China's bid for Unocal heightens tension with the US

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A huge $US18.5 billion takeover bid by China's state-owned National Offshore Oil Corporation (CNOOC) for the US oil conglomerate Unocal has triggered a fierce debate in Washington over whether to block the move, and confronted the White House with a dilemma.

Oil has been central to the Bush administration's strategy since it was installed in office in 2000. The invasions of Afghanistan and Iraq were aimed at securing long-term US control of key resource-rich areas of the globe—the Middle East and Central Asia—and cutting out its European and Asian rivals. Now a Chinese state-owned corporation is seeking to take over the eighth largest oil company in the US, potentially giving Beijing a direct say over Unocal's extensive oil operations in Asia and elsewhere.

At the same time, if it blocks the takeover, Washington faces the possibility of retaliatory economic action by Beijing. After all, CNOOC's bid for Unocal is still small compared to the flood of investment from the US, Europe and Japan into China to exploit the country's cheap labour. The US is also dependent on the continuing inflow of funds, particularly from Asian central banks including China's, to cover its huge trade and budget deficits.

The Bush administration is under mounting pressure to act against CNOOC's bid. In a recent letter, 41 members of the US Congress urged Treasury Secretary John Snow to review the takeover on security grounds. "Energy security is a matter of significant and increasing importance for the US. We are very concerned about China's ongoing and proposed acquisition of energy assets around the world, including those in the US."

On June 28, House Energy and Commerce Committee chairman Joe Barton, a Republican, sent a letter to President Bush in the same vein. "The Chinese are great economic and political rivals, not friendly competitors or allies in democracy," he stated. Barton's language deliberately recalls Bush's anti-China rhetoric during the 2000 election campaign when he declared China to be "a strategic competitor".

Two days later, the US House of Representatives voted overwhelmingly for a non-binding resolution urging the Bush administration to block the CNOOC bid on national security grounds. Republicans and Democrats joined the anti-China bandwagon. In April, the US Senate threatened to impose trade sanctions on China if it failed to revalue its currency against the US dollar.

The response of the Bush administration has to date been relatively muted. An unnamed Bush advisor told the *New York Times* on June 26: "We have so much on the plate with China. How do you come down hard on them for this deal?" James Steinberg, a deputy national security advisor under President Clinton, commented: "It's nothing but a headache for them [the Bush administration]."

Sections of US business have been demanding protectionist measures against China, but many major American corporations have huge investments in China and are concerned about any disruption to economic relations. In response to a wave of congressional and media comments about China's "threat," Snow told CNBC television on June 28: "The national security interest of the United States will always be protected, I can assure you of that."

The US Treasury oversees the Committee on Foreign Investment in the US (CFIUS) that will review the CNOOC bid. In 1999, the body rejected the sale of a $450 million satellite owned by bankrupt telecom company Global Crossing to a Chinese consortium on the grounds of technology transfer and national security. Earlier this year, however, the committee approved the purchase of IBM's personal computer business by Chinese computer company, Lenovo, despite similar concerns being raised.

CNOOC's chief competitor to buy Unocal is the US oil giant Chevron, which has offered $16.45 billion. Chevron is seven times bigger than CNOOC, but the Chinese company is backed by Beijing and its huge reserves of US dollars. At this stage, Unocal has indicated its preference for the Chevron bid but the Chinese company is not about to give up.

CNOOC chief executive Fu Chengyu sent a letter last week to the US Congress trying to placate opposition to the company's bid. He urged the lawmakers not to politicise what he called a purely "commercial" deal. If its takeover succeeds, CNOOC has promised to maintain jobs and the present management in Unocal's US operations and to continue to produce oil for the North American market.

On July 4, CNOOC lodged a formal application with the CFIUS committee to allow its takeover bid. A Chinese foreign ministry statement on the same day urged Congress to keep out of the issue. “We demand that the US Congress correct its mistaken ways of politicising economic and trade issues and stop interfering in the normal commercial exchanges between enterprises of the two countries,” it stated.

Beijing has major economic and strategic interests at stake in the CNOOC bid. Unocal produced 155 million barrels of oil last year and has proven reserves of oil and natural gas amounting to 1,198 million BOE (barrels of oil equivalent). Most of these reserves are in Asia and 62 percent are natural gas. By taking over Unocal, CNOOC would more than double its output and increase its reserve by nearly 80 percent. The CNOOC already has joint operations with Unocal in South China Sea and Bohai Gulf.

Most of Unocal’s Asian assets are in areas geographically close to China, including Burma, Thailand, Indonesia, Bangladesh and Azerbaijan. Unocal has 100 platforms in the Gulf of Thailand, supplying natural gas to meet 30 percent of the Thai power demand. In oil-rich Indonesia, the US oil firm has $5 billion invested. In Bangladesh, Unocal has over $1 billion of energy projects.

Beijing recognises the growing international rivalry for oil and wants to strengthen its hand. As industry has burgeoned in China, so has the demand for oil. Just a decade ago, China was still a net exporter of oil. Now it is the world’s second largest consumer and importer of oil after the US. China’s energy demand is growing at 15 percent annually, while its oil imports are increasing by 30 percent. In total, China now accounts for 12 percent of the world’s energy demand.

China’s state-owned oil companies have in recent years been actively involved around the globe in buying oil and gas fields and establishing energy supplies. CNOOC itself has operations in South Asia, Australia and Canada. The company is the largest offshore oil producer in Indonesia.

In 2004, two Chinese energy companies signed agreements with Iran to import 360 million tonnes of liquefied natural gas (LNG) over 25 years. China’s total oil and gas investment in Iran is estimated to reach $100 billion over the same period. China has also invested tens of billions of dollars in Latin America, particularly in Venezuela—the largest oil producer in Western hemisphere—to facilitate the export of oil and raw materials to China. Until recently, the main oil export market for many of these countries was the US.

Some analysts point out that Chinese companies are investing at “inflated prices” in many of these energy projects. As a result, China may pay double or even treble the present price for oil from these sources. Beijing’s willingness to pay high prices highlights the fact that its main motivation is long-term energy security, which is bound up with strategic concerns.

He Jun, an energy consultant for China’s oil companies, told the *Washington Post* on June 27: “Like other big countries, China naturally wants to share proven oil reserves. But if the West treats China as a threat, it will inevitably have to find its own path to meet its energy needs. A popular saying abroad is that oil is just a commodity that anyone who has money can buy. But this saying is most popular in the countries that already control the supplies.”

Beijing is well aware that the US invasion of Iraq was aimed at monopolising Middle East oil and is taking steps to secure its supplies. *Washington Post* columnist Paul Krugman commented on June 27 that Unocal was “exactly the kind of company the Chinese government might want to control if it envisions a sort of ‘great game’ in which major economic powers scramble for access to far-flung oil and natural gas reserves”.

China established its first strategic oil reserve this year in the coastal Zhejiang province. According to the International Energy Agency, China’s stockpiling of oil could lead to increasing demand and even higher oil prices. Beijing’s ultimate aim is to create a reserve large enough to sustain the Chinese economy and military for three months without any oil imports.

The Chinese leadership is clearly worried that a military conflict with the US, especially over Taiwan, would almost certainly result in a naval blockade. A large element of China’s military modernisation is aimed at protecting the country’s oil supplies. China has expanded its naval forces, particularly submarines, long-range aircraft and anti-ship missiles, and is seeking to secure port facilities in a number of countries along the sea routes to the Middle East.

China and Russia’s first joint military exercise planned for August is likely to take place in the Yellow Sea and to involve naval forces and long-range bombers. Both countries are concerned about the US military buildup in Central Asia, considered to be their strategic backyard. China is building several pipelines to the Central Asian republics.

Whether or not the CNOOC bid for Unocal succeeds, the issue underscores the sharpening tensions over oil between all the major powers. At a certain point these frictions will spill over into military conflict. It is worth recalling that World War II in the Pacific was provoked by sharp rivalry between the US and Japan over economic interests in China. Washington imposed an oil blockade on Japan in 1941, confronting Tokyo with a blunt choice: complete capitulation or war. Months later, the Japanese military struck Pearl Harbour.