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America's Response to Energy Demand of China and Sino-US Relationship in the 21st Century: A Case Study of Failed Merger and Acquisition between the China National Offshore Oil Corporation and the Union Oil Company of California

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Abstract: On June 23, 2005, CNOOC announced to bid for America's seventh Oil Corporation, Unocal, for 18.5 billion dollars. The news shocked both Washington and America's general public. Although CNOOC made all kinds of concessions to clear Washington's concerns, the bid was withdrawn due to political reasons. Failure to win the bid raised a series of economic, political, financial and diplomatic issues between China and America. Even though the failed case is just an occasional occurrence, it negatively affected the relationship between China and the U.S. In the new century, both China and the United States should work together to enhance their mutual trust and avoid misjudgment.

Keywords: Alumni donation behavior; Higher education foundation; Financing management; Analytic hierarchy

1. Introduction

According to estimate of the United States Department of Energy, China's oil consumption is 5.6 million barrels per day, which exceeded Japan for the first time in 2003. At this rate, China became the second largest oil consumer, just after the United States. Though China consumed 8.5 percent of global production, it only held 1.3 percent of proven world oil reserve. It is also forecasted by the International Energy Agency that China will consume 14 million barrels per day by 2025. Confronting the challenge, energy security plays a more important role in China's foreign policy. Inevitably, China's oil strategy and ambition of global energy searching activities would arouse anxiety and doubt of western countries, especially the United States.

On June 23, 2005, the China National Oil Corporation (CNOOC) announced to bid for America's seventh oil corporation, Union Oil Company of California (Unocal), for $18.5 billion. The news shocked both Washington and America's general public. Although CNOOC made all kinds of concessions to clear Washington's concerns, the bid was withdrawn due to political reasons. Failure to win the bid raised a series of economic, political, financial and diplomatic issues between China and America.

This paper sought to analyze America's response to China's energy demand, and how it influences the Sino-U.S. relationship in the 21st century. The first section of the paper will elaborate on Washington's response on CNOOC and Unocal deal. Different stakeholders, Congress, the White House, the Committee on Foreign Investment in the United States, American general public and American Corporations, displayed different attitudes. The second section will illustrate America's China policy in the wake of Unocal and implications for the Sino-U.S. relationship in the 21th Century. The Theory of Power Transition and Lateral Pressure Theory will be used to analyze the Sino-U.S. relationship in the context of rising of China.

Finally, the paper will argue that although National Security Review Mechanism of inward foreign direct investment was necessary for protecting national security of host countries, the mechanism should not be used as an excuse for political intervention on normal market dealings. Washington's reaction on CNOOC and Unocal deal signified the transformation of America's domestic economic policies and new attitudes toward China.

2. Politicization of CNOOC's Unocal Bid

The CNOOC bid "simply is not a market-based transaction" because "China is not a market economy".

The Chinese government would not allow an American company to take over such a Chinese company and the CNOOC is the corporate vehicle of a "Communist dictatorship".

We handed China the money they are using to try to buy Unocal, and now we are telling the Chinese, please keep investing in our bonds but you can't invest what amounts to a sliver of their surplus in an oil company.

CNOOC's bid for Unocal will threaten American energy security, national security, and economic independence.

Facing successive waves of opposition, voices supporting the deal faded. On August 8, 2005, CNOOC announced in strong terms:"CNOOC has given active consideration to further improving the terms of its offer and would have done so but for the political environment in America. This political environment has made it very difficult for us to accurately assess our chance of success…. Accordingly, we are reluctantly abandoning our higher offer to the clear disadvantage of Unocal shareholders and employees". The following will explain different attitudes of Washingtonians: proponents and opponents, toward CNOOC and Unocal deal in detail.

2.1. Standpoints of opponents

When the White House was to some extent silent on the deal between CNOOC and Unocal, Congress expressed unprecedented concern on the deal. Congress did not only take actions to paralyze the deal, it also generated public awareness through hearings, statements, and studies to pressure CNOOC. At the same time, the legislative branch wrote letters to request the Secretary of Treasury to conduct thorough review of the deal.

2.1.1. The bid was not a market-based transaction

Criticism that the bid was not a market-based transaction to a large extent was influenced by the argument that China is not a market economy. The reprehension of the deal focused on the fact that mergers and acquisitions (M & A) represented government's strategy. It was not a business activity.

It was argued that CNOOC is "state-owned enterprise directly under the State-owned Assets Supervision and Administration Commission of the State Council of China" and CNOOC got its financing from non-market approach, because, out of the $18.5 billion bid, a $7 billion loan came from its parent corporation, China National Offshore Oil Company, without interest and $6 billion was from the Industrial and Commercial Bank of China, a state-owned bank. In this regard, some conservatives were concerned that the deal represented Chinese government strategy.

Critics were of the notion that the direct investment models of Chinese Multinational Corporation listed China's "non-economic" actions. Chinese multinational corporations' direct investment modes, favoring mergers and acquisitions, were as a result of the Chinese government's motivation to promote competitive power of its favored companies. By mergers and acquisition, Chinese multinational corporations could acquire technologies, management techniques and know-how. However, the mode had no benefit to American economy because it could not produce more job opportunities.

2.1.2. The deal threatened American national interest, especially energy security

The biggest concern of the deal for Washington was that CNOOC's takeover of Unocal would threaten America's national security, especially its energy security because Unocal was regarded as a strategic asset to the U. S. Domestically, it had both deep water drilling and deep well drilling operations in the Gulf of Mexico; it also had platforms in Alaska's Cook Inlet, and interest in North Slope fields. Internationally, the company operated platforms in Thailand, Indonesia, Bangladesh, Myanmar, the Netherlands, Azerbaijan, Congo, and Brazil. Moreover, the company could produce 577 million cubic feet of natural gas and 69,700 barrels per day of petroleum in 2004.

According to Congress's logic in its HR 344 (June 30, 2005), oil and natural resources are strategic assets to American security and economic independence. Second, China is still "strongly committed to national one-party rule by the Communist Party" and the government owns 70 percent stock of CNOOC. Thirdly, CNOOC's acquisition activity was financed and subsidized by state-owned banks. Fourth, if CNOOC acquired Unocal, CNOOC would ship all oil and natural gas exclusively into China. This would raise oil price in the world market and influence oil demand and economic independence of the United States. Fifth, the acquisition could allow CNOOC to acquire Unocal dual-use technologies. Therefore,

"the Chinese state-owned China National Offshore Oil Corporation, through control of Unocal Corporation obtained by the proposed acquisition, merger, or takeover of Unocal Corporation, could take action that would threaten or impair the national security of the United State".

In fact, China's world demand for oil had raised American concerns for many years. And critics labeled Chinese oil-motivated actions as "Mercantilism." Implying "Beijing, in emulation of the European colonial powers, is directing its National Oil Companies to acquire oil assets abroad to exclusively supply China".

Due to uncertainty of future energy demands, and its remarkable role for domestic economy, both politicians and legislators in Washington expressed their concern for the world energy market. Moreover, because larger percent of Unocal's interest was in East Asia, some critics were of the concern that, if CNOOC acquired Unocal, then China could exert more influence on East Asia and could threaten both Taiwan and Japan's national security because those two countries imported large amounts of oil from Indonesia.

2.1.3. China blocked American corporations to acquire same kind of Chinese corporations

As to the remarkable strategic value of oil companies, Congressmen posited: whether the Chinese government would approve this kind of deal for American companies. In the process of CNOOC's bid, Senator Charles Schumer detailed many kinds of obstacles of foreign corporations to acquire Chinese corporations. According to Chinese laws and regulations, foreign corporations could invest in many kinds of permitted areas. However, when the target company was a state-owned corporation, the M&A should be approved by the board of the target company, and the same kind of approval should be passed by shareholders. The state is the biggest shareholder of energy companies and supervisor of state-owned corporations, and therefore must accent to all transactions on behalf of the state.

In the past several years, although shares of Chinese oil companies were bought by foreign corporations, such as BP and Shell, they were just minority shareholders without seats on boards. In order to meet increasing energy needs, the Chinese government encouraged foreign investment by establishing cooperative joint ventures. However, it is difficult to get an approval for foreign corporations to merge with Chinese energy companies.

2.1.4. The takeover of Unocal by a Chinese company would affect the world's human rights, labor conditions, and democracy

A marginal criticism was that China's oil exploitation in developing countries, such as Sudan and Burma, promoted human rights violations in these areas. This situation did not only tense the Sino-U.S. relationship, but also conflicted with international effort to address human rights. In this regard, if Unocal was taken over by CNOOC, human rights, labor conditions and democracy in those countries where Unocal's interests were located would be in danger. In addition, Washington related China's human rights records to foreign direct investment from China. Thus, denying trading with China could pressure China to improve its human rights situation.

2.2. Attitudes of proponents

Compared with opponents, proponents had different opinions on the CNOOC and Unocal deal. But as to whether the failure between the CNOOC and Unocal deal could constitute new protectionism. Scholars did not want to enrage Washington too much. They predicted that the contemporary ownership protectionism was just an occasional occurrence. Although the struggle between protectionism and liberalism would continue, open market was still the sustainable force in the long term.

2.2.1. Washington was on the way to "economic protectionism" by labeling the deal "non-economic transaction"

Blocking a business activity by political pressure, Washington's action aroused a puzzle—who is a "non-market economy" country, China or the United States? Thus, it implied the United States was becoming "protectionist capitalists" while China was on the way to "capitalist communism".

A former member of the White House Commission, James A. Dorn, criticized Washington for sacrificing free-trade principles for special interest groups. CNOOC's competitor, Chevron, profited a lot from CNOOC's failed bid. Chevron was located in the constituency of Richard W. Pombo, chairman of the House Committee on Resource. It was she who was responsible for amending the Energy Independence and Security Act of 2007. Based on the new act, the takeover between CNOOC and Unocal would take 141 days and this almost made CNOOC's bid impossible.

Although Congress denied CNOOC's bid and persuaded Unocal to accept Chevron's lower bid, the administrative interference sacrificed interest of shareholders of Unocal, who lost at least one billion dollars because of CNOOC'S withdrawal. In a letter written by shareholder Peter Schoenfeld to Unocal's board, he stated "It is your duty to maximize value for stockholders". However, in the process, Congress treated shareholders' interest as public good. Going one step further, even the Chinese government subsidized CNOOC's bid with its foreign exchange reserves, it was a gift for Unocal's shareholder. The Chief Executive Officer of Exxon Mobile Corp, who has a large investment in China, criticized Congress's action as a "big mistake." "You have to have free trade, if you start to put inefficiencies in the system, all of us eventually pay for that".

2.2.2. Protecting national security or playing a political trick

Although Congress relied on national security to oppose the deal between CNOOC and Unocal, the national security risk was so insignificant that the pretext was absurd. In economic sense, denying the transaction on the excuse of national security risk was just a political trick. Energy economist Phillip Verleger said, "there is no national security issue here—zero. Unocal doesn't even have technology that needs to be kept secret".

In fact, Washington exaggerated the risk of the deal between CNOOC and Unocal. As to Unocal, most of its oil and natural-gas was operated in Asia, and its production constituted less than one percent of American consumption. It was difficult to conclude that acquiring Unocal would threaten American energy security. As to Unocal's technology, CNOOC could obtain it from the free market. Moreover, blocking the acquisition could entice CNOOC to go somewhere else to explore oil and natural gas. China could not curtail oil production because oil production decrease would also threaten China's economy. Even in the situation that China reduced its oil production, the impact on American economy would be insignificant because America could get their oil from the international market. Although there was a concern that it was China's strategy to acquire global energy and monopolize energy production, China's energy corporations were too weak in strength to challenge Organization of the Petroleum Exporting Countries (OPEC)'s position and implement Chinese government's strategy. Moreover, in order to remove Washington's concern, CNOOC agreed to continue "selling and marketing all or substantially all of the oil and gas produced from Unocal's U.S. properties in U.S. markets" and retain "all jobs of substantially all of Unocal's employees" if the deal was successful.

Washington's concern was derived from economic nationalism. According to the definition of Kim (2007), economic nationalism grew out of compounding fears. First, foreign ownership generated anxiety due to unfamiliarity. For instance, if the investment came from developed countries such as Japan, Singapore and Britain which had entered the American economy for a long time, they would experience less resistance than emerging countries, such as China, India and Brazil. Second, xenophobia due to racism added to the hostility toward investment from emerging countries. Again, if the investment was from leading countries, such as Canada, Germany and France, then response from America's general public would be different. Thirdly, countries always hold different or conflicting attitudes toward inward and outward direct investment. If foreign corporations were acquired by expansion of domestic companies, then the sense of pride would be generated. On the contrary, if domestic companies were merged by foreign corporations, self contemptuousness followed.

2.2.3. The privatization of Chinese corporations should be processed step by step

It is true that the Chinese government is still a shareholder, even majority shareholder of energy companies, in some corporations. However, the situation cannot be resolved within a short time. In other words, a large number of state-owned companies could not be dismantled overnight. In the privatization process, non-state capital, even foreign funds were accepted into the Chinese economy. This made China the leading emerging economy in developing countries.

Blocking a joint-stock company to acquire America's seventh oil corporation in the form of political intervention is a conflict within the spirit of capitalism and rules of international trade.

2.2.4. Denying trade right is also a violation of human right

Denying CNOOC's bid could not relieve human rights violations in those countries where CNOOC has invested. On the contrary, China's energy corporations would search for energy from other places once the deal was declined in the U.S. Moreover, trading rights are also important human rights, and denying China's trading rights infringed on China's human rights. It is obvious that those countries left outside the global trading system, such as North Korea and Cuba, had no motivation to improve their human rights condition. If America wanted to improve some countries' human rights situation, an open market would be indispensable to them.

3. America's China Policy and Sino-US Relationship after the Deal

Generally speaking, America does not prohibit foreign direct investment in its energy sector. For instance, as stated earlier, BP, the biggest energy investor in the U.S. owns significant interest in Alaska's North Slope production. Royal Dutch Petroleum, a Dutch firm, also has some interest in the U.S. However, CNOOC's investment gave rise to unprecedented panic in America. At the end, the deal was denied by the joint force between Washington's China hawks and protectionists. CNOOC's Chairman, Chenyu Fu, commented on the failed case that, "shock … was not just because of the size of the deal, but because such a volume came from a Chinese company. Nobody thought a Chinese company could do this at that time." China's Ministry of Foreign Affairs strongly criticized Washington's action on CNOOC. It said, "the U.S congress should correct its mistaken ways of politicizing economic and trade issues and stop interfering in the normal commercial exchanges between enterprises of two countries".

In his section, theories of Power Transition and Lateral Pressure will be introduced to analyze America's China Policy and Sino-US Relationship in the future. According to Kagan (2005), the Power Transition model was designed to deal with and forecast the relationship between the rising power and the existing dominant power. In his opinion, the best bilateral relationship management in the modern era was Britain's appeasement of the United States in the late nineteenth century, and concluded that "the smooth process of this power transition was largely due to the fact that both powers share common liberal democratic ideology and thus roughly consonant ideas of international order." Even though it is a little early to define China as a big power capable enough to challenge the U.S, the lateral pressure theory could provide some information about the relationship between China and U.S. According to Choucri and North (1975), lateral pressure theory states that "when a country is forced to look beyond its own borders for new supplies, it will likely run into conflict with existing consumers of that resource." As China rises economically, its addiction for oil increases as well. The addiction coincides with the increasing American desire for imported oil. The zero-sum situation implies that economic conflict would be inevitable when new and existing consumers compete with limited resources.

3.1. America's China policy: engagement versus

America's China policy is one part of the U.S. Global Strategic Priorities. During the period of the Cold War, fighting against communism, based on George Kennan's containment policy, was on Washington's top agenda. After the collapse of the Soviet Union, Washington's top priority became identifying potential rivals challenging America's position as a global superpower. Once, Japan was recognized by both Washington and the general public as the biggest challenge. At the declining of Japan's economy and rising of China, America's concern shifted to China.

When Chinese multinational corporations entered the American market with cheap commodities, Washington appealed to impose sanctions against Chinese companies. And this became Washington's customary tactic. For example, the U.S. Trade Rights Enforcement Act (H.R. 3283) was introduced by the House on July 27, 2005. Although the act was almost impossible to make law, it mentioned specifically the application of the U.S. countervailing duty law to exports from non-market economies such as China. The second example was the Action on the Schumer-Graham bill (S.295) on February 3, 2005. The bill threatened to impose 27.5% punitive tariffs on Chinese exports to the U.S. if Chinese government does not revalue its currency. The bill was temporary laid aside because China reformed its exchange rate regime. However, it led to a big backward lash for U.S- China relations.

Although CNOOC's bid in this case was only $18.5 billion, Washington's interference in the formal market transaction sets a dangerous signal that an anti-China trend was on the rise. At the rising of China and the implementation of China's energy global supplying strategy, an imperative question arose, where should China fit in the global energy market, harass Washington? After President Nixon first declared his "energy independence" goal in 1973, America imported one third of its oil from the global market. In current times, the percentage rose to 60 percent. It is inevitable that the number would go up again. As mentioned before, China consumed 8.2 percent of the global energy production and the percentage will climb in the near future. Some analysts were concerned that energy importation was a "zero-sum game," and that China's diversified sources of energy supply would aggravate American potential energy shortfalls.

It is a little excessive pessimism toward America's short-sighted strategy today. However, if Washington continued to leave decision making to hawks and China bashers, reluctant to interpret China's energy strategy and foreign policies rationally, America's free market will be in danger. Singapore's Prime Minister Lee Hsien Loong, in the U.S.-Asian Business Council, criticized Washington's discriminative treatment toward the CNOOC. He said,

"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. If it yields to short term political pressures and turns to protectionist, the damage to U.S. interests in Asia and its standing worldview will be long lasting".

3.2. Sino-US relationship in the 21st Century: partner vs. rival

Different from Clinton's policy toward China, in which China was regarded as a constructive strategic partner, George W. Bush, in his 2000 presidential campaign, made it clear that "China was not a constructive strategic partner, but rather a competitor and rival". The role of China as not a partner but a rival almost became America's consensus. the Pentagon labeled China as "'credible threat' in East Asia and beyond" in its 2005 Annual Report to Congress on the Military Power of the People's Republic of China. Preeg (2005), a prestigious international economic and foreign policy specialist and a senior fellow in trade and productivity for Manufacturers and Alliance, concluded that China is on the way to becoming a technology super state and the fundamental rival.

Although it is inevitable that the rising power would shock the existing international system, which is dominated by the U.S., it is too early to define China as America's rival. Not to mention that China has a lot of domestic issues to solve, such as the increasing gap between rich and poor, conducting reformation of the economic system and curbing environmental pollution. According to China's three-step development strategy, raised by China's second President Xiaoping Deng, China could not reach the standard of moderately developed countries until the midterm of this century. Actually, the Olympic Games and the global financial crisis in 2008 pushed China to a "global power" in advance.

Gries (2006), forecasted a 45 percent chance that US–China relations in 2015 will become rivals, 35 percent chance that the US and China will become partners, and the chance that they become both allies and enemies would be 5 percent and 15 percent respectively. Obvious-

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ly, the rising of China would challenge the American global sphere of influence. However, the influence of China's energy demands on the international oil market could be negligible and China does not have the capability to challenge America's global position. Moreover, there are a lot of common interests for cooperation between China and the United States. Taking energy as an example, presented in a 2007 Naval War College research study, their common interest will include:
"Underwriting additional energy exploration; enhancing energy efficiency; encouraging resource conservation; and reducing the long-term environmental consequences of fossil fuel consumption."

4. Conclusion

Whether the international community accepts it or not, the rising of China is a reality. This follows China's global oil demand to develop its economy and corresponding global sphere of influence. Rise notwithstanding, the initiative to improve the Sino-U.S. relationship depends on both sides. In other words, the future of the bilateral relationship between China and the U.S. depends on how both sides could build trust for each other.

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