Rebooting Canada's Relationship with China

Windows of opportunity are currently open to deepen Canada's economic interaction with China. But if we don't act quickly, they will close.

by Wendy Dobson

SUPERLATIVES HAVE BECOME COMMONPLACE in describing China's global position: it has the world's largest population and second-largest economy, is the largest exporter of goods, holder of the largest foreign exchange reserves, the largest automobile market and the largest carbon emitter; the list goes on. By 2030, the **Asian Development Bank** estimates that China will be home to 20 per cent of the world's middle class, an urban population of more than one billion people, and a related explosion in demand for housing, education, healthcare and financial and environmental services.

The Chinese are known to actively study Western history and culture with a view to adapting the best foreign ideas and institutions. However, the reverse is not true: those in the West have been slow to learn about China, and there is a tendency to picture the country in ways that are biased — coloured by the hope that as the Chinese become wealthier, they will become 'more like' us and adopt Western values and institutions.

The fact is, that is not likely to happen, and as a result, we must take steps to learn more about China and how to interact with the Chinese as the country evolves.

China's Political Environment

Understanding China's development begins with a recognition that much change in the country is administered rather than springing from the grassroots — driven by the central political imperative of raising living standards and maintaining the Communist Party's central control. Over the past 30 years, rapid industrialization has been spectacularly successful in achieving those goals — but at the cost of a severely degraded environment, rising inequality and corruption.

A key question for the future is whether the Communist Party's search for administrative efficiency will substitute for political reform. Current indications are that party leaders are determined to avoid simultaneous political and economic liberalization of the kind they believe led to the collapse of the Soviet Union.

It is too soon to draw conclusions from the three-year record of President **Xi Jinping**. Some argue he has a plan that will succeed in retaining party legitimacy, and that programs to redistribute opportunity and incomes throughout the country beyond the dynamic coastal provinces will lift the entire

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population out of poverty. Others argue that the political pressures created by the energetic anti-corruption campaign are generating rising risks of push-back that could cause disarray.

China's growing international presence is raising hope and alarm simultaneously. The growth slowdown and stock market gyrations of 2015 have caused significant cross-border concerns. At the same time, China is now becoming more assertive in the region, aggressively pursuing what it defines as its 'core interests' in defending its maritime boundaries.

Why now? This assertive turn reflects several factors: the desire to build domestic support for Xi's anti-corruption drive and economic reforms agenda; rising confidence stemming from China's economic success and its ability to avoid the worst effects of the 2008-09 global financial crisis; and a calculation that American power is declining in Middle East conflicts, even as the U.S. 'pivots' back to Asia.

China is now playing a central role and seems to have adopted a complex set of objectives that may be difficult to achieve. Regardless of whether the Chinese leadership succeeds or fails, there will be large-scale implications across borders that will affect us all.

Public Anxiety About China

Recent polling by the **Asia Pacific Foundation of Canada** (APFC) paints a picture of growing public anxiety about China. In 2014, more than 70 per cent of Canadians felt that within a decade, China would be more powerful than the U.S., but only 36 per cent supported a possible free trade deal with China; 14 per cent supported the prospect of a Chinese state-owned enterprise (SOE) owning a controlling stake in a major Canadian company; and only 10 per cent had 'warm feelings' about China.

In 2009, surveys conducted by the **Pew Research Center** revealed that 53 per cent of Canadians had a favourable view of China; but six years later, this share had declined to 39 per cent. During the same period, American views became more negative by about the same degree. Australian views of China are more positive and stable, with 57 per cent holding a favourable view in a recent Pew Center poll. And polling by the Sydney-based **Lowy Institute for International Policy** indicates little support for the idea that a more powerful China would threaten national interests.

Meanwhile, in recent years, much of the media attention and public comment China has received has been critical. The negativity has three elements. The first is *experiential*, a product of the fact that interactions with China are multiplying rapidly and are not always positive. For instance, rising house prices in Vancouver are attributed to Chinese buyers. The second reason for the negativity involves *attitudes* about the nature, legitimacy and domestic policies of China's political system, the role of the state in its economy, and societal values and practices that are very different from our own. On issues ranging from human rights to democracy and labour policies, Canadians question the role of the Chinese state. The third reason for the negativity involves *fears* about China's rising international presence — including fears about its influence in Africa and Latin America, its rapid military modernization, its assertive defence of its maritime borders and the potential threat that it poses to an international order that Canadians have helped build since the Second World War.

Data from the APFC provide some insights: Canadians prefer to trade with countries with similar values and institutions, like European Union members and Americans. Attitudes toward engagement with potential Asian partners like South Korea, India and China — and less so, Japan — are shaped by misinformation. For example, respondents expressed concerns about 'political rights in South Korea', even though it has a strong and lengthy record of political rights. Such negativity feeds on itself, inhibiting balanced discussion and encouraging caution by political leaders.

What is missing in Canada is public leadership and education — both of which Australia has provided particularly effectively: for a generation, its top political leaders have actively engaged in public discussion and explained the importance of Asia and China; and there is ongoing debate — sometimes rancorous, but on balance, healthy — among academics, policymakers, civil society, the media and business leaders.

Significant Economic Complementarities

The fact is, there are remarkable complementarities between the Canadian and Chinese economies, and business leaders on both sides need to embrace them. In particular, five sectors are filled with opportunity.

ENERGY. China is now ranked by the **U.S. Energy Information Administration** as the world's largest net importer of petroleum and other liquids. China seeks *security of supply* while Canada seeks *security of demand*, and as a result, the energy sector is a potential game changer for this relationship. As the Canada-Asia Energy Futures Task Force (organized by the APFC) emphasized in its 2012 report, the potential for oil and gas exports across the Pacific is evident in the large price differentials between North American and Asian markets. The task force pointed out the market development opportunities in China for Canadian firms — including those in eastern Canada offering hydroelectric and nuclear expertise, and suppliers involved in energy conservation, renewables and clean tech across the country.

THE ENVIRONMENT. A cleaner environment is a high priority for China, and Canadian clean-tech and uranium suppliers are already supplying it with wind generators and equipment for smart grids. China has turned to nuclear power to help replace its heavy reliance on coal, and Saskatchewan-based **Cameco Corp**. has won five- and ten-year uranium supply contracts; but the numbers are small relative to potential. As China searches for ways to promote energy efficiency, the window of opportunity is closing, for two reasons: more aggressive competitors are meeting existing demand for fossil fuels, and demand is expected to shrink as China's growth slows and as climate change concerns deepen.

FOOD SECURITY. Middle-class demand is shifting towards high-protein diets, and shortages in animal feed are changing import and investment patterns. **McCain Foods**, Canada's top food products company, has experienced first-hand the speed of change: its investment in a potato processing plant in Harbin began in 2005, and by 2013, capacity had to be doubled to meet demand. Yet in 2014, China accounted for just 6.4 per cent of Canada's total agricultural trade.

Just as China makes the transition from traditional to modern agriculture, Canada's sector is investing heavily in innovative technology and practices to increase productivity. Demand for meat, fish, seafood and vegetables is strong, but lags behind the growth of markets for grain and oilseeds. Pork exports to China increased five-fold between 2008 and 2012, and collaboration on pig genetics is ongoing between a Canadian company and one of China's largest pig-breeding companies.

Dairy is a sector of unrealized potential: Canada is the world's 14th-largest dairy producer, but it exports less than five per cent of total production. In New Zealand, by comparison, dairy exports account for one-third of merchandise exports, and China is its largest market. Canadians are missing out on dairy exports because of protectionist supply management arrangements that came under fire from trading partners in the Trans-Pacific Partnership (TPP) negotiations.

INFRASTRUCTURE AND TRANSPORTATION. Both of these industries have high potential for market development over the long term, especially as China strives to improve linkages along the historic land and sea routes between China and Europe. Initially labelled as the Maritime Silk Road and Silk Road Economic Belt initiatives, they have become known as One Belt, One Road (OBOR), encompassing both the overland (belt) and maritime (road) routes.

President Xi Jinping's announcement of OBOR at the Beijing Asia-Pacific Economic Cooperation (APEC) summit in November 2014 (along with Chinese funding of $40 billion) was followed by the formation of the **Asian Infrastructure Investment Bank** (AIIB) in March 2015, with 57 members from Asia and Europe and a Chinese capital commitment of $100 billion. These programs draw on Chinese capital to promote development in central Asia and facilitate closer economic cooperation over a very long term. If the infrastructure development even partially succeeds, it will have a significant impact of linking

In particular, five sectors are filled with opportunity: energy, the environment, infrastructure, food security and service industries.

poor Asian countries to the global economy.

Canadian firms have globally-recognized expertise in land- and marine-based transportation technologies, and in construction, construction machinery and building materials. To realize these opportunities, Canadian firms will have to expand their links with Asian supply chains, and Canada will need to join the AIIB.

Prospects for collaboration in transportation services are also significant. China's air services industry is already the world's second-largest market, while Canada is the world's fifth-largest exporter of aerospace products and has developed competitive advantage in technical and management skills. In the next decade, it is expected that China will build 97 new airports, many of them smaller regional airports that handle planes of sizes similar to those produced by **Bombardier**, in addition to 35,000 kilometres of new expressways and 30,000 kilometres of new rail tracks. Winning even a small slice of this business would be significant.

SERVICE INDUSTRIES. Chinese tourism will continue to grow from its level of 500,000 Chinese travellers to Canada in 2013. **Euromonitor**, a business research firm, ranked Canada as the number 22 destination for Chinese tourists in 2012, a position that seems far below its potential when compared with the U.S., Japan, France and other European countries.

Canada is already an education destination. Many Chinese parents think their own system prepares children to succeed in national tests while a foreign education ensures the English-language proficiency and cultural skills necessary to be leaders in China and beyond. Canadian educational institutions have aggressively recruited Chinese students, and a federal international education strategy has set a target of 450,000 foreign students studying in Canada by 2022, up from 239,000 in 2011.

As the Chinese government shifts its objectives toward reversing the outflow of students by 2020, China itself is becoming an education destination. Canadians should anticipate this shift by delivering more educational services abroad. We should also change our current emphasis on recruitment to a broader concept of 'delivery of quality education' and to encouraging young Canadians to study in China.

The potential for exporting other services to China or investing in China stems from the growth of Chinese middle-class demand for healthcare, environmental services, transportation and financial services — all of which Canadian firms do well.

Recommendations

In a recent public white paper co-authored with University of British Columbia Professor **Paul Evans** [see end of article for URL], we make recommendations for the future conduct of political, economic and security relations between Canada and China. Following is a summary of our political and economic recommendations.

1. REBOOT THE POLITICAL RELATIONSHIP

In Asia — more so than in the West — key linkages among countries are built on foundations of state-to-state relationships, maintained through regular contact by prime ministers and presidents. Forty-five years ago, Canada was an early mover in recognizing China's communist regime, and other western countries followed. But today, because a narrow focus on commercial interests has dominated strategic issues, Canada is not taken seriously. High-level political engagement is essential, and President Xi Jinping's statement to Prime Minister **Trudeau** in October of 2015 — recalling Canada's early acceptance as something China would 'always remember' — indicates that the door is open.

2. MODERNIZE OUR ECONOMIC TIES

China's recently concluded Free Trade Agreements (FTAs) with Australia and South Korea indicate that China is willing to liberalize its bilateral trading regime. As a relative latecomer to such trade liberalization in the region, Canada faces two options. First, it should support and encourage China's inclusion in the next round of Trans Pacific Partnership (TPP) talks — expected once the current 12-country agreement is ratified by national governments. Chinese officials have been studying the TPP, and some see it as a way to push through difficult reforms, such as changes to state-owned enterprises (SOEs), by blaming foreign pressures from such negotiations. A second round of TPP negotiations, in which South Korea, Philippines, Taiwan, Indonesia, Thailand (and possibly China) have each expressed interest in participating, is likely to take some time to launch.

In the meantime, Canada should launch a bilateral trade negotiation with China. The FTAs with Australia and South Korea indicate that China has moved beyond simple tariff reductions on goods to include a range of services and investments. The Australian agreement has particular potential for diverting trade away from Canada, because of the bilateral concessions agreed by the two governments. Canada should also work collaboratively on APEC's Free Trade Area of the Asia-Pacific (FTAAP) — an idea championed by Canada in APEC more than a decade ago; participate in the major infrastructure projects expected in the OBOR initiatives; and fix the opaque rules for screening inward investments by large foreign firms.

3. BUILD ON OUR ECONOMIC COMPLEMENTARITIES

China's recent FTAs with our competitors add to the urgency of more proactive engagement. One possibility is equity investments by Canada's large pension funds in Canadian and Chinese agricultural firms aiming to expand food production and promote innovation; another is to organize mechanisms in Canada to enter into long-term supply contracts of food and energy as part of the traditional cross-border trade in goods and services.

Collaboration on energy security depends in large part on Canada addressing transportation bottlenecks. The APFC Canada-Asia Energy Futures Task Force recommended a public energy transportation corridor, one that would be created by governments, regulated like a public utility and operated by the private sector. The proposal is an innovative way to recognize and mediate among the multiple interests concerned with new pipelines in British Columbia. The benefits of collective action in the national interest outweigh individual interests; the proposed collective action framework can be constructed in ways that minimize risks, maximize public gains and fairly share the benefits. This is not to diminish the political difficulties of managing land use issues and rights of First Nations; but failing to try means denying all parties the benefits of a major collaborative opportunity.

In infrastructure and transportation services, Canadian firms have competitive advantages to be tapped in the surge of infrastructure and connectivity projects planned for OBOR projects announced in late 2014 and early 2015. These initiatives could offer new areas of fruitful long-term collaborations, including links with our own investments such as the Asia-Pacific Gateway and Corridor Initiative (begun in 2007) — but only if we turn up and participate. Canadian firms should also organize to participate in Asian and Chinese value chains for these projects.

Furthermore, goals should be set for five- and ten-year two-way flows of goods and services trade and investment. In trade, the target should be to double the value of exports to China by 2020, to \$40 or \$50 billion from \$21 billion in 2013. The additional exports could create more than two million new jobs. Setting a similar target for Canada's outward FDI is more problematic because it would depend on company strategies. To the extent that inward FDI is determined by Canada's regulatory regime, a transparent review process based on best practices would have to be introduced before any goal could be determined.

In closing

Windows of opportunity are open to deepen Canada's interaction with China. As a matter of both necessity and opportunity, expanding relations with China should be the centrepiece of a broader and deeper embrace of the Asian century. With verve, imagination and an effective policy framework, we can help to make it the Asia-Pacific century. ***RM***

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