United States Response to CNOOC Bid for Unocal

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Chinese outward foreign direct investment (FDI) has been steadily increasing in recent years. In 2004 China's yearly outward FDI stood at $3.6 billion, a 24% increase from 2003. In 2001 the yearly figure was only $.7 billion. In total, China has spent a total of $37 billion in FDI over the years.[1] Most of this money has historically been invested in Asia. In 2003, 53% of all investments went to Asia, followed by 36% for Latin America, only 2% for North America. However, nearly all of this North American investment was in the US. In fact, at $65 million in 2003, the US was China's 7th largest single country destination for foreign direct investment and largest destination outside of Asia.[2] But these figures should be put into perspective. Chinese investment in the US amounted to only .1% of the total US directed FDI in 2003.[3] By comparison, in the same year the US invested $4.2 billion in China alone, roughly 8% of inward Chinese FDI.[4]

Despite the relatively small amount of Chinese investment in the US, fears of Chinese firms taking over the US have been growing due to several highly publisized cases. In December 2004 the Chinese electronics company Leveno (whose largest shareholder is the Chinese government) bought the personal computer devision of IBM for $1.75 billion. Despite IBM's strong desire to go forward with the sale, Congress became concerned that the merger might give away important technological secrets to the Chinese government and therefore should be blocked out of security concerns. The acquistion went before the Committee on Foreign Investment in the United States (CFIUS). This is the organization in charge of reviewing mergers and acquisitions by foreign countries of US firms. CFIUS ruled that the acquisition of a relatively low-tech personal computer branch did not violate any security laws and therefore allowed it to continue.

In 2005 two new high profile acquisitions came under scrutiny in the media.

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1 Cui Jun, "Overseas Mergers and Acquisitions, an Inevitable Trend, *China Economic Net*, May 30 2005, <http://en.ce.cn/Insight/200505/30/t20050530_3933383.shtml>
2 *2003 Report on Chinese Outward FDI*, Commerce Ministry, China, 2004. (in Chinese)
3 Thomas W. Anderson, "Foreign Direct Investment in the United States," *US Bureau of Economic Analysis*, Jun 2004, <http://www.bea.gov/bea/ARTICLES/2004/06June/0604FDIUS.pdf>
4 Foreign Investment in China, *US China Business Council*, Dec 4 2004, <http://www.uschina.org/statistics/2004foreigninvestment.html>

Haier, China's largest appliance company, tried to acquire the US appliance company Maytag with an offer of $1.28 billion. This bid was later challenged by rival US firm Whirlpool's offer of $1.36 billion. Haier withdrew from the competition because it could not compete with this higher bid.

The case for Unocal, an American oil company, has been a different story. Unocal is the 9th largest oil company in the US and controls significant natural gas reserves in Southeast Asia. CNOOC Ltd., a Chinese oil company, has made an unsolicited offer to buy the company for $18.5 billion, by far the largest amount of money ever put down by Chinese firm for a US investment. Before CNOOC made the bid, Unocal was in talks with Chevron, who recently raised its own bid $17.7 billion in retaliation to Cnooc's offer.

Outside of the bidding war, cries against the Cnooc acquisition are being heard both in Congress and the media. These groups believe that the acquisition poses a serious security risk for the US. In early July, the House of Representative passed a non-binding resolution demanding that the Bush administration investigate the acquition thoroughly before it is allowed. In a congressional hearing, former Clinton CIA Chief Woolsey spoke out against the purchase. A mid-July Wall Street Journal poll found that 73% of the public was opposed to the Chinese acquisition. Congress became suspicious of the "secretive" CFIUS, which rarely blocks foreign takeovers. Led by California Representative Richard Pompo, in late July a bill was passed that required the Bush administration to investigate CNOOC. It also required that there be a 120-day review of Chinese energy needs before the acquition is allowed to go through. These measures are now required on top of the standard review by the CFIUS. Such huge delays may force CNOCC to withdrawal its offer. At the very least, it will probably have to raise its bid in order to compensate Unocal investors for the time delay and the risk associated with the possibility of the US government shooting down the acquisition.

The Chinese company did not expect such a backlash. Much of Chinese investment goes into energy projects. A full 50% of investments in 2004 were in the mining industry. However, it is thought that Chinese companies usually acquire US and other western companies for their brand names and also for their managing experience.[5] The Chinese acquirers often leave the former companies structure in place, as was the case with Lenevo acquiring IBM. In order to alleviate fears, the company has even agreed to sell off Unocal controlled oil assets in the US.

Many American free-market thinkers have also criticized the anti-acquisition

[5] Cui Jun, "Overseas…"

campaign. They believe that CNOOC has the right to acquire the company so long as Unocal's owners are in agreement. Below is a list of the arguments on both sides of the debate.

Anti-Acquisition Faction:

People in this group come from Congress, certain US defense-related organizations and think tanks such as the Heritage Society, and the majority of the American public.

1. Security Consideration 1: Both the US and China depend vitally on carbon based energy such as oil and natural gas. The Chinese have rapidly been acquiring or making contracts with oil companies all over the world in order to secure their supply. The purchase of Unocal is just one more step in this process that is leading to Chinese domination of the oil industry. If China controls Unocal, it has the potential to cut off American supply during an oil crisis or a war. This would damage the US strategic position.
2. Security Consideration 2: Unocal owns the US rare-earth mine MolyCorp. This mine produces the mineral lanthanide used in magnets for high-tech military equipment. Chinese companies own the remaining supply of these metals. If CNOOC were to acquire Unocal, China would have a monopoly on this material. China would have free reign to block the sales to the US in the future.
3. Fairness Considerations: The CNOOC purchase of Unocal is unfair and anti-market because CNOOC is backed by the Chinese government, which could potentially provide it with unlimited resources. Chinese National Offshore Oil Company, a Chinese state owned enterprise, owns 70% of CNOOC It is providing CNOOC with $2.5 billion in zero-interest loans, plus another $4.5 billion in loans at 3.5%, which are below market rates.[6] This state owned company is essentially the Chinese government, and therefore it will always be able to provide more money to CNOOC in order to beat out bids by rival Chevron.

Pro-Acquisition Faction:

This group includes an unlikely combination of thinkers from the libertarian think tank Cato Institute, the Neo-conservative American Enterprise Institute, and the liberal

[6] Kate Linebaugh, "How Favorable Is Oil Bid's Financing?," *Wall Street Journal Online*, Jun 30 2005, <http://online.wsj.com>

Brookings Institute. Editorialists from newspapers such as the Wall Street Journal and the Washington Post have also expressed views in favor of the acquisition. Below are the rebuttals they would give against the aforementioned criticisms.

1. Security Consideration 1: Unocal only controls about .3% of the total US oil consumption. Most of Unocal's product is natural gas that is tied up in long-term contracts with Thailand. Even if China decided to cut off its supply to the US, it would hardly constitute a crisis. The oil market itself is a very broad market with many players and multiple sources. Oil embargos would be ineffective at preventing the flow of oil to the US because that oil could simply be bought from somewhere else. Additionally, because it is a competitive market, the increase in the price of oil in one area means the increase in prices everywhere else. Since China and the US are both oil importers, it would not be to China's advantage to restrict the oil supply, as it would raise the prices it must pay as well.[7]
2. Security Consideration 2: Lanthanide is not particularly a military concern because it can easily be purchased over the Internet from a number of distributers.[8]
3. Fairness Considerations: CNOOC is listed on the New York Stock Exchange. Therefore, it meets the regulatory requirements for being able to compete with other companies in an acquisition bid. Unlike many Chinese government owned companies, the parent company China National Offshore Oil Company itself has significant resources. All of the financing it has given to CNOOC has come directly from its own cash reserves, rather than from the government.[9] But even if the government did have a direct hand in the purchase, Unocal is the property of its shareholders. They have the right to choose whom they sell their company too, whether it is a public or private company. Additionally, one must question the fairness of the US side. Rival Chevron has significantly lobbied Congress to block the acquisition. Congressman Richard Pompo represents the California voting district where Chevron is incorporated. He has received $21,500 in contributions from Chevron since 1989. He received an additional $2,000 from the company just after he introduced the anti-CNOOC legislation mentioned above.[10] Pompo and certain other vocal Congressman certainly have alterior

[7] Jeffrey Taylor, Testimony before Armed Services Committee's National Security Implications of the Possible Merger of the China National Offshore Oil Corporation with Unocal Corporation, US House of Representatives, Jul 13 2005, <http://www.cato.org/testimony/ct-jt071305.html>

[8] Alan Reynolds, "Unocal Shareholder Rights," *Cato Institute*, Jul 20 2005, <http://www.cato.org/pub_display.php?pub_id=3994>

[9] Kate Linebaugh, "How Favorable…"

[10] John M. Biers, "Lawmakers Critical of Cnooc Took Donations From Chevron," *Wallstreet Journal*

motives for blocking the acquisition.

As can be seen, despite the loud anti-acquisition ferrvor in Congress, there is significant voice in the US that is favorable to the deal. The debate really comes down to two sides of classic America thought. One is a protectionist, somewhat isolationist view that believes that "China's Communist government gaining foothold in the U.S. economy."[11] The other is a liberal, free-market, free-trade view that believes in small government and open global markets. According to this liberal view, we should "let managers and shareholders make their own choices, based on sound business judgment, not on fear, jingoism or just bad economics."[12] These two lines of American thinking go back historically a long way. In the East, the long held American policy to have an "open door" in China for US trade and business often met with conflict from a Congress that wanted the US to play less of a role in Asia.

Recently, the liberal free-trade faction has been winning out. Since the fall of the Soviet Union it has promoted its agenda around the world by spreading its market economy theories. In one of its greatest victories, it convinced Congress to allow China to join the WTO. This line of thinking holds that the US will be better off with China as an open member of the global marketplace. Such integration will insure that it is less belligerent in the future and that it will emerge as a partner, rather than a military competitor, to the US. Protectionist policies that restrict what companies China can buy only damages this process, because it shows that the US is not willing to play by its own rules. These thinkers believe that universal fairness is a key to global stability.

Whether the liberal faction will continue to hold the upper hand remains to be seen. Protectionist thinkers claim that the US has suffered from globalization since China joined the WTO through the loss of thousands of manufacturing jobs and outsourcing. Recent concerns that the US may be losing its status as the only superpower only fuel fears and make protectionist action more likely. The Unocal acquisition case seems to be an important litmus test for the future climate of United States politics.

Online, Jul 22 2005, <online.wsj.com>

[11] Gal Luft, Testimony before the US-China Economic and Security Review Commission's Hearing on China's Future Energy Development and Acquisition Strategies, Jul 21, 2005, <http://www.uscc.gov/hearings/2005hearings/written_testimonies/05_07_21_22wrts/luft_gal_wrts.htm>

[12] James K. Glassman, "China Oil Deal: Pols Stay Away!," *American Enterprise Institute for Public Policy Research*, Jul 12, 2005, <http://www.aei.org/publications/pubID.22829,filter.all/pub_detail.asp>