U.S.-China Relations after CNOOC

BY JAMES A. DORN

When the China hawks in Congress joined forces last summer with protectionists, a strong (and dangerous) coalition formed to effectively end any hopes that CNOOC Ltd., a subsidiary of the state-owned China National Offshore Oil Company, would succeed in its bid to acquire Unocal. Indeed, after Congress amended the energy bill to require a lengthy review of the proposed takeover, China's third-largest oil company withdrew its $18.5 billion offer.

In a congressional hearing last July, Frank Gaffney Jr., president of the Center for Security Policy, told the House Armed Services Committee that the sale of Unocal to CNOOC "would have adverse effects on the economic and national security interests of the United States." He pointed to "the folly of abetting Communist China's effort to acquire *more* of the world's relatively finite energy resources," and warned of "the larger and ominous Chinese strategic plan of which this purchase is emblematic."

Such fears are evident in the flurry of anti-China resolutions and bills introduced by members of Congress. In June a nonbinding House resolution recommending presidential review of the CNOOC-Unocal deal passed by a wide margin. In a letter to President Bush, House Energy and Commerce Committee Chairman Joe Barton of Texas declared, "We urge you to protect American national security by ensuring that vital U.S. energy assets are never sold to the Chinese government."

Even without a legal prohibition on a deal, Congress can intimidate a foreign company such as CNOOC by imposing considerable costs on the takeover process and using the secretive Committee on Foreign Investment in the United States (CFIUS) to breed uncertainty. That is not to say foreign companies should have totally free access to the assets of U.S. companies. In some cases, especially in the area of sensitive technology with military applications, foreign investment might pose a legitimate risk to U.S. security. A government vetting process would then be warranted. In the CNOOC-Unocal case, however, it is difficult to find a credible threat. As energy economist Phillip Verleger said, "There's no national security issue here—zero. Unocal doesn't even have technology that needs to be kept secret."

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There was no need for Congress to get involved in the CNOOC-Unocal transaction, or to amend the energy bill to require a separate investigation. If a legitimate security risk existed, then CFIUS—a multi-agency panel chaired by the secretary of the Treasury and empowered by the Exon-Florio amendment to the Omnibus Trade and Competitiveness Act of 1988—could have addressed that issue and recommended presidential blockage. It is doubtful that the President would have agreed.

According to the June 24 *Wall Street Journal*, only 12 cases have reached the President's desk, and of those only

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one foreign acquisition was denied on national security grounds. With the bulk of Unocal's oil and natural-gas operations in Asia and with its U.S. production accounting for less than 1 percent of American consumption, it is difficult to see how the committee could have found credible evidence that the proposed takeover posed a threat to U.S. security.

Congress's latest attack on private property has come at the expense of Unocal shareholders, who lost at least $1 billion because of CNOOC's decision to drop its bid. In a letter to Unocal's board, Peter Schoenfeld of P. Schoenfeld Asset Management, which controls a block of the oil company's shares, wrote, "It is your duty to maximize value for stockholders." Indeed it is. But Congress inserted itself into what should have been primarily a market transaction—and in so doing became an overseer rather than a protector of shareholder rights. If Beijing wanted to provide cheap credit by using part of its massive foreign exchange reserves to help CNOOC purchase Unocal, that would have been a gift to American shareholders—not a concern for Congress or U.S. energy security.

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By politicizing the takeover market and weakening the private property rights of Unocal's shareholders, Congress violated the very free-market principles it is supposed to uphold. Unocal was treated like a public asset rather than a private firm with the right to conduct its own business. Chevron, which merged with Unocal, is the clear winner, but Congress's confrontational approach could have serious implications for U.S.-China relations in the medium to long run. Specifically, the hawkish and protectionist stance toward China might embolden hardliners in Beijing, with the potential to fuel anti-American sentiment and crude nationalism.

The U.S. Trade Rights Enforcement Act (HR 3283), passed by the House in July, is yet another sign of growing hostility against the People's Republic of China and a prime example of using the PRC as a scapegoat for U.S. domestic problems. Although this Act is unlikely to become law, it is a step backward for U.S.-China relations. In particular, the Act "authorizes the application of the U.S. countervailing duty law to exports from nonmarket economies such as China."

Rep. Tom Tancredo of Colorado has introduced similar legislation (HR 1450) calling for "additional tariffs" on "any nonmarket economy country until the President certifies to the Congress that that country is a market economy." He would then earmark those tariff revenues for the "Social Security trust funds." This is the same congressman who argued that the CNOOC-Unocal deal "may seem small, but a few more deals like this one and America could find itself held hostage not just to the energy brokers in the Middle East but to China as well."

Such anti-China hyperbole poses a serious threat to the policy of engagement and economic liberalization. China's private sector is now a large part of its robust economy and has given millions of people the opportunity to exit the state sector and escape poverty. Eventually, growth of the middle class will increase the demand for political reform to protect fundamental human rights. Indeed, this is already occurring, as seen by the recent amendments to the PRC Constitution that give greater protection to private property rights.

Yet American politicians on both sides of the aisle see China as a major threat to American jobs and view trade as a form of economic warfare, rather than as a mutually beneficial arrangement that increases the wealth of nations. Blocking trade with China will ultimately destroy jobs, not create them. Our future—and China's—will be brighter under what President Hu Jintao calls a policy of "peaceful development" than under a policy of protectionism and misplaced nationalism. As Federal Reserve Chairman Alan Greenspan said in his testimony before the Senate Finance Committee in June,

> In the decades ahead, it is in our interest and that of the global economy that China continue to progress toward becoming a more market-based, productive,

> and dynamic economy in which individual initiative, not government decision making, is the fundamental strength behind economic activity. For our part, it is essential that we not put that outcome, or our future, at risk with a step back into protectionism.

A prime example of "a step back into protectionism" is Congress's threat to impose punitive tariffs on China if Beijing does not revalue the yuan by up to 27.5 percent (the so-called Schumer-Graham bill). Although that legislation has been delayed because of last summer's change in China's exchange-rate regime (from a pegged exchange rate to a managed float), many in Congress still feel that China is engaging in unfair trade practices by undervaluing its currency.

China's Socialist Market Economy

Congress is right to criticize China for its adherence to a "socialist market economy," but the PRC has moved steadily toward a real market system by removing barriers to trade and investment, and freeing most prices. We should recognize those gains while criticizing China's human-rights violations and the lack of a just rule of law. Even with China's shortcomings, however, Congress was not justified in interfering with the CNOOC-Unocal deal. As the Chinese Foreign Ministry said before CNOOC's pullout, "We demand that the U.S. Congress correct its mistaken ways of politicizing economic and trade issues, and stop interfering in the normal commercial exchanges."

Alarm over China's economic and military rise is often justified by reference to China's poor human rights record. The record is indeed poor, but it will not be improved by denying the Chinese people the right to trade, which itself is an important human right. Countries that are left outside the global trading system, such as Cuba and North Korea, have shown no interest in advancing human rights and have perpetuated poverty.

What China needs is less government and more markets. The surest way to achieve that result is to strengthen the policy of engagement, not to threaten China with protectionist measures under the guise of national security. Beijing will view Congress's interference as yet another attempt by the U.S. government to widen its power at the expense of China's development.

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China's thirst for oil and natural gas has driven world demand upward and increased prices, and that trend is likely to continue. Over time, production and consumption will respond to higher prices as producers search for new supplies and consumers conserve and switch to cheaper alternatives. If the U.S. government interferes with the market process, future production will suffer and American energy companies will find it more difficult to operate in foreign countries.

Of course, if CNOOC were a truly private firm, Congress would not have been so concerned. China's challenge is to move more rapidly toward privatization and the rule of law. Future cross-border transactions will then be less costly and more successful, and U.S.-China relations will improve.

At the same time, Washington would be wise to heed the advice of Prime Minister Lee Hsien Loong who, in his July 12 speech to the U.S.-ASEAN Business Council, said that if the United States values its influence in Asia, it must take "a considered, long-term approach, upholding its commitment to free markets, free trade, and international rules." However, "if it yields to short-term political pressures and turns protectionist, the damage to U.S. interests in Asia and its standing worldwide will be long lasting."