed deal could pose a threat to national security. The Treasury secretary oversees the Committee on Foreign Investment in the United States (CFIUS), a 12-member panel that can review mergers that pose potential risks to national security. Under a 1988 law, the president can kill a foreign takeover only if a CFIUS review finds evidence that the international firm may threaten national security.

June 27 CNOOC says in its letter to Congress that it is eager to have the U.S. Government scrutinize the national security implications of the deal.

June 29 The U.S. Government gives final clearance to Chevron's bid for Unocal, leaving China's CNOOC just six weeks to convince Unocal's board that its own bid for the California oil and gas producer is superior.

July 14 The Unocal board meets, but makes no announcement about rival bids from Chevron and CNOOC to take over the company.

July 20 Unocal endorses a sweetened $17 billion offer from Chevron, though it is still lower than CNOOC's bid of $67 per share. Chevron boosted its cash and stock offer by about $2.50 a share to $63 per share--or $17 billion overal--shortly before the Unocal board met late July 19. Two days earlier, Unocal's board had informed Chevron it was inclined to shift its support to

CNOOC.

July 28 U.S. Senate passes an energy bill by a vote of 85-12 after tacking on a series of last-minute amendments, including one aimed at slowing any proposed purchase of a U.S. energy asset by a Chinese company.

August 2 CNOOC announces it has withdrawn its acquisition offer for Unocal.