



True North In Canadian Public Policy

Commentary

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China's "Long Con" in the Arctic

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Introduction

Estimated to possess some 30 percent of the world's untapped natural gas, 13 percent of its undiscovered oil, 40 percent of its natural minerals and sea-based resources, and one of the world's most promising fishing grounds, the Arctic region has become a strategic prize in China's global quest for resources and Asia-Pacific hegemony. Indeed, Beijing is willing to "buy" territories or governments with an Arctic presence to advance its standing and influence in this rising theatre of operations.

Part of China's strategy is based on a term of art used in the confidence racket – the "long con." This term is used when a "con man" (or entity) makes a sizeable investment of capital, time, and energy over an extended period to engage his victim's (the "mark's") trust in order to achieve a far more valuable "score" at the end of the scheme.

In China's case, being granted observer status at the May 2013 Arctic Council meeting in Kiruna, Sweden – after having been deferred twice – represented an important milestone in slipping into the tent of the leading governing body of one of the largest strategic resource and transportation "finds" of our time. Beijing's state-owned enterprises (SOEs) are more than willing to play along with the Council's focus on the environment and sustainable economic development – for now.

Security-minded analysts should be concerned that China's true intention is to position itself to influence heavily, if not outright control, the awarding of select Arctic energy and fishing-related concessions as well as the rules and political arrangements governing the use of strategic waterways now gradually opening due to melting ice. In order

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to preclude this possibility, member states engaged in discussions regarding Arctic development ought to conduct discreet counter diplomacy, ensure competitive bidding and good governance, insist on commercial fairness, demand “know your customer” diligence, and conduct appropriate military planning.

China’s Soft and Hard Arctic Power

Beijing’s Arctic strategy is underpinned by the initial use of soft power to attain its regional objectives. Science and resource diplomacy and active engagement in multilateral institutions are already playing a large role in this “long con” in the so-called High North. The Chinese navy (PLA Navy or PLAN) is at the helm of several of the country’s seemingly benign Arctic initiatives. It is hastily constructing the capability to operate in the harsh polar environment. This includes a fleet of dual-use icebreakers (with both civilian and military applications), aircraft equipped to fly in inhospitable weather, and reinforced bulk carriers and tankers that can navigate dangerous Arctic waters (Rainwater 2013).

Although environmental research, especially climate change, will be the primary public face of China’s deepening commitment to the Arctic, this soft power strategy is being shadowed step by step by a military build-up specifically designed to engage in Arctic operations, particularly with respect to Russia’s North Sea Route, Canada’s Northwest Passage, and the Bering Strait.

One military expert from the US National War College suspects, for example, that the 1999 expedition to the Arctic by China’s huge Xuelong ice-breaker to conduct oceanographic and benthic studies helped advance PLAN’s anti-submarine warfare capability (Cole 2010, 24). It is almost certain that China will eventually deploy submarine patrols and surface warships in Arctic waterways for surveillance and peaceful “exercises” (such as search and rescue). Using its icebreakers as a soft power calling card, Beijing will be actively looking for one or more friendly ports on the Arctic perimeter. China’s unsuccessful gambit to purchase some 300 square kilometres of Iceland’s northern coast – ostensibly for a golf resort – may have represented such a foray. An Arctic naval presence would protect Beijing’s “regional interests” and multiply its options should it need to confront Canada or the US in the region.

When – as it undoubtedly will – China turns the dial to its hard strategy, it may be fortunate for Canada and the US that China’s only current point of entry to the Arctic is through the Bering Strait. This choke point – with only some 85 kilometres separating Russia and Alaska, and a similar configuration as the Malacca Strait or Strait of Hormuz – will surely be contested at some point and, at minimum, prove to be an abiding threat to vital Chinese strategic interests because of its proximity to the US. This is just one reason that several Chinese scholars have challenged (probably with government encouragement) the rules and norms governing the sovereign claims of the circumpolar states (Canada, Denmark, Finland, Iceland, Norway, Russia, Sweden, and the US). Initially, it has selected so-called “lawfare” to rewrite the statutes presently in force that favour these nations and affect future governance issues.

Enter the Russians

Fortunately for Beijing, China has “friends”, first among them Russia. The Russians have sovereignty over the bulk of Arctic resources. The North Sea Route (NSR) runs predominately adjacent to Russia’s coast. Russia’s president, Vladimir Putin, has proclaimed that the NSR will emerge as a direct rival to the Suez and Panama canals in the near future. China appears to agree; it stands to save US\$60–120 billion a year in trade-related costs were it to make greater use of this alternative waterway (Rainwater 2013, 70).

China has placed special emphasis on harnessing technology that enables it to geographically survey the Arctic more thoroughly than most other countries. For example, its Polar Research and Scientific Institute developed the Xuelong “Snow Dragon,” an icebreaking vessel capable of breaking 1.2 metres of thick, de-oxygenated ice. Beijing has already scheduled three research expeditions to the Arctic between now and 2015, most likely to familiarize itself with the new sea route.

Writing for the *Financial Times*, Tim Reilly tracked this potential rerouting of a sizable portion of global trade and commented on May 23, 2013 that it is easy to imagine an increasing volume of Russian Arctic gas being shipped through the NSR, financed by, and earmarked for, China. Already, China National Petroleum Corporation (CNPC) has signed an agreement with Russia's Sovcomflot Group regarding shipments of hydrocarbons through the NSR. More such deals will likely follow despite some Kremlin anxiety over China having such a large stake in Russia's Arctic development play. This is largely because Moscow's annual revenue stream of hard currency remains unduly dependent on commodity prices for oil and gas, and the country is entering a period of considerably slower growth and higher capital flight. Such a scenario could put at risk Putin's increasingly authoritarian rule, which depends heavily on the military, security, and police services remaining well-funded. Beijing's billions of dollars in cash infusions will likely overwhelm any naysayers in the Kremlin or military who suspect that China will ultimately turn on Russia in its Far East and perhaps elsewhere.

Accordingly, Russia could well serve as the principal gateway to the Arctic that Beijing has been searching for. The two countries may form a partnership of authoritarian regimes that both wish to outflank Canada and the US in this new "Great Game." At this stage of the long con, China can reasonably count on Moscow's political support in multilateral Arctic fora, contingent on Beijing steering clear of suggesting that circumpolar sovereignty claims to the Arctic are somehow invalid or questionable. This is a trade-off China is likely to make – for now.

Moreover, China has recently lavished on the Russian government large-scale energy deals, most of which involved upfront payments of billions of dollars to cash-strapped state-owned or controlled entities. China routinely uses this brand of "pre-export finance" (also known as structured commodity finance) globally to secure prized energy contracts, concessions, and joint ventures. For example, Dan Molinski and John Lyons writing for the *Wall Street Journal* on April 18, 2010, report that in 2009, Beijing advanced some US\$20 billion to cash-starved Venezuela to secure discounted oil deliveries over a 10-year period.

In June 2013, Putin announced a deal between China and Rosneft that would double the size of total bilateral oil trade, Courtney Weaver and Neil Buckley write for the *Financial Times* on June 21, 2013. China provided a front-end loan valued at US\$25–30 billion, with the proviso that Russia work with Sinopec to acquire oil and gas assets in the Russian Far East (Blank 2013). This most recent Rosneft deal, on top of one previously concluded with Rosneft for the East Siberia Pacific Ocean pipeline, would bring Rosneft's total indebtedness to China to somewhere around US\$30-55 billion. This worrying scale of indebtedness goes a long way toward ensuring China has the leverage it needs for future purposes such as reducing Russian tariffs for shipping through its dominant section of the NSR. Rosneft also concluded a transaction with CNPC to drill in the Pechora and Barents Seas in the Arctic.

Enter the Nordic Member States

China's long con involves lulling the Nordic and other Arctic states into a sense of security, commercial benefit, and complacency. This is best illustrated by a brief review of some of the deals and understandings China has underway with some Nordic states and the common characteristics to its brand of "resource diplomacy." Such characteristics include the following:

- moving in its large SOEs with offers to underwrite ambitious projects with long-term, low-cost financing, often on an up-front basis;
- asserting its intention to be a responsible steward of the environment and sensitive to the Arctic's delicate ecosystems;
- accelerating an elaborate diplomatic and lobbying campaign that involves buying "friends" (corporate heads, land owners, politicians, regulators, key bureaucrats, and so forth) and influencing government policy makers;
- consolidating its strategic positioning in the country quickly, in large part through being perceived as a job-creating, generous, responsible, and enthusiastic friend and partner to industry, society, and the host government;

- importing “boots on the ground” (bringing in thousands of Chinese workers to Greenland to create a mini colony at the worksite); and
- employing its leverage at key junctures (after a certain “grace” period of having asked for little) to secure its strategic, military, commercial, and diplomatic objectives.

This discernible pattern of behaviour has even greater prospects for success when romancing smaller countries or territories that have very limited financial and other resources. It is, therefore, no coincidence that China has directed its attention to the “low-hanging fruit,” which, in this context, means Greenland (and Denmark), Iceland, and other Nordic member states of the Arctic Council. Norway in particular recalls that China is capable of playing hardball, as they did when the Nobel Committee awarded the peace prize to Chinese dissident, Liu Xiaobo.

China’s “Green Light” in Greenland

China has found a friend in the Self-Rule Authority of Greenland (granted by Denmark in 2009), where it is hoping to invest US\$2.3 billion in a large, British-led iron-ore mine close to the ice sheet. This project, proposed by Sichuan Xinya Mining Investing Co., would bring with it a mini colony of about 3000 Chinese workers, representing over 5 percent of Greenland’s total population of some 57,000. Among the economic knock-on effects are diesel power plants, roads, and ports. To suggest that Greenland is financially vulnerable would be an understatement. Until 2009, Denmark provided some 50 percent of its territory’s annual budget (US\$1.2 to \$1.3 billion). The end of this subsidy made Greenland desperate to attract foreign investment and an easy “mark” for China’s long con strategy.

Greenland is estimated to harbour 10 percent of the world’s unproven oil reserves and 30 percent of its unproven gas reserves under its rapidly shrinking ice sheet, as reported by *Ice News* on November 14, 2011. Greenlanders claim that their Kvanefjeld mineral deposits could provide some 20 percent of the global rare earth elements (REEs) and large amounts of uranium when production comes on line in 2016. China’s existing 95 percent monopoly on the sale of REEs makes snapping up this would-be competitor something to salivate over. When this possibility alarmed the European Union, it pleaded with Greenland’s leadership not to sell. Greenland’s reported response: “Greenland is open to investments from the whole world.”

It requires only a small leap to imagine China “calling in the chits” with the Self-Rule Authority to demand the ability to install a signals-intelligence facility or construct a deep-water port that could accommodate PLAN naval “visits.” These are the kinds of longer-term pay-offs that China has in mind with its Arctic long con.

“Golf Anyone?” Iceland

When reviewing China’s influence attempts in Iceland, starting with the polar golf resort caper is irresistible. In 2011, Chinese billionaire Huang Nubo requested permission from the Icelandic government to purchase some 300 square kilometres of property on Iceland’s wind-swept North coast, ostensibly to build an ecotourism golf resort. There was also a rumoured association between Mr. Huang and the People’s Liberation Army (PLA) at the time. To date, this initiative has not moved forward. This setback did not slow China’s enthusiasm for a significant stake in the financially beleaguered country’s economic future. That same year, it concluded its first-ever Free Trade Agreement with a Western country there. It also built an outsized embassy in Reykjavik that can reportedly house more embassy staff than the entire employment roster of Iceland’s Foreign Ministry (Ford 2013).

On the business front, China National Offshore Oil Corporation (CNOOC) has already announced a partnering agreement with Iceland’s Eykon Energy Company to explore for oil off that country’s Southeast coast and to cooperate in developing geothermal resources (Blank 2013).

Recommendations for Risk Mitigation

As Chair of the Arctic Council from 2013 until 2015, Canada should take careful note of China's methods and tactics in securing attractive projects and stakes around the Arctic perimeter, as it can expect similar approaches to its government and private sector firms. This strategy was on vivid display in Ottawa during the course of the \$15.1 billion acquisition of Nexen by CNOOC in December 2012.

Moreover, Chinese leadership and the ascendant PLA understand and are quite experienced at the art of building seemingly insuperable political momentum on an incremental basis behind their claims. It is akin to compiling a dossier of concrete Arctic engagements and large-scale transactions that underscore why China deserves to be treated – in its language – like a “near-Arctic state” as well as an “Arctic stakeholder” (Blank 2013). The beginnings of this litany were already being recited in the run-up to the May 2013 Arctic Council session. This lengthening Chinese narrative will become routine in the course of multilateral and bilateral settings.

Clearly, Canada, the US, and (hopefully) other Arctic member and observer states (such as Japan) will resist being bulldozed into unwise concessions that advance Chinese strategic goals in the Arctic.¹ As China surges ahead with its Arctic ambitions and the larger pay-offs associated with its long con diplomacy, it is reasonable to expect that it will begin to show its true hand as early as 2014–2015. In the meantime, Beijing will likely move briskly to acquire or otherwise secure key pieces of its desired Arctic architecture. This paper alludes to some of those pieces and offers the following recommendations to avoid some of the pitfalls of this Arctic long con and properly manage “China risk.”

CONDUCT DISCREET COUNTER DIPLOMACY

Canada and the US should step up their *démarches* to the Nordic member states and Greenland on the China gambit as early in this process as possible to improve their awareness concerning the political, environmental, commercial, and broader strategic risks attendant to repeatedly acceding to Chinese demands and/or supporting China's initiatives and positions in the economies of the northern states and other fora. There are several examples worldwide of China defaulting on its pledges to protect the environment and/or serve as a reliable trading partner, among them Beijing's outrageous REE embargo against Japan in 2010, stemming from Tokyo's legitimate detention of a reckless Chinese trawler captain in the East China Sea.

In this connection, it was heartening to learn that, in 2012, European Commission Vice President Antonio Tajani flew to Greenland with reportedly hundreds of millions of dollars in development aid to exchange for a pledge not to grant China exclusive access to the territory's REEs. Such proactive, preemptive diplomacy and resource/waterway understanding can spare countries and the region a great deal of wear and tear over time, particularly after the con has been exposed, and competition in the Arctic becomes more bare-knuckle political combat. Canada also tasted what is likely to come when it noted China's reluctance to recognize Canada's sovereignty over the Northwest Passage.

The Arctic states should continue signing declarations and other understandings in much the way the 2008 Ilulissat Declaration (dealing with peaceful dispute resolution) was released. Such joint actions symbolically and substantively serve as an important reminder that the core states can and will take appropriate and necessary steps to protect, manage, and preserve Arctic resources, waterways, and ecosystems. China will continue to advocate for freedom of the seas and unrestricted shipping through Arctic passages, but it is important to recognize in Arctic Council corridors that an unduly emboldened China is likely to become a dangerous China. These declarations and other joint pieces of business can temper expectations in Beijing in a positive way. The Chinese can also be counted on to engage in “venue shopping” (by entering new, less restrictive groupings like the Arctic Circle, a new forum for a more diverse group of Arctic stakeholders such as China, India, and Singapore) where they can tap into the feelings of exclusion of other countries and mobilize them to advance their Arctic demands.

ENSURE COMPETITIVE BIDDING AND GOOD GOVERNANCE

There should also be a concerted effort by “core” Arctic players to institute or, at minimum, encourage competitive bidding for major Arctic-related contracts to avoid the kind of sole-source bids Beijing has in mind. For example, Japan has access to long-term, low-cost government financing mechanisms (such as the Japan Bank for International Cooperation) that could compete toe-to-toe with the Chinese, yet represent a secure, professional, democratic alternative. To the extent that China’s government-subsidized financing terms are so generous as to be predatory, it could be taken before the WTO or other venues for adjudication and public scrutiny. Transparency, disclosure, accountability, good corporate and sovereign governance, reliable statistics, and the rule of law should be “watch words” with regard to monitoring and disciplining China’s Arctic diplomacy and business activities. When demanding reliable statistics, it might be useful to call attention to the estimate by the University of British Columbia’s Fisheries Centre that China catches 12 times more fish outside of its waters than it reports (Pauly et al. 2013).

INSIST ON COMMERCIAL FAIRNESS

“Fairness” has been alluded to already. Although this is somewhat subjective, it is clear, for example, that when China employs its PLA hackers to penetrate the proprietary, internal deliberations of corporate targets or foreign business partners to strengthen its poker hand in negotiations, this is not fair play. Indeed, it is a criminal act in many countries, and warrants harsh penalties, such as unwinding acquisitions, re-awarding contracts to non-tainted competitors, or excluding the entity from further business in the country. The entity in this case is China itself, as none of these unfair tactics can take place without the express approval of Chinese government authorities, usually very senior ones.

DEMAND “KNOW YOUR CUSTOMER” DILIGENCE

China requires a rigorous, “know your customer” type of due diligence, including the security-minded variety. The PLA cyber-theft scandal that gained in intensity following the release of an investigative report by Mandiant Corp. in February 2012, which documented China’s targeting of some 150 major American companies, again put into stark relief the often-intimate relationships that exist between Chinese SOEs, the PLA, and other security services. Indeed, there is even the possibility that the SOEs in question (not yet identified) actually tasked and compensated the PLA for gathering corporate and competitive intelligence from foreign firms, likely including those of Canada and other nations. If proven to be true, this would represent an even more damning indictment of certain SOEs, likely including some of the Chinese oil majors most active in the Arctic. My June 2013 Macdonald-Laurier Institute **Commentary** entitled “Standing On-Guard Post-Nexen: Chinese State Owned Enterprise and Canadian National Security” contains a list of the security-minded diligence questions that Arctic Council member and observer states should ask before partnering with a Chinese SOE.

CONDUCT APPROPRIATE MILITARY CONTINGENCY PLANNING

As discussed above, there is likely to be a prominent “hard” dimension to China’s Arctic strategy that demands increasing attention and concern among the military and security establishments of the circumpolar states and observer states, such as India and Japan. China’s polar-equipped military build-up directed toward the Arctic sea-lanes and territories cannot be ignored. Table-top exercises among key allies like Canada, the US and Japan are simply a must, designed to game-out the planned architecture of Beijing’s Arctic influence attempts (both hard and soft) and PLAN’s likely deployments, should tensions rise.

China brings all its instruments of national power to bear on its targets – even the most frail and small – for “negotiations.” There need to be countervailing pressures available among Arctic allies (whether or not Russia cooperates), especially with respect to Greenland and Iceland. Currently, China could inflict real hardship on this sensitive region, should it overestimate its military prowess and make a reckless, PLAN-driven move that disrupts the regional status quo (for instance, a naval show of force).

Conclusion

China's original idea was to promote the notion that the Arctic was a global commons, open for exploitation by any and all nations. This was when Beijing used to state that the Arctic is the inherited wealth of all mankind. That line simply did not sell internationally, estranged the very Arctic states that it is assiduously courting today, and even complicated its own rigid demands concerning the East and South China Seas. The propaganda narrative was promptly retooled to emphasize China's determination to help protect against environmental despoilage of this pristine frontier and join the rule-making of Arctic states to help ensure fair and common benefit for all mankind.

Although this retooled narrative is highly suspect, the recommendations outlined above are not designed to suggest that business cannot be sensibly or safely done with Chinese entities in, or near, the Arctic. They are rather intended to point out the special risks that accompany doing business with SOEs that are often tasked with performing multiple functions, including establishing strategic beachheads, gathering intelligence, and serving as forward-deployed assets of the PLA and the security services. In this connection, it is also useful to keep in mind that the political disconnect between the PLA and Chinese civilian leadership is clearly widening, with less predictable consequences for the country's Arctic soft and hard power architecture.

Although the SOEs, particularly those in the energy sector, advertise themselves as benign commercial entities with no hidden government agendas, this is regrettably not the case. The complacency and compliance of several Arctic Council member and observer states that are the objective of China's long con need to be replaced with healthy doses of vigilance, security-minded due diligence, and hard-headed realism concerning the Chinese purveyors of seemingly richly rewarding resource development and transportation opportunities.

Perhaps the risks described in this Commentary will, for the most part, not materialize into full-blown disputes and/or security threats. Perhaps we should take China at its word through its state-controlled news agency Xinhua, that "China's activities are for the purposes of regular environmental investigation and investment and have nothing to do with resource plundering and strategic control." Perhaps Malte Humpert, Executive Director of the Arctic Institute, is right when he observed in an interview, "I don't think there's any more reason to be concerned about China's ambitions than there is about anyone else's ambitions in the Arctic." That is certainly the most desirable calculus and outcome.

The question is: given the evidence, would you, as a policy maker or business executive, wish to stake your country or firm's strategic interests in the Arctic on that sunny proposition?

About the Author

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Endnotes

- 1 The problem will lie with the industrial companies of the Council's member states that may have a difficult time resisting lucrative Chinese offers during a period of economic distress.