

SUBMITTED TESTIMONY OF

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‘CNOOCERED’: THE ADVERSE NATIONAL SECURITY IMPLICATIONS OF THE PROPOSED ACQUISITION OF UNOCAL BY THE CHINA NATIONAL OFFSHORE OIL CORPORATION

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Introduction

Mr. Chairman, thank you for affording me an opportunity to address the proposed acquisition by an American oil company by one of Communist China’s large state-owned oil corporations. I commend you for your leadership in exploring and informing our Nation’s government and people about the national security implications of this possible transaction.

I would summarize my assessment of those implications as follows: The purchase of Unocal by the China National Offshore Oil Corporation (CNOOC) would have adverse effects on the economic and national security interests of the United States. Such a conclusion arises from three factors: 1) The folly of abetting Communist China’s effort to acquire *more* of the world’s relatively finite energy resources. 2) The contribution this purchase would make to the PRC’s efforts to dominate the vital supply of rare earth minerals. And 3) the larger and ominous Chinese strategic plan of which this purchase is emblematic. Permit me to address each of these points in turn.

Energy: The *Sine Qua Non* of 21st Century Economic and Military Power

At the risk of stating the obvious, no nation can afford its people the quality of life, let alone the economic and security benefits, associated with being an advanced 21st Century society without assured and cost-effective access to energy. Today, for the United States and most of the rest of the world – including, increasingly, Communist China – that means having access to reliable sources of imported oil.

China is mindful of the lessons of the 20th Century with respect to energy insecurity. Imperial Japan’s thirst for imported oil was a principal catalyst for its war with the United States. For the moment, the PRC is neither able nor willing to emulate the violent seizure by Japan some sixty-four years ago of petroleum and other natural resources in East Asia. We ignore at our peril, however, the fact that Beijing is engaged in an even-more-ambitious effort to acquire legal title to energy resources, not only in the

Western Pacific – where much of Unocal’s reserves of 650 million barrels of oil are to be found – but literally *around the world*.

What is particularly worrisome is that Chinese deals being struck from Siberia to Venezuela, from Indonesia to Sudan, from Iran to Canada, from Azerbaijan to Cuba appear not only designed to secure oil to meet Chinese needs. In a world in which such resources are certainly finite, and possibly contracting, they also have the effect of taking them off a global market upon which the United States is increasingly dependent.

As you and Rep. Bartlett know, Mr. Chairman, Jim Woolsey, Bud McFarlane, Boyden Gray and a number of other national security-minded individuals and organizations have joined the Center for Security Policy in advancing a plan for energy security we call the “Set America Free” blueprint. (The blueprint can be viewed at www.SetAmericaFree.org.) It offers practical steps that can be taken immediately to begin reducing the Nation’s need for imported oil.

Unless such steps are taken, it would appear that, as a practical matter, we will inevitably find ourselves on a collision course with Communist China, particularly if world-wide demand for oil approaches anything like the projected 60% growth over the next two decades. As I will discuss in a moment, such a Sino-American conflict may be unavoidable even if we have substantially weaned our economy from its present dependence on foreign energy. It certainly behooves us in the meantime, however, to preserve, wherever possible, for our own use domestic and offshore oil reserves owned by American companies and others to which we have reliable access.

Unocal: The Last American Source of Rare Earth Minerals

A second cause of concern about a Chinese purchase of Unocal involves assets other than the latter’s oil reserves. The Unocal-owned Molycorp mine in Mountain Pass, California is America’s only indigenous source of rare earth minerals known as lanthanides, including neodymium.

In 1999, the Select Committee on U.S. National Security and Military/Commercial Concerns with the People's Republic of China released what came to be known as the “Cox Report.” Noting that the “main aim for the civilian economy [in China] is to support the building of modern military weapons and to support the aims of the People's Liberation Army (PLA),” the Cox Report determined that “rare-earth metals” and “special-function materials” are considered by the Chinese to be “exotic materials” that are “the key areas of military concern.” As a result, the applications of such materials have been for some time the focus of intensive intelligence collection and technology theft by the PRC.

An October 16, 2002 article in *Insight Magazine* described how China stole one of the most promising military applications of metals derived from rare earth minerals – a product developed at considerable expense for the U.S. Navy, called Terfenol-D. According to *Insight*, the Chinese company that is now marketing a comparable product has claimed that, when used in underwater sonar, this material “brought up the best

quality ever with the detection range that can reach as far as 10,000 [kilometers, or 6,200 miles] and when applied to aircraft, this smart material makes a smart wing, which can be controlled much faster with enhanced reliability."

Subsequently, in a March 6, 2003 article, *Insight* reported on how Chinese "princelings" – relatives of senior civilian and military leaders – had purchased an American manufacturer of rare earth magnets, Magnequench, and thus obtained critical technology now being used to produce "neodymium-iron-boron magnets for servos used in U.S. guided missiles and smart bombs."

The 2003 article noted that "the PRC acquisition of the rare-earth-magnet technology was part of a long-term campaign initiated by Deng Xiaoping, who ruled the PRC from 1978 until his death in 1997. In 1992, Deng acknowledged the value of the PRC rare-earth reserves in the Baotou region, saying, 'There is oil in the Middle East; there is rare earth in China.'"

Particularly relevant to today's topic are documents cited by *Insight* from China's Baotou National Rare Earth Hi-Tech Mine – the principal alternative to rare earth minerals from the Molycorp mine – which reportedly declared:

The reason why rare earth, a small industry with annual consumption of only 75,000 tons REO [rare-earth oxides] and a market value below U.S. \$100 million, has been given attention by Chinese leaders at all levels is due to its uses in modern high-tech industries because of its special chemical and physical properties. As a matter of fact, rare earth has been listed in the category of strategic elements in many countries, such as the U.S.A. and Japan.

I would ask the Committee's indulgence to quote from this article at some length insofar as it summarizes very well the problem we currently confront in the rare earth mineral arena – a problem that would be greatly exacerbated if China were to own the Molycorp mine:

Critics say the Chinese plan is transparent. While the PRC was engaged in high-level technological acquisitions to obtain the related technology and machine tools that make permanent rare-earth magnets, a U.S. company mining the raw materials for the magnets was about to be closed. **Until 1998, there were essentially two active mines in the world producing rare earths for the exotic magnets – the PRC's Baotou mine and an American-owned mining operation in the Mojave Desert. The tiny town of Mountain Pass, Calif., was home of the Molycorp mine from which experts say the highest-grade rare earths in the world came.**

In 1996, the vital Molycorp mine was accused by the Bureau of Land Management of running afoul of regulations to protect the desert-tortoise habitat. After paying a series of fines and spending a fortune to jigger its mining so as to

accommodate protectors of the desert tortoise, the company that supplied almost all the U.S. rare earths laid off hundreds of workers and stopped production.

Prior to the 1998 shutdown of the Unocal-owned mine, Molycorp and its leading competitor, China's Baotou mine, supplied more than 80 percent of the world's rare earths. Afterward, according to Baotou company documents, "The U.S.A. has rare-earth resources, but has nearly stopped rare-earth production because of high production cost and environmental concerns, and instead has become one of the major rare-earth importers. ... In 1999, the total world consumption of rare earth was about 75,000 tons REO, and **China met 88 percent of this demand.**"

Walter T. Benecki is a consultant to the Worldwide Magnetics Industry. He tells *Insight* that the PRC has ambitions beyond supplying the world with rare earths: "**The Chinese, in my opinion, are going to dominate the worldwide production of sintered neodymium-iron-boron magnets in the next five years**" – the kind of magnets necessary for making missiles and smart bombs and that soon no longer will be made in the United States.

U.S. government officials in charge of national security see importation from communist-controlled China of strategic components for U.S. weapons systems as a choke point in the event of hostility in the Pacific Rim. **The lag time for the United States to reopen rare-earth mining and build an assembly line to produce the allied magnets could cripple crisis response, defense experts say.** (Emphasis added throughout.)

China' Larger Strategy

Unfortunately, Communist China's play for Unocal's energy and rare earth mineral assets is no more an isolated incident than it is, as the Chinese insist, a "purely commercial transaction." Rather, it falls into a pattern of PRC activity around the globe that is clearly deliberate, well-thought-out and ominous in its implications.

This activity is guided by a long-term strategy. It involves the dominance of strategic energy resources, materials and minerals, technologies – all aimed at providing a civilian economy that will, consistent with Deng Xio Peng's famous "16 Character" dictum, serve China's military needs.

The PLA's needs are also rapidly being advanced by the combined efforts of the most comprehensive espionage and technology theft program in the history of the world – involving untold numbers of overseas Chinese businessmen, students, tourists and others, as well as professional collectors. In addition, the PRC's requirements for an increasingly formidable, long-range and offensively oriented military are being satisfied thanks to the willingness of the Russian government and, to varying degrees, European, Israeli and even American companies to supply advanced arms technology and dual-use equipment, software and know-how to China.

China's plans also extend to securing influence in and, if possible, control over strategic choke points and regions. The latter include not only the Far East, but Africa, the Middle East, Siberia, Central Asia and Latin America. I believe **the PRC's aim is inexorably to supplant the United States as the world's premier economic power and, if necessary, to defeat us militarily.** As members of this Committee know, the Chinese have long told their party cadre and military leaders that war with the United States is "inevitable." While they are clearly preparing for such a war, the strategy they are pursuing appears designed, in keeping with Sun Tsu's dictum, to win without having to fight.

Powering all this, of course, is the immense wealth China is accumulating by dint of its many years of trade surpluses. It is an irony not lost on the Communist Chinese that they have done Lenin's putative dictum one better: **We are paying for the rope they will use to hang us.** In addition to our money coming back in the form of weapons designed to kill Americans, it is being used to: secure immense leverage over our policies (not least, in the form of holding U.S. debt instruments); buy up what is left of this country's productive and competitive industrial capacity and other irreplaceable assets; and close off regions of the world to U.S. influence and counter-moves.

A Real CFIUS

In light of the comprehensiveness and zero-sum nature – not to say audacity – of Communist China's strategy, it is imperative that the United States utilizes a far more rigorous, transparent and national security-minded process for evaluating Chinese investments like CNOOC's proposed purchase of Unocal. **The existing Committee on Foreign Investment in the United States (CFIUS) is clearly wholly inadequate to the task.** Having the Treasury Department – whose job it is to promote foreign investment in the United States – charged with evaluating such investments is a formula for precisely what we have seen to date: rubber stamp approval of virtually every transaction, with no regard for the long-term or cumulative impact they will have on U.S. national security equities.

It does not help that the CFIUS process is a completely unaccountable "black-box" operation. I commend my friends and colleagues, **Dick D'Amato** and **Roger Robinson**, the Chairman and Vice-Chairman, respectively of the U.S.-China Economic and Security Review Commission, for their leadership in recommending sweeping statutory changes in the configuration and workings of the Committee on Foreign Investment in the United States. It is past time for the United States to have a mechanism that is charged with thinking as strategically as the Chinese do about transactions that could constitute real problems for American security, to say nothing of economic interests.

A 'Second Opinion' on China

Before closing, Mr. Chairman, I would like to make one further observation about the context of this hearing. The importance of the U.S.-China Economic and Security Review Commission in providing an all-source-informed “second opinion” on the PRC is all the more vital in light of the serious dysfunctionality that afflicts most other official U.S. government work on this topic.

That dysfunctionality should hardly be a surprise given the following factors:

- Many American businesses are convinced that shilling for Beijing will improve their prospects for a piece of the ever-illusive “China market.”
- Individuals currently serving in influential posts like **John Langdon**, the current chairman of the President’s Foreign Intelligence Advisory Board, and **William Reinsch**, a member of Mr. D’Amato’s Commission, who – as lobbyists – have profound conflicts of interest on China.
- Many others who previously held Cabinet and sub-Cabinet posts, but who remain influential in government circles, are similarly compromised.
- The Congress and the American people are denied the unvarnished truth about China’s activities as official testimony is dumbed down and a statutorily mandated annual report on the PLA is subjected to the same treatment and delayed, seemingly indefinitely, lest it prove (properly) alarming.
- Meanwhile, the new Director of National Intelligence has entrusted oversight of U.S. intelligence analysis to individuals like the Foreign Service’s **Thomas Fingar** and DIA’s **Lonnie Henley** known for their “see-no-evil” attitude with respect to China. This is a formula for “group think” and a strategic failure of intelligence that could make anything we experienced before or since 9/11 pale by comparison.

Speaking of Energy

No testimony by me before this Committee would be complete without a word of thanks to you, Mr. Chairman and to your colleagues – especially Congressmen Bartlett and Weldon – for your work on the danger posed to our nation and way of life by the threat of electro-magnetic pulse attacks.

As China is one of the potential adversaries who understand our nation’s acute vulnerability to such attacks, I urge members of this Committee to ensure that the findings of the blue-ribbon Commission on the EMP Threat, that you did so much to make possible, are presented to the full House with a view to implementing as quickly as possible that Commission’s many important recommendations

Thank you, Mr. Chairman.