ALBERT KEIDEL: Well, thank you, Carolyn Bartholomew. That was a very stimulating presentation and I feel fortunate to have heard it and I’ve learned a great deal from it. My own remarks are from the perspective of an economist who was also in the Treasury department, where I dealt with a combination of economic issues and U.S. national security in the Asian region as a manager of its office of East Asian nations and an advisor to the secretary, undersecretary, and assistant secretaries.

Carolyn just asked who is looking out for U.S. national interests. I would say I am. (Chuckles.) My conclusion from my study of this issue is that CNOOC’s purchase not only would not compromise U.S. national security, but preventing the deal would compromise U.S. national security. My reasoning has to do with the challenge, creating a world legal and commercial environment that can encourage and reassure China to take the path of openness and market-oriented expansion as it grows into an economy and a military presence that is normal for a country of its potential. We can signal to China that it can rely on the rules-based international system for its future security, including its future ability to bid for products and for resources that can produce those products, or we can signal to China that it needs to prepare its own non-market solutions to its energy needs, including expansion of its own sphere of influence based on exclusivity and ultimately, its military’s capacity to secure supplies. Those are our choices.

That second development would resemble a return to 19th-century colonial spheres as the basis for guaranteeing raw materials and that was an era, which, in spite of the opinion of a number of books that have been recently written, was an unhealthy global segmentation and not an era of globalization success that we should want to emulate today. Hence, phrases like the need for U.S. strategic independence as pillars of our national security strategy cannot be our absolute standards if we care about our national security. That kind of absolute standard, strategic independence, would be more harmful than helpful. We need degrees of strategic dependence among major players in the world to create a world safe from the threat of future conflict with China.

I won’t go into the facts of the Unocal case. I want to, however, correct an impression that many have received from the media that the Chinese are playing catch-up, that Chevron researched and produced a deal and the Chinese learned about it and said me too. That is not the case. A number of in-depth media reports have documented how, when word hit the street in Asia late last year that China was interested and had done a great deal of work on purchasing the Asian assets of Unocal, when that news became public, Chevron learned that Unocal was on the market, and there was a phone call between chairmen of the board, talking about the possibility of a friendly takeover. So China has not been playing catch-up, quite the opposite. It is Chevron that has been playing catch-up. And that is all fair, I just want to correct an impression that China is somehow an unfair player. And I’ll come to that issue again in a minute.

But first, I want to do something to point out three different emphases that I’ll have in my remarks today. I don’t want to say the three emphases. It sounds too sanga joo wee (ph) or something like that. It’s not right. But these are important. We need really to emphasize, if we’re concerned about U.S. military security, actual contingencies.
Under what military, security, and national security contingencies would this Unocal deal, if it were to go through, represent any kind of a threat to the United States?

The second, I really encourage us to emphasize the role of price. Now this is a fundamental concept for economists, but it is central to the issue that Unocal presents to us, because we can either think about the exclusive access in which we ignore the role of price when we say we don’t want others to be able to outbid us for something we wish to acquire inexpensively. In that case, we eschew market forces and a global system based on global forces. Or we can embrace price as the measure of competition, as the measure of who purchases what instead of somebody else. Only if we are ready to use non-market methods, which ultimately comes down to military methods, to secure our own energy resources and exclude China from them, can we say that we do not want price to be the arbiter of who owns which resources.

And finally, let me emphasize the combination of who is saying what in this debate. Most major energy companies are vertically integrated, and ownership of affordable sources of your raw material help your profitability. In Chevron’s case, its reserves have been falling. It’s looking for new resources and it’s willing to pay for them. The question is how much? You have therefore groups that are very interested in acquiring certain assets and possibly preventing competitors from bidding on the basis of price. And try to notice when you hear arguments on one side or another – and it certainly doesn’t reflect anybody at this table, but certainly in the media, you will find many quotations – and I would say, in the political sphere, where politicians represent certain districts or certain constituencies. Remember where their bread is buttered, because it helps a lot in sorting out who is saying what.

I now want to say that a number, unfortunately, of developments in recent months have prepared the way for misunderstandings and exaggerations in this issue of CNOOC’s bid for Unocal. They have misleadingly characterized China as an unfair player, as a cheater, and as a country that is a major threat to the United States to be guarded against at all costs. And this is very recent and it’s unfortunate. But I think it also reflects a failure on the part of American politicians and leadership in general to have allowed these misleading impressions of China to poison and discolor our understanding of China’s behavior and of the promise or prospect we have of China emerging and engaging in a world in a competitive way that uses a rules-based system.

First, very quickly, high energy prices. There are claims that China is the cause of high energy prices today, the prices of oil. But if you look at the facts, that is just not the case. I’m not now talking about the fact that U.S., Europe, and Japan’s total consumption and imports, not just consumption but imports of oil, are more than tenfold of what China’s is. I’m talking about in the last couple of years, we have seen an incremental increase in net oil demand in the world’s system. China’s increase in that demand has been one-third of the increase in oil demand from the United States, Europe, and Japan. As the U.S. recovered from its recession in 2002, and as the European and Japanese economies – unlike China – that rely on the U.S. economy recovered, their demand for
oil skyrocketed. China’s increased also, but it was at the pace of one-third of that of the major economic powers in the world.

So this development, along with supply constraints not unrelated to the war in Iraq are really responsible for the spike in oil and energy prices combined with the role of futures and forward markets as supplies tighten. And the risk of their being a cutoff becomes expressed in the marketplace while large investors realize that the price spikes in energy represent perhaps an acceptable medium-term moneymaking opportunity. So we have seen a number of events affecting oil prices. China is not the key factor at all.

Second is the currency. There has been a misleading view that China’s exchange rate is undervalued, that it makes the currency too cheap and therefore Chinese products too cheap. And this feeds the misleading impression that China’s money and CNOOC’s money are ill-gotten gains used to purchase American assets. Those of you that were here three weeks ago or have read the policy brief on this issue that we have just written know that the facts say just the opposite. And I’m sorry to say that one of the major causes of this misleading view is the repetition ad nauseum – I mean, not just now – but of the notion that the bilateral trade relationship between the United States and China is the key to whether China’s currency is undervalued or not. It gives a false impression. We’re not trading with China when we do this. We’re trading with a global supply chain. And the U.S. deficit is a deficit with the global supply chain.

Who is selling to that global supply chain in large amounts? The Chinese? The Chinese surplus is only 8 percent of the U.S. deficit. The Euro Currency Zone, poor Euro currency, it’s been buffeted by Chinese cheap currency so many say, but the Euro Currency Zone countries have a surplus with the global supply chain that is 26 percent of the U.S. deficit. It is the major component of our deficit. The next one is Japan. Japan’s surplus with the global supply chain is 21 percent of our deficit. If you get the rest of non-China, non-Japan Asia, it’s 19 percent. So add those up and you have two-thirds of our deficit coming from those sources. But that doesn’t stop politicians who know that we don’t have troops on Chinese soil. We have them in Germany. We have them in Japan. We don’t have them in China. It’s a fair game. It’s a way to explain for a few constituencies why perhaps you are out a job. And I would say to those politicians, stop it. (Chuckles.) Just stop it. You are poisoning an atmosphere in which China represents and has the potential to join a world on the basis of rule-based systems of which purchases by price is a critical component.

A third misunderstanding or misleading depiction of China has to do with its trade relations. There are descriptions of how its IPR behavior is counter to world’s standards, how its textiles are expanding rapidly. And I would just remind you and remind those that make these claims that China accepted WTO concessions far in excess what any other country, and in particular developing country, has accepted. And when major industrial countries continue to carve out protected segments of their economies, China, for a poor country of about $1,300 per capita, has agreed to a very severe opening of its economy and its financial sector in ways that no other developed economy has agreed to. And by all accounts, U.S. embassy accounts, the Chinese are on track to meet those
commitments. And the fact that there are disagreements, clarifications, that is perfectly understandable. It’s a difficult job. But I don’t think you will find any serious commentator who says that China is abusing its promises in its WTO accession agreement.

And fourth, finally, the unsatisfying and really sad development in recent months has been a very strong spat over the U.S. attitude towards the European arms embargo language. This has resulted in a furious explanation of how China represents a threat to the U.S. We’ve had four conferences on this in recent months, some of them in Europe. And it turns out that the symbolism of this is more important to the United States than any particular weapons system the Europeans might sell. The Europeans have measures to prevent sale of dual-use technologies. But the U.S. has made the position that the symbolism of removing an arms embargo language describing China would somehow compromise our relationship on security terms with China.

The national security issues represented by the Unocal takeover need to be reviewed by CFIUS, the Committee in Foreign Investment in the U.S. It is chaired by the Secretary of the Treasury, the groundwork is done by an office in the Treasury department whose staff I know. They will be very careful about it. The cavitation technologies, the rare earth sources, all of those will be on the table. And CNOOC has said it is willing to abide by those decisions and divest itself of whatever turns out to have national security implications in those dual-use or critical product areas. So I would say, by all means, let’s get CFIUS on this. And they will do a good job.

The broader questions is if you don’t identify a dual-use technology or if you say that, as many do, that energy is of course a strategic sector and therefore this compromises U.S. national security, then you’re in another area. And here we hear lots of phrases like how much of our country are we willing to sell to a Communist country we may be fighting someday? Energy supplies in a tight market are a national security issue. The acquisition raises concerns about U.S. jobs, production, and energy security. The strength of the economy and military prowess of the United States is dependent on economic security tied to oil and gas. The quotes go on and on and on.

I would say that we really need to talk about specific military contingencies. One is Taiwan, and the other is a group of much less likely developments, all of which would only occur if relations between the United States and China deteriorated dramatically. And in each of these cases, my point is, China’s company’s purchase of Unocal will be irrelevant. We have so many instruments as a superior military power in the world, if we’re at war with China, to retake any assets, to block shipments, to stop pipelines that the practical security significance of China owning or controlling these resources is zero.

And I don’t want to list them all but there can be conflicts in the South China Sea, Spratly Islands, conflict on the Korean peninsula, if China objects to our going in there without consulting with it adequately, independence for Tibet, we have developments in Xinjiang, and perhaps we will maintain military bases in central Asia in spite of requests to leave. China may not be happy and has already said it and those countries are not
happy about permanence there. Perhaps Chinese military support for Iran, should the United States decide to take the oil fields in Western Iran, which are very close to Iraq right now, which would be easy to do without having to fight all of Iran. So there are these various, at this point, far-fetched contingencies, and the issue is, would Chinese company’s control of Unocal affect them at all? And my answer is clearly not. We have many other instruments, which would be dominant under those circumstances.

I think the issue of economic security, American jobs, energy production – we’re involved in a great transformation of the global economy. If the U.S. gets behind the 8-ball on this transformation, it will suffer. If we don’t prepare our labor force to be flexible, to be mobile, including education, training, trade adjustment assistance, and I would say, portability in health care, pension, if we don’t do these things, yes, we will be hurt by countries that are eager to work hard, eager to be productive. And so the challenge lies there, not in pointing a finger and blaming this or that false source of our discomfort.

So my final conclusion, of course, then is that we need to engage China in a rules-based global system as the bedrock for our national military security going forward. If we try to create a non-price-based system for securing or guaranteeing energy sources or any other scarce resource, we will be creating a climate that will force China into a similar posture. And that is dangerous in a national military security sense to my child and to her children and her grandchildren, because that’s the timeframe we have to worry about is later in this century. What kind of global community will we have? And I would therefore come back to this false notion that national security independence is the secret to our safety. We need to build a world where we are interdependent and where we take the lead in a degree of that dependency on a world system, because otherwise nobody will follow the notion that they should all be dependent on resources that we control, much less the Chinese.

So under any military contingency, this Unocal deal will not compromise U.S. military security, given the eventualities that are sure to emerge under those emergencies, which is enormous U.S. military superiority. And I would say, Michael is going to speak about this next, but as an economist, so much attention is paid on the size of China’s military budget compared to the size of the U.S. budget, and it’s something in the ratio of ten to one or in that order of magnitude. For an economist, that’s not the right measure. The United States has an accumulated capital stock of military technology and capability accumulated over many decades that changes that ratio from ten to one to something over a hundred to one. And if you include in that the value of bases placed around the world, which are not for sale, and whose value increases decade after decade, the super dominance of the United States in Asia and globally, compared to what China could hope to be anytime in this century is unarguable.

And so in that kind of a context, we would have the ability to – (break) – to China to take out pipelines, and under any contingency that we can think of – and that’s why I would urge you to insist on contingencies, not just hand-waving about energy is a security significant sector – under any contingency that we can think of, this sale is not a
threat. Quite the opposite is my point. If we prevent it, we’re starting down a road of creating a world in which China feels it must also carve out its sphere of influence ultimately backed up by a military force. Thank you very much.

(Applause.)