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CHINESE INDUSTRY AND  
FOREIGN ECONOMIC POLICY:  
LESSONS FOR CANADA

**Wenran Jiang**

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## ABSTRACT

This paper examines the transformation of the foreign policy process in China as a result of its changing political economy over the past three decades. The pluralization of the policy process beyond the Chinese Communist Party hierarchy and the fragmentation of China's policy formation allows large corporations that are nominally subordinate to both the state and the Party to exercise autonomy in their economic operations and to have substantive input in, and impact on, the regulatory policies that shape their own activities. More specifically, the paper looks at the impact of China's "go-out" strategy for its enterprises in a globalized market economy on the making of China's foreign economic policy. Through substantive, factual and policy-oriented case studies, the paper dispels some myths about the business orientation and operations of China's key state-owned enterprises (SOEs). It argues that 30 years of reform and openness have significantly contributed to the separation of the Chinese state and SOEs, some of them being former government ministries.

## RÉSUMÉ

Cette étude examine comment la politique étrangère de la Chine a évolué sous l'effet des changements apportés depuis trois décennies à la politique économique du pays. La pluralisation du processus politique au-delà de la hiérarchie du Parti communiste et la fragmentation de l'élaboration des politiques ont en effet permis aux grandes entreprises chinoises, théoriquement subordonnées à la fois au Parti et à l'État, d'exercer leurs activités avec plus d'autonomie et d'avoir une influence considérable sur la réglementation qui encadre leur fonctionnement. Plus précisément, l'étude analyse l'impact sur la politique économique étrangère chinoise de la stratégie « hors frontières » que la Chine a établie pour ses entreprises dans le contexte d'une économie mondialisée. S'appuyant sur des études de cas approfondies, documentées et axées sur les politiques, elle réfute certains mythes sur l'orientation opérationnelle et les activités des grandes entreprises d'État chinoises. Et elle soutient que 30 ans de réforme et d'ouverture ont significativement favorisé la séparation de l'État chinois et de ces entreprises, dont certaines sont en fait d'anciens ministères gouvernementaux.

## ABOUT THE AUTHOR

Dr. Wenran Jiang is the Mactaggart Research Chair, former founding Director of the China Institute and Associate Professor of Political Science at the University of Alberta. He is also a Senior Fellow at the Asia Pacific Foundation of Canada, Special Advisor on China to the Canada and US-based Energy Council and an online *Bloomberg Businessweek* columnist. He has organized an annual Canada-China energy and environment forum since 2004, bringing government officials, private sector and the academics from both countries together to discuss and debate key issues in bilateral energy relations.

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## INTRODUCTION

Over the past three decades, China has undergone large-scale economic, political and social changes. These changes have not only transformed China's domestic scene but also have profound implications for Chinese foreign policy, including the policies of the government and Chinese enterprises, many now engaged in overseas business operations. The pluralization of the policy process beyond the Chinese Communist Party hierarchy and the ways in which the fragmentation of China's policy formation allow large corporations that are nominally subordinate to both the state and the Party to exercise autonomy in their economic operations and to have substantive input in, and impact on, the regulatory policies that shape their own activities.

This paper examines the transformation of the foreign policy process in China as a result of its changing political economy. The focus of the paper is on the impact of large enterprises, especially state-owned enterprises (SOEs), in the policy process, with a particular interest in the energy and resource sectors. More specifically, the paper looks at the impact of China's "go-out" strategy for its enterprises in a globalized market economy on the making of China's foreign economic policy. Through substantive, factual and policy-oriented case studies, the paper dispels some myths about the business orientation and operations of China's key SOEs. It argues that 30 years of reform and openness have significantly contributed to the separation of the Chinese state and SOEs, some of them being former government ministries.

The paper is not intended to address the entire corporate sector comprehensively or even the whole energy and resource sector. Rather, it selects three case studies, supported by the author's interviews and other materials, to examine the following:

- The changing structure of regulation and policy on the autonomy of SOEs;
- The tension between China's foreign policy goals and the operations of Chinese firms;
- The tension between state policy and corporate advocacy emerging into the public sphere and
- The influence of SOEs on the regulatory environment in which they operate.

## THE INTERNATIONAL ORIENTATION OF CHINESE SOES

The operation was code-named "Treasure Hunting Ship." The target was a major piece of US energy real estate. The \$18.5 billion cash offer was the largest corporate expansion ever in Chinese history at the time. The strategy was to play the free market game with a lobbying effort worth several hundred million dollars.

This was the acquisition effort for the control of Unocal Corporation in the United States in 2005 by China National Offshore Oil Corporation (CNOOC), China's third-largest oil and gas company. In the takeover bid for Unocal, CNOOC was competing with Chevron, the second-largest US energy company, whose earlier cash-plus-stock offer of \$16.4 billion was accepted by the Unocal board of directors and which received the necessary regulatory approval. The CNOOC bid came at a sensitive time in US-China relations. Earlier in the year, members of the Bush administration repeatedly warned that the United States had previously underestimated the speed of the Chinese military's modernization drive. With the US trade deficit going further into the red, Washington put more pressure on Beijing, calling for the appreciation of the Chinese *renminbi* (RMB). And the US government had imposed duties on a range of Chinese textile products.

Therefore, we should not have been surprised that when CNOOC, a venture that is 71-percent controlled by the Chinese government, made a "friendly merger" offer to the ninth-ranked US energy firm, Unocal, American politicians and the public, in general, reacted as if a "red storm" had touched down on US shores. Subsequently, the US Congress voted to demand that the Bush administration review the deal based on national security grounds, effectively killing the possibility of a CNOOC takeover. Clearly reflected in this case was the perception that CNOOC was an agent of the Chinese state, and that CNOOC's behaviour was equivalent to the behaviour of the Chinese central government.

However, an examination of the Chinese operational processes at the corporate level and of Chinese perspectives, both official and unofficial, reveals substantially different concerns and conclusions than those stirred up by the debate the bid generated in the United States. At the time, the public discourse in the United States was primarily focused on two dimensions: whether CNOOC's takeover attempt was the beginning of the Chinese takeover of US energy and other corporate assets, and if the deal posed national security threats to the United States. But according to Fu Chengyu, chairman and CEO of CNOOC, the bid was simply a normal business activity based on the principles of the free market, nothing more.<sup>1</sup> But the considerations of the Chinese government was certainly more than just a "commercial transaction," as the spokesperson of China's Ministry of Foreign Affairs put it.<sup>2</sup>

This raises immediate questions as to whether the core leadership of CNOOC was coordinating with the Chinese government's position regarding this takeover bid. More importantly, we need to examine closely what drove CNOOC to undertake such an unprecedented, large-scale and high-profile acquisition.

Since early 2003, energy shortages have become a major obstacle for the continued growth of the Chinese economy. In the 10 years from 1994 to 2004, China's dependence on imported oil grew from 6 percent to 42.6 percent; Chinese demand for oil is projected to double in the next 10 years, from six million barrels a day (bpd) in 2005 to about 11.5 million bpd. Following such a trend, China is expected to import 60 percent of its oil supply by 2020. At the same time, the production of coal, which accounts for 67 percent of China's energy supply, cannot meet the increasing demand, nor can the transportation infrastructure keep up with the volume of shipments to other parts of the country. By the end of 2004, China's installed gross capacity of power generation had reached more than 440 million kilowatts (KW), over one-half of the US capacity of 800 million KW. Yet China experienced a severe electricity shortage that year, and the prospect for 2005 was even worse.<sup>3</sup>

Alarmed by the so-called "coal-electricity-oil-transportation bottleneck," the Chinese leadership implemented a medium-to-long-term energy plan to secure China's energy supply, including the establishment of a strategic oil reserve. But the Chinese felt that their efforts to cope with the growing domestic energy crisis were hampered by a number of negative international factors.

First, China was paying a high penalty for the sharp increase in international oil prices, and as such saw it as "unfair" to blame the rise of oil prices on China. In 2004 alone, China spent an extra \$7 billion of its foreign exchange on climbing oil prices, with payments totaling \$43.16 billion, making crude oil and oil products China's largest single import category.

Second, Beijing was facing intensified geopolitical and geostrategic competition for access to global energy supplies. The US occupation of Iraq, America's tension with Iran and the presence of US military bases in Central Asian states were all interpreted by Beijing as part of Washington's designs to control oil and gas resources in the Middle East and Asia. Russia was playing China and Japan off each other on a potential oil pipeline in Siberia to maximize its own interests, thus making future Russian supply to China uncertain. Japan was taking a hard line in its dispute with China over the oil and gas fields in the East China Sea, with the potential for escalation into a military confrontation. Beijing's strategic planners had also interpreted a US-Japan joint declaration early in 2005, treating Taiwan as a "common strategic objective," in the context of controlling the sea-lanes for energy shipments.

Third, the overseas search for energy supplies, as a part of China's "go-out" strategy by major Chinese energy companies, was just at its beginning stages, and these companies had not yet secured large-scale, overseas deals. The Chinese were keenly aware that they were often forced to pay higher than market prices for equity in energy exploration around the world, and that they had to operate in countries (such as Iran, Sudan and Venezuela) and regions (the Middle East and Africa) that are volatile and unstable.

1 Fu, "Why Is America Worried?" *The Wall Street Journal Asia*, July 6, 2005.

2 Office of the Commissioner of the Ministry of Foreign Affairs of the People's Republic of China in the Macao Special Administrative Region, "Foreign Ministry Spokesman Liu Jianchao's Press Conference on 28 June 2005," <http://www.fmcojprc.gov.mo/eng/gsxwfb/lxjzffh/t201684.htm>.

3 The People's Republic of China State Council Information Office, "Comment on Hot Energy Problems of China," *China New Opportunity – Energy*, May 2005.

These may well be the factors behind the decision that China must compete and cooperate with large US energy companies head-on. There is little doubt that the motivation for CNOOC's Unocal bid was strategic, but it was more a reflection of Beijing's unease about an inability to secure adequate energy supplies for its domestic economy, rather than an ambition to take over Uncle Sam's property, one piece at a time.

CNOOC clearly had come to realize that it was no longer enough to dance around the fringe of the international energy business. But the implementation of its "go-out" strategy was not simply marching under the orders of the central government. Instead, the company took a very market-oriented approach to this takeover bid. Proud of being the most Westernized Chinese energy company, CNOOC familiarized itself with Western-style company-to-company takeover procedures, and went ahead with the acquisition proposal of Unocal according to the textbook. It was revealed later that the central government had concerns about the deal itself, but it was not the government's concerns that stopped CNOOC senior executives in the earlier stages of the negotiations. The reason that CNOOC did not put in an early bid for Unocal was due to the objections of two foreign members on the CNOOC board of directors. Later on, when the internal discussions and debates resulted in a unanimous decision among the board members, CNOOC proceeded with its cash offer of \$18.5 billion. People familiar with the case also noted that the government played a very minor role in the transaction, and the rejection by the US Congress based on political reasons dumped cold water on CNOOC's enthusiastic approach to model itself after major Western oil companies.<sup>4</sup>

Puzzled by the strong and negative reaction of Congress, CNOOC executives questioned how US politicians measure China's threat to US national security. They did not seem to understand why CNOOC's merger with Unocal, which accounts for less than 0 percent of the total US energy supply, could in any way endanger US national security. Others pointed out that the US Congress has not passed any bills limiting China's continuous subsidies of the US government deficit by purchasing and holding some \$230 billion of US government treasury bonds at the time.<sup>5</sup>

Many in China accused the United States of hypocrisy and double standards. A popular perception was that over the years Western countries have lectured the Chinese a great deal about free markets, comparative advantage, non-intervention by the government and open competition. But the overwhelming opposition by both American politicians and the US public demonstrated that these principles are only applicable to others for convenience. Many reports also complained that a potential block of the CNOOC takeover of Unocal, based on national security grounds, was further proof of US intentions to contain China's rise as a global power. Critics claim that China is facing a long learning curve when it comes to playing the Great Power energy game on the world stage. The failed Unocal bid, they warned, showed that the "China threat" had leaped from the realm of perception to the realm of policy, and China should be prepared to live with that reality. Instead of taking a confrontational approach that is likely to be to China's disadvantage, many advocate that Beijing should get on the bandwagon with US energy firms by creating a win-win environment, thereby easing the anxieties of the US public. As such, China should ultimately pursue an energy strategy based on increasing its domestic supply, rather than paying tens of billions of dollars to continue a treasure hunt abroad. Meanwhile, critics say Beijing would be wise to spend the money on energy conservation and reduce the tremendous waste of energy at home.

As it turned out, the moves by the US Congress to block the Unocal takeover, the general public discourse in China following the failed bid and an executive team that felt betrayed led CNOOC to re-think its investment strategies. The government's general strategy of "going-out" may coincide with CNOOC's venture into Africa and other regions, but the decisions at the company level are based more on the global energy business environment the company faced in the post CNOOC-Unocal period.

Around the time of CNOOC's high profile bid for Unocal, Chinese energy and resource firms were also eyeing Canada. China Minmetals Corporation, a leading state-owned metal company, entered exclusive negotiations

4 Author's interviews in Beijing, summer 2006.

5 As of April 2010, the Chinese holding of US treasury bonds is approximately \$800 billion.

with Noranda Inc. in late 2004. As one of Canada's leading copper and nickel firms, which also has investments in fully-integrated zinc and aluminum, Noranda's potential alliance with a Chinese SOE led to a similar debate in Canada about Chinese intentions in buying Canadian resource companies. The negotiation eventually did not lead to a definitive agreement. But the suspicions and hostilities expressed in the Canadian public discourse had a similar impact on the Chinese perception of the North American market. As a result, Chinese businesses' initial enthusiasm of investing in the North American energy and resource sectors cooled off by late 2005, leaving several years of relatively low-key posture by Chinese firms. At the same time, China shifted the focus of its energy and resource extraction activities to the Middle East, Africa, Latin America and other developing countries. Additionally, whatever level of coordination among Chinese firms to target Canada's resource sectors may have existed, it ended with a wait-and-see attitude when Prime Minister Stephen Harper's Conservatives came to power in 2006.

## THE MARKET ORIENTATION OF CHINESE ENTERPRISES

After three decades of economic reform and opening itself up to the outside world, China's SOEs are often likely to function in conflict with the stated interests of the Chinese state. The CNOOC case demonstrates that even under circumstances when the state and the firm may seem to be pursuing similar goals, the rationale for each could still be different. But for many Chinese firms, large or small and state-owned or private, they act more and more according to what is best for their own self-defined interests rather than following the grand, proclaimed "national interests" of a given time as defined by the state.

Take the debate on the value of the RMB. There have been repeated calls in recent years by the United States and other Western countries for China to let the RMB appreciate. Critics cite China's growing trade surplus and its foreign reserve as hurting the economies of other countries. The US Congress has been particularly vocal by threatening to pass legislations that will implement heavy tariffs if there is no action by the Chinese side on the issue. But Beijing has resisted such pressure, arguing that there is little correlation between China's trade surplus and the domestic economic conditions of the United States and other economies that run a trade deficit with China. Beijing also points out that between 2005 and 2008, the RMB gained 21 percent against the US dollar, yet China's trade surplus with the United States increased substantially in the same period. During the latest global economic crisis, there have been renewed calls for China to appreciate the RMB, and there are clear signals that the US Congress will soon take punitive actions through legislation. Yet, Beijing is holding its ground, insisting that millions of jobs are at stake, and if there is any movement of RMB upwards, it will be through gradual reform and adjustment rather than significant rate adjustment.

What is often overlooked in this heated debate is the internal dynamics among Chinese policy makers, academics and, more importantly, Chinese enterprises. It is in fact remarkable to survey a range of different opinions on the subject in the Chinese press and in cyberspace, where arguments and counter-arguments are no less intense, than the one that is going on between China and other countries.<sup>6</sup> As recently as the 2010 annual People's Congress in March, Chinese Premier Wen Jiabao laid out a clear argument that the RMB is not undervalued. He presented China's latest international trade statistics to show that it is moving towards an overall balanced trade structure. Wen also argued that between July 2008 and February 2009, the months when the world economy was hit hardest by the recession, the real exchange rate of the RMB had appreciated by 14.5 percent.<sup>7</sup> Wen made China's case at the high profile press conference of the People's Congress in front of the world media, and clearly stated that the value of a country's currency mechanism is determined by that country's economy, that excessive demand for China to change its currency rate is unfair and that Beijing had no intention of changing the current RMB managed floating system.

<sup>6</sup> See for example, *Caijing's* website, <http://www.caijing.com.cn/>; *Dongfang Caifu* website's special on the subject, <http://topic.eastmoney.com/RMB/>; and the author's frequent interviews in China on the subject over the past two years.

<sup>7</sup> "Wen Jiabao Zongli Da Zhong-Wai Jizhe Wen: Renminbi De Bizhi Meiyou Digu," ("Premier Wen Jiabao Answers Foreign Correspondent's Question: The Renminbi Is Not Undervalued") *East Money*, March 15, 2010, [http://finance.eastmoney.com/100315\\_1322887.html](http://finance.eastmoney.com/100315_1322887.html).

Yet Wen's position was immediately challenged by a group of high profile Chinese executives. China Eastern Airlines Corporation is the country's second-largest carrier, and its President Ma Xulun said, five days after Wen's press conference, that for every 1-percent annual RMB gain because of its dollar debt, the company would increase profits by \$41 million.<sup>8</sup> Yang Yuanqing, CEO of Lenovo Group Ltd. which bought IBM's personal laptop computer line, stated that RMB gains would boost consumers' purchasing power. Chen Daifu, Chairman of Hunan Lengshuijiang Iron & Steel Group Corporation, advocated that a strong RMB would cut import costs. And Lu Guanqiu, Chairman of Hangzhou-based Wanxiang Group Corporation, China's largest auto-parts maker, said the firm could cope with a gradual advance.<sup>9</sup>

Obviously, these senior business executives were speaking for their own companies' interests rather than following the standard government line, even if it was put out by Premier Wen himself. Such open defiance was unthinkable even a few years ago. But the Chinese economy has progressed and evolved to such an extent that the old-style Party propaganda line can no longer effectively control dissident voices.

Contrary to those outspoken senior executives of these large companies that stand to gain from a stronger RMB, other Chinese firms speak against any upward adjustment. Ironically, this often happens as a fight against a perceived potential Chinese government policy. During a research trip, this author was confronted and challenged by an old friend, Mr. Zhang on this particular subject. Being a high ranking official in charge of the textile industry in northeastern Heilongjiang Province, Mr. Zhang claimed that he had "Googled" me and found out that I was writing in favour of a rising RMB that would benefit China in the long run.<sup>10</sup> He then gave me a long lecture on how foreign academics write about Chinese currency without checking the reality on the ground, especially in the struggling manufacturing industries that depend on export markets. To hundreds of thousands of textile workers in Heilongjiang, Mr. Zhang emphasized, even a single percentage of RMB's rise would mean the loss of jobs on the factory floor. With competition so severe and a profit margin so thin, workers can barely survive. An appreciation of the RMB will send many people home under the conditions of *dibao*, or low-level unemployment benefit, with a monthly package of ¥500 (\$80). As most textile workers are female, their lost jobs would mean more hardship on the entire family. Mr. Zhang, a graduate from an elite university in China in the early 1980s, went on to observe that there might be good macroeconomic considerations of the overall RMB rates, but from a local perspective, he and his other colleagues in similar situations have no choice but to do everything to preserve the jobs in their respective industrial and manufacturing sectors, even it comes down to fighting the central government's decision to appreciate the RMB.<sup>11</sup>

It is true that the Chinese government would like the country to speak with one voice. But it is also true that business and economic issues are less sensitive than political ones. Although there is little pluralism in China's political realm, there is much more diversity in the Chinese economy, with the private sector growing stronger over the past three decades. As a result, government control of the agenda is often weak with many private enterprises that perceive their interests from a microeconomic firm perspective. And thus there is the situation of *shangyou zhengce, xiayou duice* ("There are policy directives from the top while there are counter measures from below"). Yet different voices have in one way or the other affected the policy formation process, making decisions on China's currency rate adjustment an extremely difficult one for the central government.<sup>12</sup>

Aside from pursuing options contrary to ones espoused by the Chinese leadership, many more deviations in practice from the Party line are visible in the operations of Chinese enterprises. The high profile arrest of

8 Cao and Chen, "Breaking Up a Bipolar Argument," *Bloomberg Businessweek*, March 25, 2010, [http://www.businessweek.com/magazine/content/10\\_14/b4172038526024.htm?campaign\\_id=rss\\_topEmailedStories](http://www.businessweek.com/magazine/content/10_14/b4172038526024.htm?campaign_id=rss_topEmailedStories).

9 "China CEOs Join Obama in Supporting Appreciation (Update 2)," *Bloomberg Businessweek*, March 24, 2010, <http://www.businessweek.com/news/2010-03-24/china-ceos-join-obama-in-supporting-yuan-appreciation-update1-.html>.

10 Mr. Zhang declined to reveal his precise working position, and the following is likely the source of his findings of my writing in Chinese: "Jianada Xuezh: Jianting De Renminbi Keneng Shi 'Zhongguo De Jiuxing,'" ("Canadian Scholar: Strong Renminbi Can Be 'China's Liberator'") *Xinhua*, April 14, 2008, [http://news.xinhuanet.com/world/2008-04/14/content\\_7971956.htm](http://news.xinhuanet.com/world/2008-04/14/content_7971956.htm).

11 Author's field research interviews, Beijing and Heilongjiang, November 2008.

12 The announcement by the People's Bank of China of moving the Chinese currency to a more flexible rate mechanism, effectively de-pegging the RMB from the US dollar on the eve of the June 2010 G20 Summit in Toronto is a clear reflection of the Chinese leadership's continuous struggle with the issue.

the four Rio Tinto China executives by Chinese authorities in 2009 and their eventual trial and sentence of long prison terms in the spring of 2010 not only sent shock waves to the world, but also revealed much about the inner working complexities of the iron and steel industries in China.<sup>13</sup>

The Rio Tinto case demonstrates a fragmentation of a major Chinese industrial sector after decades of economic reform and a booming economy. Back in the pre-reform era of the 1970s, the iron and steel industry was simply a major state sector under the centrally planned economy that followed mostly a Soviet economic development model with some Chinese modifications. By the mid-1990s, when China's economic reform, privatization and open-door policy were well under way, the sector was still able to manage with the domestic supply of iron ore for its expansion. Since then, the development of the country's infrastructure has been going through a rapid growth period unprecedented in Chinese history. The expansion of highways, skyscrapers in urban centres, large-scale factories, real estate booms and other projects have pushed China's iron and steel industry to a new height, making China the largest iron and steel producer in the world. This development has also made China the largest importer of iron ore in the world. From a structural point of view, the Chinese economy at the current stage is closely linked to the global price of iron ore and related minerals. In the early 2000s, there was a major expansion of capacity in steel production. According to one estimate, the global share of China's industrial output in GDP is 43 percent, and among China's top 13 largest industrial enterprises with assets of ¥1 trillion or more, 10 are related and affected by the global iron and steel pricing mechanism.<sup>14</sup>

Clearly, the price negotiations of iron ore are crucial to both the bottom line and the profit margin of China's iron and steel industry. The China Iron and Steel Association (CISA) is officially designated to negotiate with the international "Big Three" iron ore producers – BHP Billiton, Rio Tinto and Vale. But CISA only represents a group of 112 large iron and steel enterprises among more than 8,000 iron and steel makers nationwide.<sup>15</sup> They are authorized to import iron ore through the negotiated benchmark price set by international producers with Japanese and South Korean mills.

Meanwhile, accompanying the expansion of China's iron and steel industry has been the widespread establishment of locally-operated medium- and small-size iron and steel mills. Yet they have no access to such benchmark prices and have to settle for a much higher spot price, mostly provided to them by the bigger state mills, with the latter profiting from the huge margin between the benchmark and spot prices.<sup>16</sup> With such a systemic problem of import pricing control via CISA, corruption and bribery have become widespread. Whereas the rest of the world has only paid attention to these problems in China's iron and steel sector with the sudden arrest of the Rio Tinto executives, insiders point out that "in fact, there are officials in charge of iron ore trade in large state enterprises who get arrested every year on corruption charges, but are just not being noticed by the outside world."<sup>17</sup>

Another consequence of this pricing system in China's iron and steel industry is that it has simply led to the direct violation of such an arrangement. Rather than following the central government's orders on how the prices of imported iron ore should be decided, privately owned and local steelmakers approached the international producers directly. In early 2009, while CISA was in intense negotiations with the "Big Three" for the year's benchmark price, 38 local and private Chinese steelmakers signed a deal with Vale in the amount of 5,000 tonnes of iron ore, a move angrily characterized by CISA as undermining China's international bargaining position. It was also in this context that many of the bribery crimes of the Rio Tinto Four took place.<sup>18</sup>

13 For more on the Rio Tinto case, see this special coverage in Chinese: "Rio Tinto Group," 163, <http://news.163.com/special/00013GS9/riotinto.html>; for more on China's policy making process, see Paltiel, "Structure and Process in Chinese Foreign Policy: Implications for Canada," *China Papers* 8, (March 2010), <http://www.onlinecic.org/download/resourcece/archives/chinapapers/chinapapersno8paltielpdf?attachment=1>.

14 Lang, *Xin Diguo Zhuyi Zai Zhongguo 2* ("New Imperialism in China 2") (Beijing: Dongfang Chubanshe, 2010), 143.

15 Zhang, "Pandian 2009: Zhongguo Gangtie Gongye De Chengjiu Yu Sikao," ("Inventory 2009: China's Iron and Steel Industry's Achievements and Considerations") *Sohu*, April 13, 2010, <http://business.sohu.com/20100413/n271484493.shtml>.

16 In 2008, the profit margin between the benchmark (¥700-800 per tonne) and spot price (¥1,400 per tonne) of iron ore was as high as 100 percent. Ceng, "Gangtieye Shenhou Baoguang: Dao Kuang Lirun Bi Chan Gang Gao," ("Iron and Steel Industry Insider Reveals: Iron Ore Profits Decreasing More than Steel") *Sina*, July 10, 2009, <http://finance.sina.com.cn/roll/20090710/04086463792.shtml>.

17 Ibid.

18 For detailed trial documents, see Sainsbury, "'Conflict of Interest' in Focus in Trial of Rio Tinto's Stern Hu," *The Australian*, April 19, 2010, <http://www.theaustralian.com.au/business/mining-energy/conflict-of-interest-in-focus-in-trial-of-rio-tintos-stern-hu/story-e6frg9df-1225855615105>.

As a result of such internal fragmentation and unified policy failures, the Chinese government and the CISA have lost control of moving pricing mechanisms in their preferred direction over the past two years.<sup>19</sup> The consequences have been severe revenue losses for the Chinese iron and steel sector and a massive jump in the profits of major international ore producers. The profit of BHP Billiton, ending December 31, 2009, was \$6.1 billion, a net increase of 134.4 percent year on year. This figure is close to the total profits of China's 68 large- and medium-sized iron and steel enterprises for the year, which dropped by 31.43 percent in comparison to 2008.<sup>20</sup>

A major lesson for Canada to learn from both the RMB and the iron and steel cases is the growing competitive nature of the Chinese enterprises among themselves. Such a high level of competition for market share, for pricing and for profits make it very difficult for China's energy and resource companies to have a cooperative relationship inside China and around the world. It is a well-known fact that the major Chinese energy companies, such as China National Petroleum Corporation (CNPC), China Petroleum and Chemicals Corporation (Sinopec) and CNOOC, actively compete with each other. In China and around the world, they compete for oil and gas assets. Although the Chinese government tries to coordinate their operations, profit motivations and company strategies often take priority over coordination requests from the government.<sup>21</sup> In the Canadian market, there is no indication of a well-coordinated strategy by SOEs to target certain Canadian energy and resource assets. All the aforementioned big three Chinese energy companies have their respective subsidiaries in Calgary, but each operates independently. They may not display the kind of fragmentation China's iron and steel industry has experienced in recent years, but there is no evidence of a joint approach to the Canadian market.

## CONCLUSION

While the Chinese government may direct its large SOEs and the growing number of private enterprises to venture out for China's overall national interests, corporate interests, profit considerations, firm development strategies, growing legal limitations and many other factors preclude these firms from simply marching in step with Beijing's orders. While they are often perceived to be working to advance China's overall national interests at a given time, the reality is far more complex. More and more often, many of the decisions and practices of these enterprises do not necessarily coincide with the directives of the Chinese leadership and, sometimes, are even in conflict with them.

In this paper, three case studies were selected. The first, CNOOC's failed bid to purchase the US energy firm Unocal, was a case where the goals of both the Chinese government and CNOOC coincided. Yet CNOOC happened to have its own rationale for going forward with the acquisition, which was not quite the same as Beijing's "go-out" strategy. In the second case, the value of RMB, the central government continues to face resistance from both the pro- and anti-appreciation camps, thus putting the Chinese leadership in the current difficult position of how to move forward. The third case, the pricing mechanism of China's iron ore imports, demonstrates a total breakdown of the system as put in place by the central government, and almost all steelmakers, state-owned or private, have violated the rules, resulting in total disorder and huge losses in revenue.

Many of the international operations of the Chinese enterprises follow the same pattern. For example, China's national oil companies (NOCs) operate in Africa in a complex manner, not just implementing Beijing's "Grand African Strategy," if there is one to talk about.<sup>22</sup> There is no clear evidence of a Canadian resource strategy to speak of by China. But even where a grand strategy has been announced, as was the case for Africa, Chinese private and state-owned firms do not blindly follow the Party line. Beijing may have some overall

19 For a more detailed account of China's negotiations with international iron ore producers, see Restall, "The Rio Tinto Case and China's Rule of Law," *The Wall Street Journal*, March 29, 2009.

20 Lang, *Xin Diguo Zhuyi Zai Zhongguo 2* ("New Imperialism in China 2") (Beijing: Dongfang Chubanshe, 2010), 144.

21 Over the years, the author was present in a number of occasions when the Chinese government officials in charge of overall energy issues could not get the major Chinese energy company representatives to achieve a consensus on certain issues related to these firms' engagement in the Canadian energy market.

22 Jiang, "Fueling the Dragon: China's Rise and Its Energy and Resources Extraction in Africa," *The China Quarterly* 199 (September 2009): 585-609.

strategic thinking on its role in Africa but China is no longer a monolith. Debates continue inside China's policymaking circles all the time. And large and small enterprises tend to make business decisions from a market-oriented perspective rather than following political directives from Beijing.

The changes and fragmentation in China's decision-making process have important policy implications for Canada-China relations as many Chinese SOEs, NOCs and other private enterprises are in the process of coming into Canadian energy, resource and manufacturing markets. A better understanding of these complex and often conflicting dimensions of policy formation in contemporary China will provide Canadian policy makers, business and academic communities with insights on how to engage a rising China on the global stage.

Facing renewed investment interests by Chinese firms in the Canadian energy and resource sectors, the Canadian discourse on how to deal with China should be informed by the internal dynamics of that country's changing relations between the government and the business sector, as demonstrated by the case studies in this paper. Since Chinese companies are not all the same, their investment patterns in Canada will also differ, depending on the sectors and their corporate intentions. The Canadian government and the business sectors should leave small size investments to the market mechanisms and Canada's well-regulated investment process. On large-scale Chinese investments, an effective strategy is to take a case-by-case approach rather than setting rigid principles. And in the long run, it would be in Canada's best interests if Beijing's ongoing reforms lead to a more economically and politically open China, with its emerging large companies becoming world-class, responsible, corporate citizens.

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## THE CIC CANADA-CHINA RELATIONS PROJECT

Bilateral relations between the governments of Canada and the People's Republic of China are a matter of strategic interest to Canada. Recent changes in the frequency of high-level visits, the effective style and content of bilateral communications and perspectives held about each country by various sectors of each other's society all suggest that the Canada-China relationship has changed significantly in recent years. Yet China remains vitally important to Canada for a variety of reasons and in a variety of sectors. Political and diplomatic cooperation on issues of direct bilateral concern and also on issues of global import remains critically important. Commercial and trade ties linking Canada with the world's third largest and fastest growing economy are of obvious importance. Cultural and civil society ties, including immigration patterns and the ancillary effects they generate, are also important. In these and other matters, the Canada-China relationship will likely grow in importance in the years to come. While the diversity of links between Canada and China militates in favour of giving due attention to a multiplicity of commercial, academic and civil society links, bilateral cooperation at the federal/central government level remains important.

In keeping with CIC objectives to advance research and dialogue on international affairs issues of importance and interest to Canadians, the CIC Canada-China Relations Project has focused on supporting research and analysis toward building a policy framework for Canada's relationship with China. The project's activities have been developed along three thematic areas that reflect issues of common concern: a) Chinese domestic institutional and normative contexts for engagement; b) Economic relations; c) Collaboration on global issues such as environment, health and security.

- a) Domestic Context for Engagement: The Canada-China relationship can be most effective when it is grounded on complementarity of interests, which in turn requires mutual understanding of domestic normative and institutional conditions in both countries. Canadian initiatives with China, ranging from WTO compliance and business regulation to human rights, can be effective only if they are designed and implemented in light of China's domestic conditions, ranging from popular norms to governmental structures and policy priorities. Similarly, China's success in nurturing productive relationships with Canada will require appreciation of Canadian domestic conditions. The papers for this thematic area were commissioned and directed by Professor Jeremy Paltiel of Carleton University.
- b) Economic Relations: Economic relations between Canada and China are critically important. Economic relations include bilateral trade and investment relations, and also extend to local effects of economic conditions and behaviour. In the trade area, Canada's strengths match up extremely well with China's needs. In trade and investment relations, efforts to promote normative and institutional accommodation in China for Canadian business objectives are consistent with Chinese development policies and also serve important Canadian interests in the areas of good governance. As well, national economic behavior by the two countries in response to changing economic conditions at the global, regional and local level have important effects on the Canada-China relationship. The papers for this thematic area were commissioned and directed by Yuen Pau Woo, President of the Asia Pacific Foundation of Canada.
- c) Collaboration on Global Issues: The importance of China's responsible participation in systems for addressing global policy concerns in areas such as environment, health and security cannot be overstated. Yet China's participation in the global community can be distorted by its responses to apprehension and competition from other global actors, particularly the United States, the European Union and Japan. Canada has a significant role to play in supporting China's responsible participation, not only through direct bilateral programming but also through our capacity to deploy good offices, legitimation and other soft power resources both bilaterally and globally. The papers for this thematic area were commissioned and directed by Professor Brian Job of the University of British Columbia.

The papers here presented in connection with the CIC Canada-China Relations Project offer informed, nonpartisan recommendations for a variety of stakeholders in Canada, including the government and private and public sector institutions and individuals, with a view toward furthering the development of healthy long-term relations between Canada and China. While historical and current conditions may result in disagreement as to how best to manage the Canada-China relationship, China's importance to the world requires our attention. We hope that the papers presented here can further the process of understanding and effective engagement that will strengthen the foundation for productive relations for the long-term interests of both countries.

**Dr. Pitman B. Potter**

*Chair*

*CIC China Working Group*

The Canadian International Council (CIC) is a non-partisan, nationwide council established to strengthen Canada's role in international affairs. With local branches nationwide, the CIC seeks to advance research, discussion and debate on international issues by supporting a Canadian foreign policy network that crosses academic disciplines, policy areas and economic sectors.

The CIC features a privately funded fellowship program and a network of issue-specific Working Groups. The goal of the CIC Working Groups is to identify major issues and challenges in their respective areas of study and to suggest and outline the best possible solutions to Canada's strategic foreign policy position on those issues. The CIC aims to generate rigorous foreign policy research and advice.

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45 Willcocks Street, Box 210  
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