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Who's Afraid of China Inc., and Why?

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The Asia Pacific Foundation of Canada found in a national opinion poll earlier this year that only 16 percent of Canadians approve of a Chinese state-owned enterprise acquiring majority control of a Canadian company. Why do more than 70 percent oppose such an action? The torrent of commentary that emerged in the wake of the proposed CNOOC–Nexen acquisition provides a useful guide to arguments against Chinese SOE investment – and why the Canadian government should resist knee-jerk or populist responses.

Leading the charge on a strictly nationalist response is business columnist Diane Francis, who fears Canada is on the path to becoming a "colony waiting to be conquered again." She would impose a 10 percent limit on all foreign ownership of Canadian companies, with the exception of green-field projects. She joins a growing chorus that laments the loss of Canadian majority ownership in corporate icons such as Alcan, Inco, and Viterra – but she goes much further in calling for radical limits on foreign ownership.

Whereas Francis would apply her foreign ownership rule to both state-owned and private enterprises, other commentators single out state-ownership as the stumbling block in the Nexen deal. They argue that Beijing will dictate how CNOOC should operate, which could lead to non-market decisions contrary to Canadian interests.

A variant of this argument focuses on state-owned enterprises from China in particular. Claudia Cattaneo fears being "played" by China but does not articulate similar concerns about other major state-led investment in the oil patch, for example by Malaysia's Petronas, Korea's KNOOC and KOGAS, Norway's Statoil, and Thailand's PTTEP. Others oppose Chinese investment because of grievances against the Chinese state, from human rights issues to the role of China in international affairs.

Jack Mintz views foreign state investment as a form of "nationalization" of Canadian industry. His objection to the CNOOC deal is based on the grounds of unfair competition (since the company is subsidized by the Chinese state), and the belief that SOEs perform less well than private companies in the long run. Mintz would place limits on all foreign SOE investment in Canada (excepting green-field projects), including state-linked pension funds and sovereign wealth funds.

A relatively new and increasingly popular line of argument is to use Chinese investment interest in Canada as a bargaining chip in bilateral relations. Roger Martin argues that the only standard for assessing the CNOOC deal is reciprocity from the Chinese government. Derek Burney and Fen Hampson take a similar position, but throw our relations with the United States into the mix, arguing for a strategic response to Beijing that also sends a clear signal to Washington.

The outpouring of views on the CNOOC-Nexen deal is a healthy development in a Canada-China relationship that is still very much in its infancy, and in a context where Canadian awareness about the rise of China on the global stage is relatively superficial. As Ottawa ponders its response, there is a danger of a populist response fueled by public suspicion of China and the misdiagnosis of experts.

The decision on CNOOC-Nexen should be based on a combination of principle, strategy, and prognosis, but the three elements are not weighted equally and they each contain opposing forces.

The starting principle for this decision and indeed on the reputation of Canada's investment environment should be on the question of openness to foreign investment. Anything other than an unequivocal statement in favor of openness (let alone a curb on foreign investment along the lines of the Francis proposal) would send a very negative signal.

Some argue that the principle of openness to foreign investment should be weighed against concerns about reciprocity. But if we believe that foreign investment is good for Canada, why would we impose a condition that works against our interest? The government has recently made bold decisions on economic liberalization (in the area of tariff reduction and marketing boards) that were based on perceived benefits to Canadians, rather than on reciprocity by trading partners.

The good news is that Canada and China may be on the verge of talks on closer economic cooperation. This would serve as the appropriate forum for negotiations on reciprocity in trade and investment, as opposed to holding hostage a specific investment proposal that accounts for a small share of Canadian oil and gas assets. Likewise, a strategic approach that attempts to simultaneously leverage our bilateral relations with China and the US works in opposite directions. Ottawa cannot hint indefinitely about diversification away from the United States and remain credible unless it moves decisively on energy relations with China and other Asian countries.

Mintz's concern about proxy nationalization is important, but I am less worried about the actual takeover than I am about future performance. To the extent that the Chinese state subsidizes CNOOC, Nexen shareholders will benefit from a higher takeover price. This may be bad for Chinese taxpayers, but it should be seen as a "net benefit" for Canada.

A legitimate concern, however, is that state-owned enterprises – and CNOOC in particular – will underperform in the medium to long-term because they don't face the same kind of market pressures that private companies have to respond to. This question, however, should rest with shareholders rather than with government officials. After all, one can legitimately question the management capabilities of any foreign investor – private or state-owned – and Ottawa is not well-positioned to make such a judgment.

This is not to dismiss broader apprehensions about the behavior of state-owned enterprises that go beyond business performance. There is growing evidence that SOEs behave like private sector players (for better or worse) and are subject to market pressures that come in part from listing on major stock exchanges. State-owned enterprises, however, are not the same as private companies, and there is at the very least a theoretical risk of state-directed actions that are inimical to Canadian interests. The best way to address such actions, however, is through domestic regulations that apply to all companies rather than by discriminating against SOEs as such.

PacNet commentaries and responses represent the views of the respective authors. Alternative viewpoints are always welcomed.