

Canada-China Economic Relations: Beyond Petroleum

Daniel Poon, Researcher, NSI
Presentation to **Canada-China
Friendship Society**, March 6 2012

Email: dpoon@nsi-ins.ca



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A photograph of a busy street in China, likely Beijing, showing a dense traffic jam. In the foreground, several red taxis are visible, including a Toyota Camry with license plate 辽A M2879 and a Chevrolet with license plate 辽A M5350. In the background, there are yellow and red buses and tall buildings. The scene is hazy, suggesting a winter day.

WINTER 2011
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POLICY BRIEF

Canada-China Economic Relations:
Beyond Petroleum

Recognizable Auto Brands?

Presentation Outline

1. Introduction and Key Arguments
2. State of Bilateral Trade and Investment
3. China: Workshop of the World, Forever?
4. Implications for Canada?

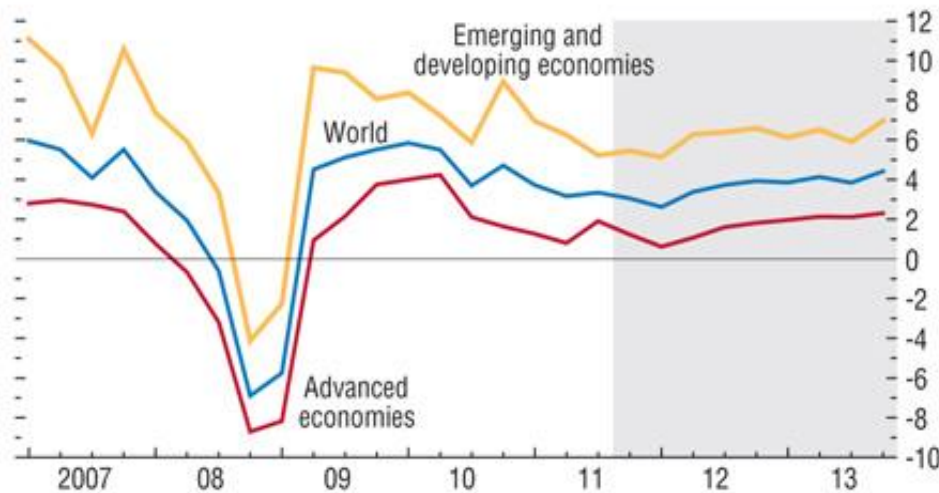
1. Introduction: Why Now?



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Figure 1. Global GDP Growth

(Percent; quarter over quarter, annualized)



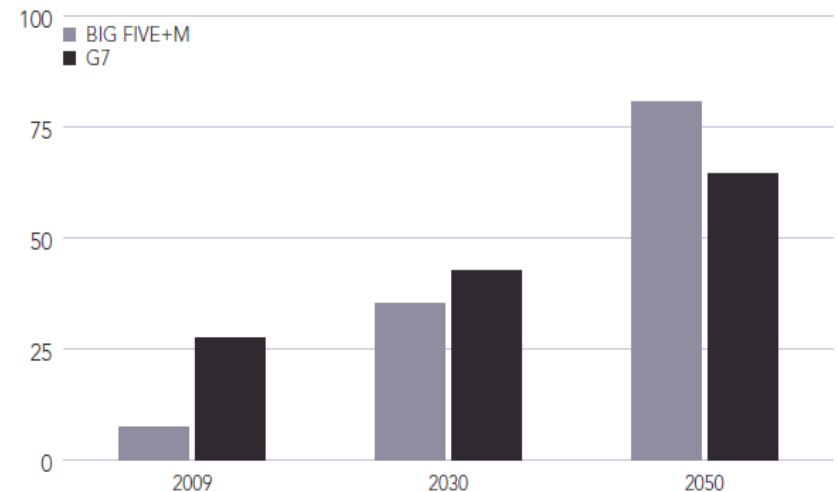
Source: IMF staff estimates.

Source:

**IMF World Economic Outlook Update, January 24
2012.**

FIGURE 3.3 THE BIG FIVE+M WILL ECLIPSE THE G7

(GDP, REAL \$, TRILLIONS)



Source: Authors' projections.

Source:

**Dadush, Uri (2011). Juggernaut: How Emerging
Markets Are Reshaping World Markets**

1. Key Arguments



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- Re-thinking Canada's "all-eggs-in-one-basket" strategy – **ie. neglect of non-US trading partners**
- China's move up the value-chain? Strong disagreement over **direction of trends**
- Leveraging China's technology/industry ambitions in ***Canada's favour***. (alleviate structural constraints, and boost national bargaining leverage)

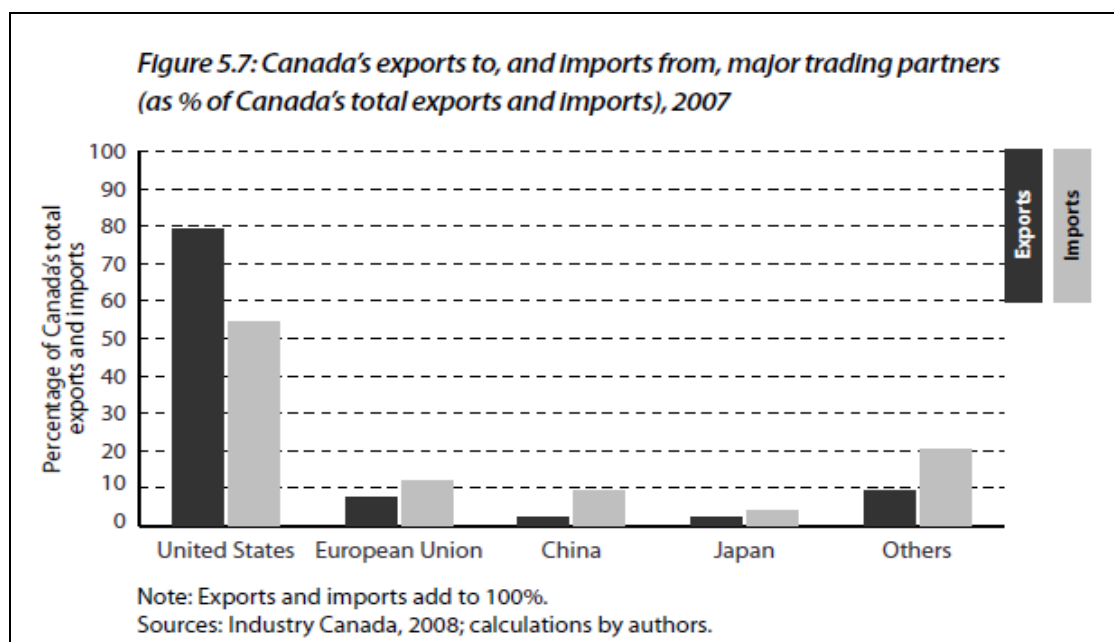
2. State of Bilateral Trade

- **Fast growth, but from low base**
(Total Trade, ex+im, C\$ millions)



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	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
World	747,197	745,339	717,313	768,176	817,209	837,409	857,622	917,487	725,021	803,147
US	76.29%	75.65%	73.97%	72.53%	71.08%	68.90%	67.22%	65.69%	63.01%	62.56%
China	2.27%	2.70%	3.26%	4.02%	4.49%	5.05%	5.58%	5.79%	7.01%	7.19%
Japan	3.08%	3.19%	3.07%	2.87%	2.93%	2.96%	2.88%	2.88%	2.85%	2.82%
UK	2.25%	1.90%	2.14%	2.26%	2.29%	2.51%	2.83%	2.78%	2.96%	3.37%



Source: Tiagi, Raaj and Lu Zhou (2009). "Canada's Economic Relations with China", Fraser Institute Studies in Chinese Economic Policy, February 19. See, <http://www.fraserinstitute.org/research-news/display.aspx?id=12861>

2. Composition of Trade, 2001-2010



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Chart 1. Share of Mineral Fuels (HS27) in Canada's Exports to Selected Countries

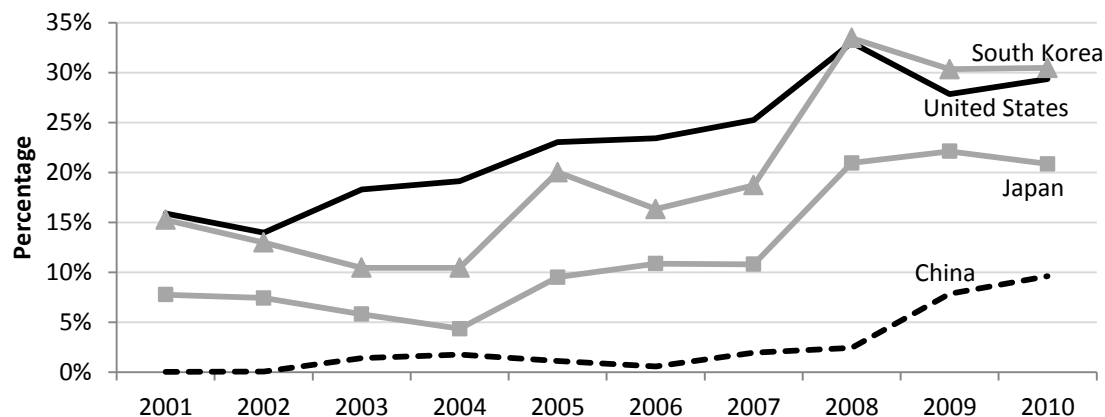
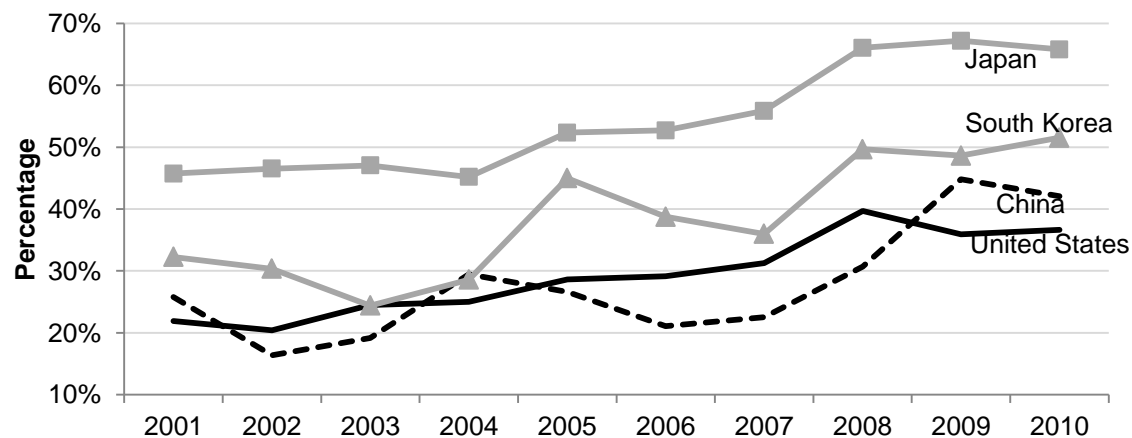


Chart 2. Share of Agricultural and Mineral Goods (HS01-27) in Canada's Exports to Selected Countries



2. Comparative Trade Performance: Commodity Exporters to China



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China Trade with Selected Partners, 1992-2010

		2010 (\$m)	1993-2010 (% growth)
Australia	EX (to country)	27,220.26	4,019.29
	IM (from country)	61,105.17	3,556.56
	Balance	-33,884.91	
Brazil	EX	24,460.65	37,677.07
	IM	38,099.45	7,236.69
	Balance	-13,638.80	
Canada	EX	22,216.13	3,301.23
	IM	14,921.96	674.56
	Balance	7,294.17	
Indonesia	EX	21,953.57	4,556.80
	IM	20,795.19	1,237.98
	Balance	1,158.38	
Mongolia	EX	1,449.76	968.12
	IM	2,549.85	5,200.04
	Balance	-1,100.09	
World	EX	1,577,763.75	1,757.50
	IM	1,396,001.57	1,632.33
	Balance	181,762.18	

2. Bilateral Investment Flows



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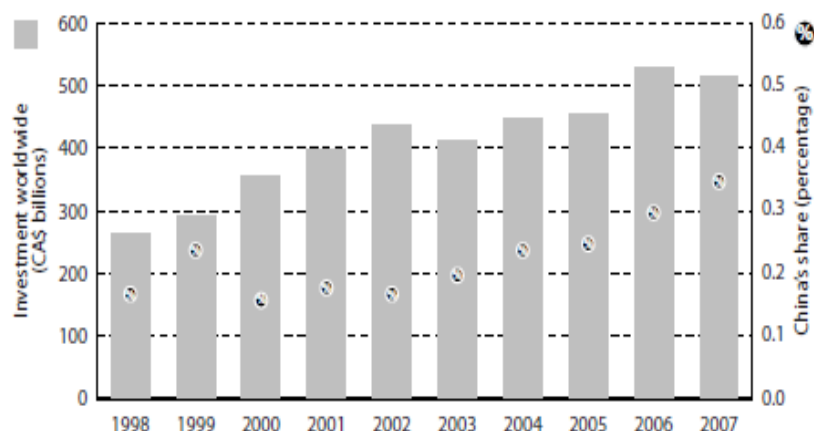
Table 7.1: Foreign Direct Investments (CA\$ millions) from Canada to major destinations, 1998–2007

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
United States	133,267	151,775	177,943	188,481	199,992	169,605	198,460	202,670	230,405	226,147
United Kingdom	24,956	25,686	35,170	39,682	40,749	43,902	44,358	47,691	58,000	54,600
Other Europe	32,274	32,156	49,476	59,558	68,265	80,445	85,832	77,650	81,958	79,966
Hong Kong	3,425	3,616	3,739	3,020	2,642	3,037	3,086	3,362	4,988	4,519
China	446	711	565	699	721	838	1,081	1,131	1,574	1,797
Other regions	68,541	76,786	89,613	107,813	123,125	114,390	115,729	122,707	153,044	147,511
Total	262,909	290,730	356,506	399,253	435,494	412,217	448,546	455,211	529,969	514,540

Note: "Other Europe" includes all European countries except the United Kingdom. "Other regions" includes North America (except the United States), Asia, and South and Central America.

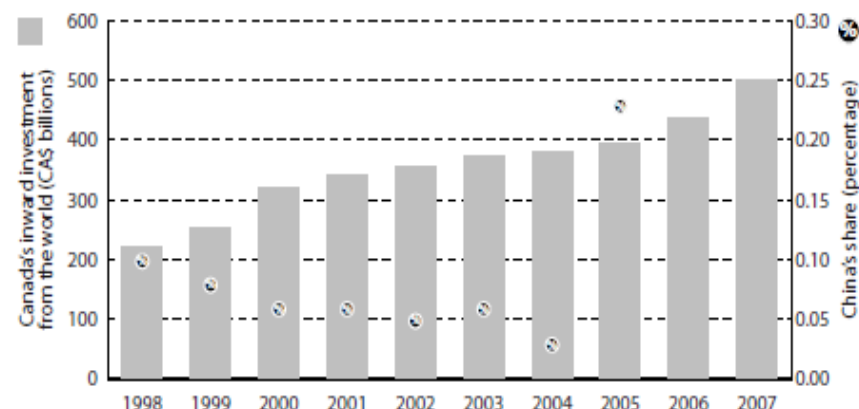
Source: Statistics Canada, 2008, year-end stocks.

Figure 7.1: Canada's overall outward investment (CA\$ billions) and China's share (%) of the total, 1998–2007



Sources: Statistics Canada, 2008; calculations by authors.

Figure 7.2: Canada's overall inward investment (CA\$ billions) and China's share (%) of the total, 1998–2007



Note: Data for China were available only until 2005.

Sources: Statistics Canada, 2008; calculations by authors.

3. China: Workshop of the World, Forever?



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International Division of Labour:

- **Western and Japanese firms:** designers and architects of electronic products
- **Taiwanese firms:** middlemen responsible for hardware production and assembly
- **China:** preferred location of assembly

TABLE 1. TRADE BALANCE, BY ELECTRONICS SUBCATEGORY, 2000 (BILLIONS US\$)

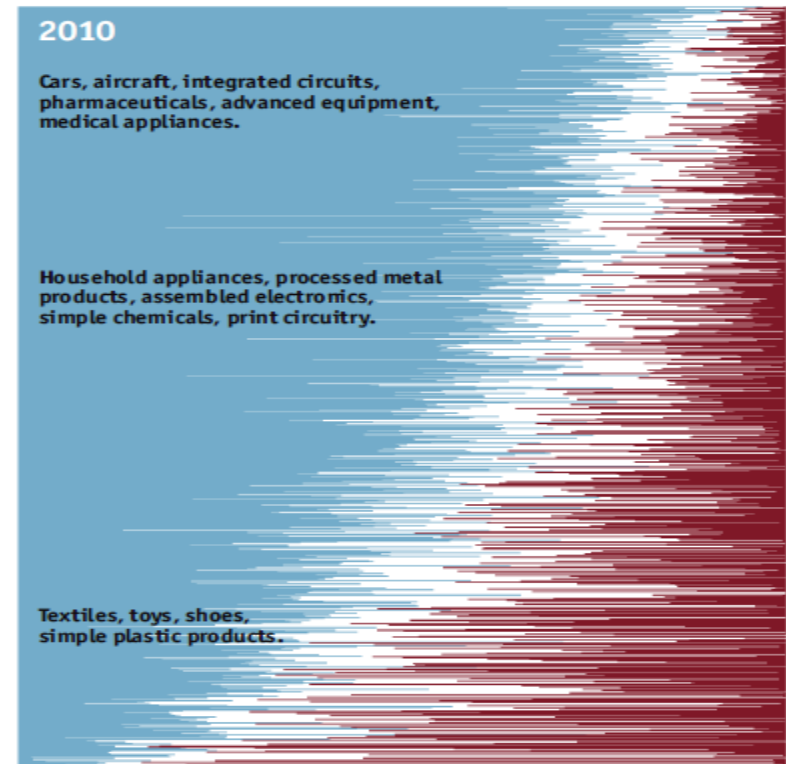
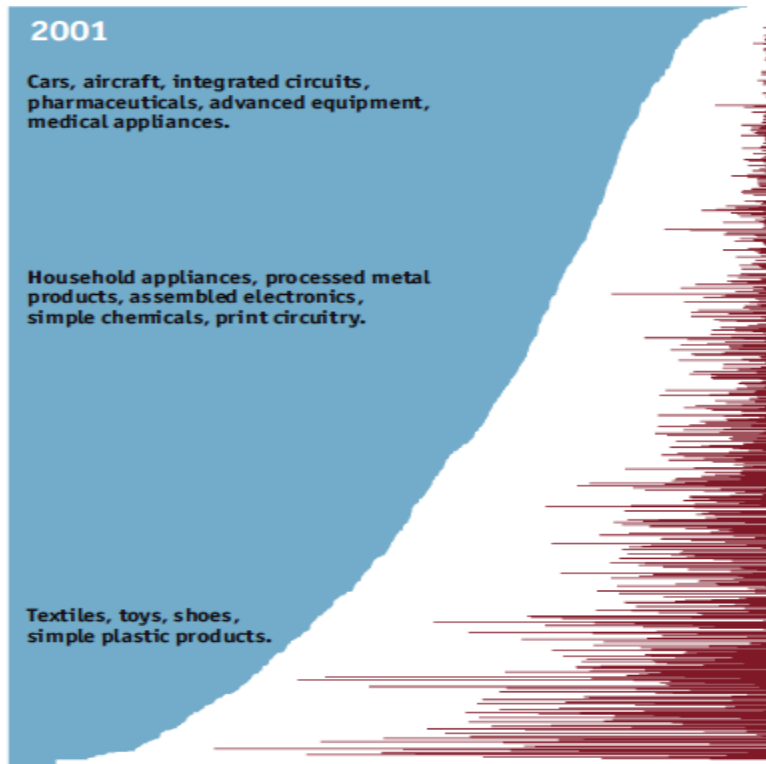
Product category	Exports	Imports	Trade balance
Final goods			
Consumer electronics	8.8	0.2	8.6
Electronic data processing	16.6	9.9	6.7
Office equipment	1.3	0.1	1.2
Telecommunications	2.4	3.2	-0.8
Components			
Active components	4.5	19.6	-15.1
Passive components	4.7	5.2	-0.5
Other components	5.5	5.5	0.0

Source: Reed Electronics Research, 2002

3. Moving up the Value-Chain?

China exports: climbing the ladder, regional share of global exports in 2001 and 2010
(export product categories sorted by developed economies global export share in 2001)

Developed World China



Sources: ITC; Economist Intelligence Unit calculations.

Source: Economist Intelligence Unit (EIU) (2011). "Heavy Duty: China's next wave of exports".
See, http://www.eiu.com/public/topical_report.aspx?campaignid=heavyduty_Aug11

3. Mid- to High-Range of Technology and Capital-Intensive Exports



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Selected “hot zone” sectors and global export market share (%)

	2010 global export value (US\$ bn)	China		OECD countries	
		2007	2010	2007	2010
Cruise ships, cargo ships, barges	124.0	14.4	28.4	76.7	65.1
Electrical switching apparatus (<1,000 volt)	75.5	8.4	11.4	70.8	71.7
Centrifuges, filtering/purifying machinery	44.9	3.5	7.1	82.7	80.9
Transmission shafts/cranks, gears	42.5	5.1	8.4	87.6	83.0
Refrigerators, freezers, etc	35.5	12.9	16.2	72.5	69.2
Heating/cooling equip for plant/lab use	31.0	3.8	7.5	85.8	84.6
Ball or roller bearings	29.0	8.0	11.0	76.4	73.4
Lifting/handling/loading machinery	18.9	6.8	12.2	86.2	80.2
Motorcycles, side-cars	16.7	18.6	26.3	72.1	60.6
Electrical ignition/starting equip	15.2	4.8	7.5	84.9	82.6
Harvesting/threshing machinery	15.2	4.0	7.6	89.3	84.7
Chemicals in wafer form (mainly silicon)	14.8	7.0	17.5	78.2	65.6
Tube or pipe fittings, of iron or steel	14.6	15.2	18.1	70.6	68.0
Derricks; cranes; trucks with cranes	11.9	16.9	22.4	74.2	69.5

Sectors bordering the hot zone

Taps, cocks, valves for pipes	65.2	13.0	15.1	79.2	76.2
Construction/mining machinery parts	60.2	5.3	7.6	82.6	79.4
Air, vacuum pumps; hoods incorp a fan	59.8	10.6	13.1	76.8	74.5
Pumps for liquids; liquid elevators	51.1	5.3	7.7	86.9	84.3
Self-propelled bulldozers, excavators, etc	35.7	3.9	6.3	87.0	84.0
Optical fibre, cables	25.9	8.3	10.7	73.3	71.5
Aluminium bars, rods and profiles	13.5	14.9	17.3	67.0	65.9
Moving/grading/boring machinery for earth	10.4	14.6	16.9	77.2	75.3
Fork-lift trucks; trucks with handling equip	10.2	4.9	7.4	92.7	90.1

Sources: International Trade Centre (ITC); Economist Intelligence Unit calculations.



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3. Why Does This Matter?

- Qualitative change in Chinese structure of production
- Mid-tech capital intensive sector, like construction equipment, unlike other exports:
- Grew on basis of domestic demand, not foreign demand
- Not driven by foreign investment or joint ventures
- Growth more organic and based on domestic supply chain = **>local content**



Case: Xugong and Carlyle

- In 2005, Carlyle Group bids \$375m for 85% stake in Xugong Group Construction Machinery (XCMG)
- Xugong, received local approval, but blocked by Mofcom
- Carlyle revised offer twice: 50:50, 55:45
- **Carlyle dropped bid in 2008**
- Case came two months after failed CNOOC bid for Unocal
- China's three largest firms dominate domestic market in cranes, cement mixers, earth movers. **Gaining market share in more sophisticated production:** hydraulic excavators.



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THE CARLYLE GROUP

GLOBAL ALTERNATIVE ASSET MANAGEMENT

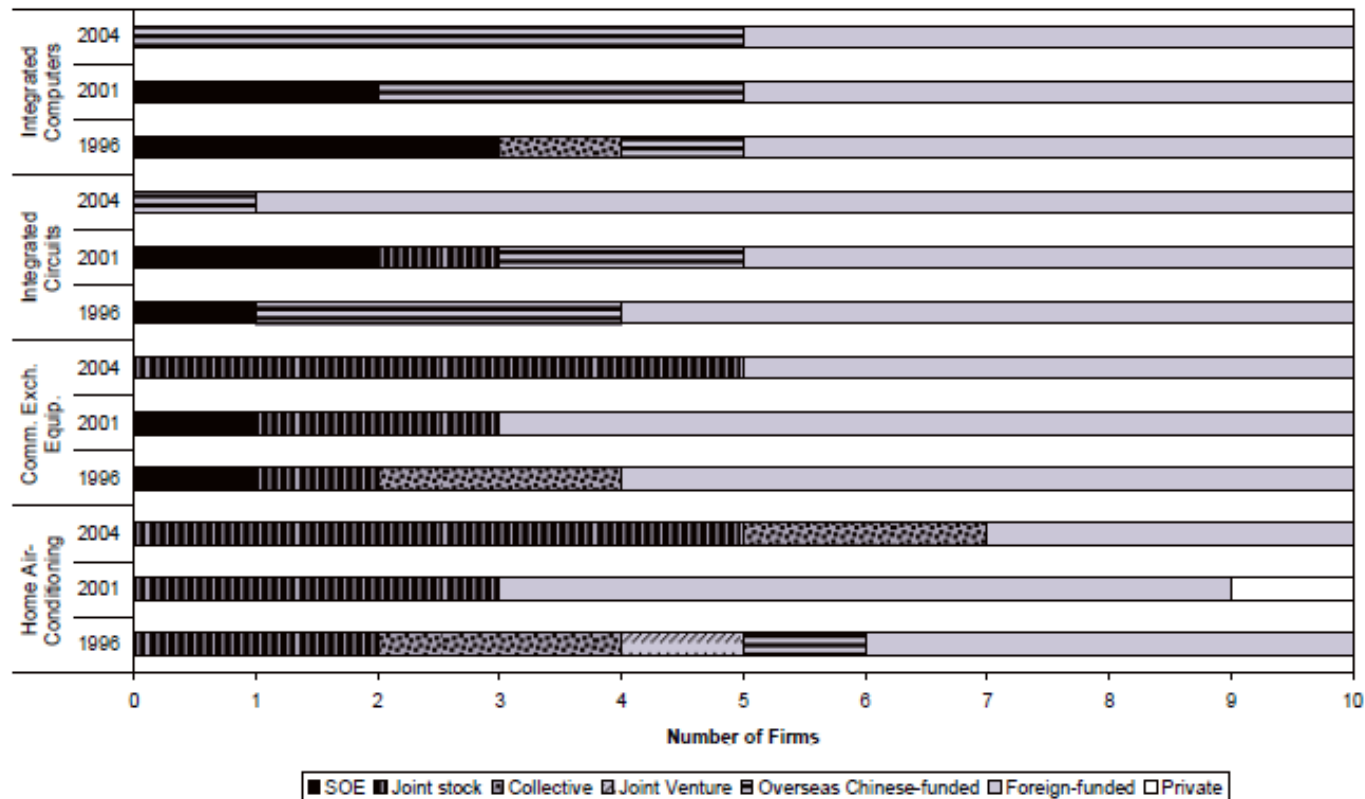


3. Ownership Trends, by sector



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Chart 4. Evolution of Ownership Structure of Top 10 Firms, Electronic Industries, 1996, 2001, 2004



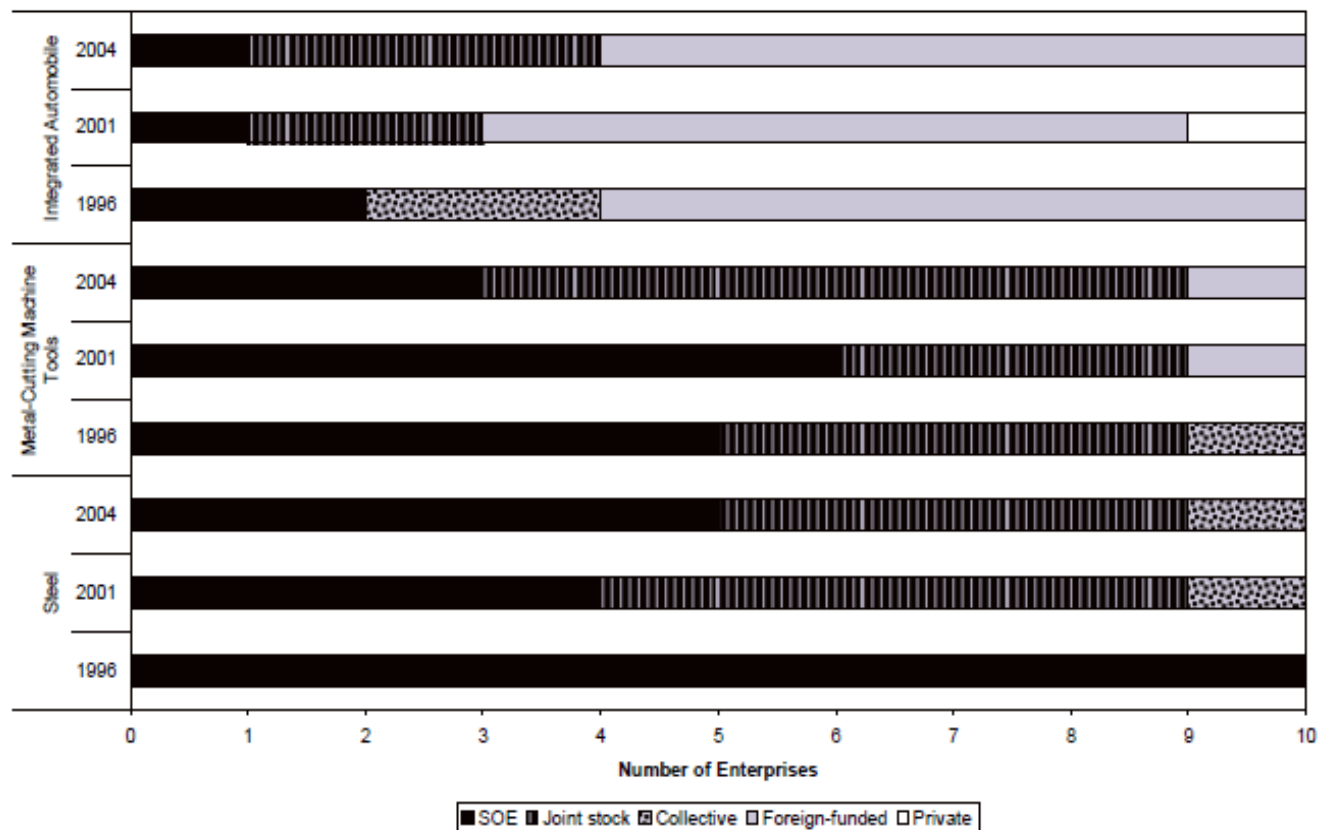
Source: China Markets Yearbook 中国市场年鉴, 1999, 2003, 2006.

3. Ownership Trends, by sector



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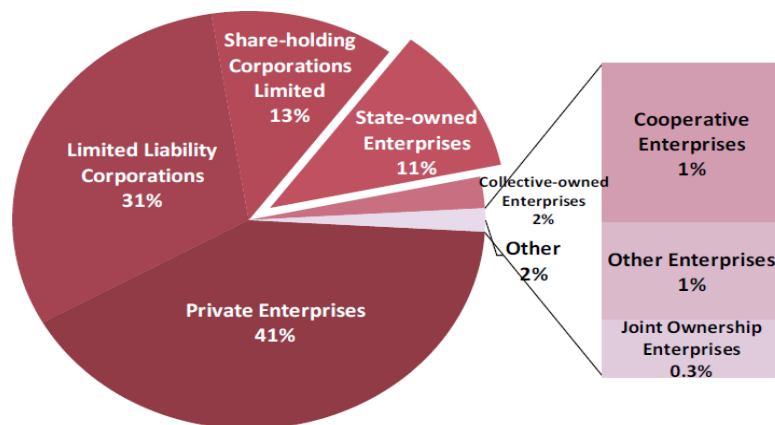
Chart 3. Evolution of Ownership Structure of Top 10 Firms, Pillar Heavy Industries, 1996, 2001, 2004



Source: China Markets Yearbook 中国市场年鉴, 1999, 2003, 2006.

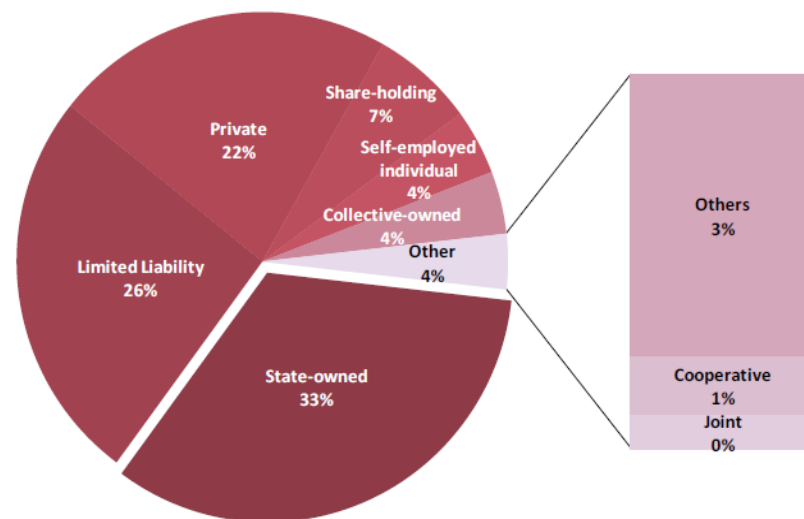
3. Concentrating Role of State

Figure III-3: Gross industrial output value by status of registration, 2009



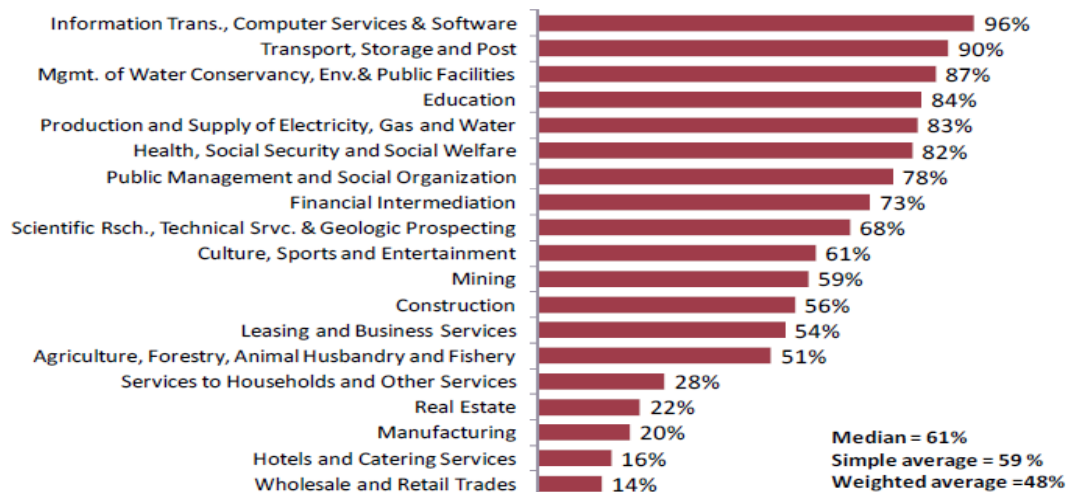
Source: National Bureau of Statistics of China.

Figure III-5: Domestically funded fixed investment by status of registration, 2009



Source: National Bureau of Statistics of China.

Figure III-6: SOE and SHE shares of domestically funded fixed investments in urban areas, by sector, 2009



Source: National Bureau of Statistics of China.

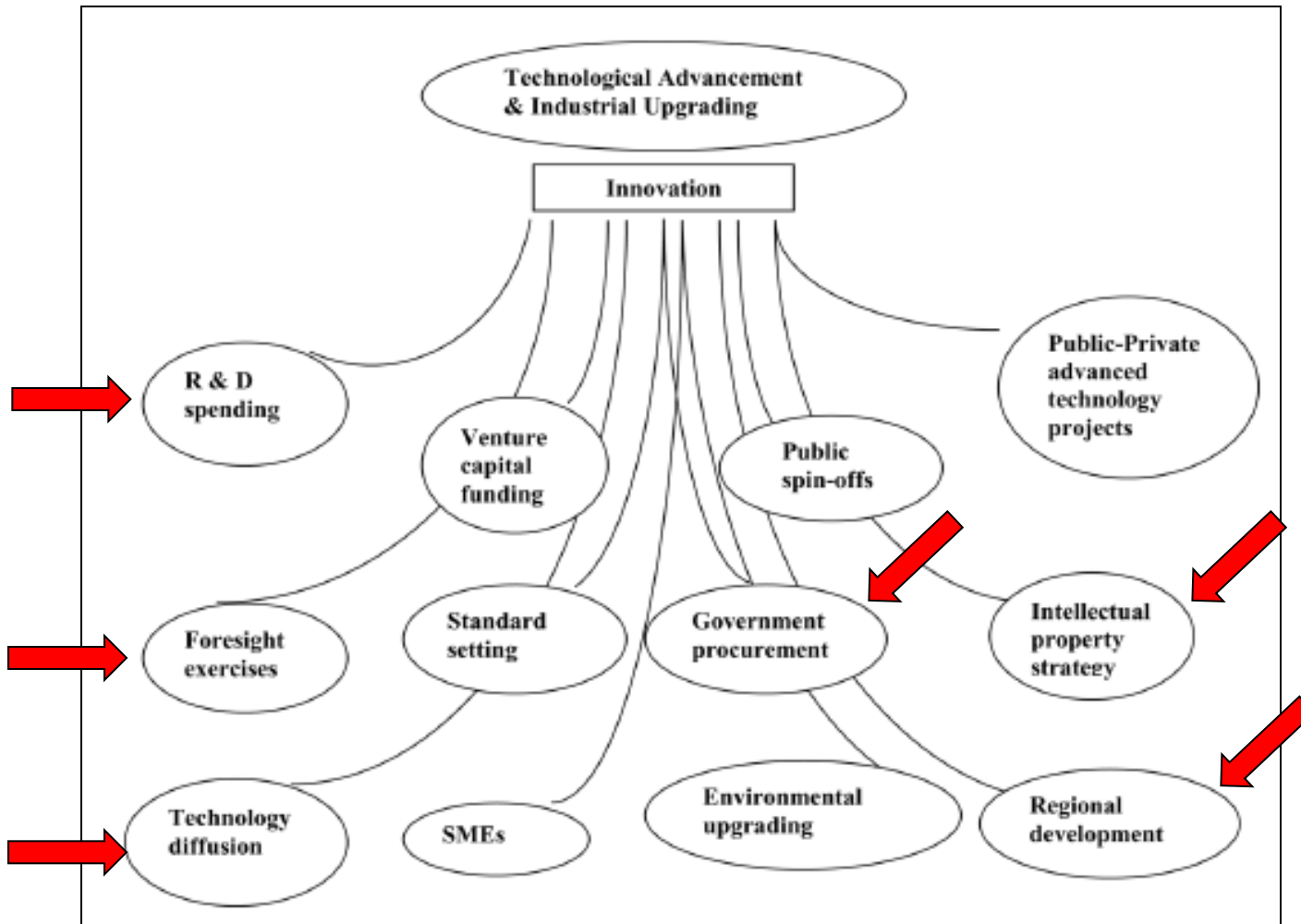
3. Playing a Different Game?

	Western Countries	China / East Asia
Priority	Maximize consumer welfare	Production and technological 'catch-up'
Markets	Ends in themselves	Means to an end
Currency	Floating, market-based	Fixed, pegged
Consumers	Consume > Save (trade deficit)	Save > Consume (trade surplus)
Strategy	Specialization of production according to what country does best, trade for the rest (comparative advantage)	Strives to change resource endowment, achieve broader range of production, targeted industries
*Potato chips, or computer chips?	"What's the difference? They're all chips"	Computer chips

3. Known 'Flexibilities' in WTO



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3. Steel Industry Preferential Policies

Instrument	Description
Transfers of ownership	Transfer of shares or facilities from one company to another at below-market, or at no cost.
Cash grants	Direct grants to producers that incur loss; some contingent on export performance.
Debt-for-equity swaps, or debt forgiveness	State banks lend at below-market rates; when borrowers unable to repay, bank converts debt to equity.
Energy and raw material advantages	Fund purchases of energy and raw materials, in grant form or in-kind, including provision of coking coal and iron ore; imposes restrictions or high export taxes on inputs.
Barriers to foreign investment	Foreign ownership ceilings, induce technology transfer.
Tariffs, and currency	Favourable tariff rates, currency undervalued to make exports attractive.

3. Renewable Energy Strategy

Instrument	Measure	Example
Creating markets and driving demand	Energy conservation targets;	Generate 15% of primary energy from nonfossil fuel sources by 2020; requires power generators (>5GW) to produce renewable non-hydro sources for 3% of electricity by 2010, 8% by 2020.
Financing	Grants, tax breaks and other incentives (favourable land pricing)	2004 Wind Power Concession Project, utilities enter into long-term power purchase agreements with developers, while utilities allowed to raise rates on end users.
Infrastructure	Incentives/subsidies	Golden Sun Demonstration Program, investment subsidies equal to 50% of investment cost for grid-connected solar power systems;
Support for domestic manufacturers of RE equipment	Domestic content requirements	2005 regulation mandating Chinese wind farms have at least 70% local content.
State-owned enterprises (SOEs)	Key 'agent' and conduit of state objectives	End 2008, big 5 state power companies accounted for 55% of installed wind capacity.



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4. Implications for Canada?

- Which direction for Canada?



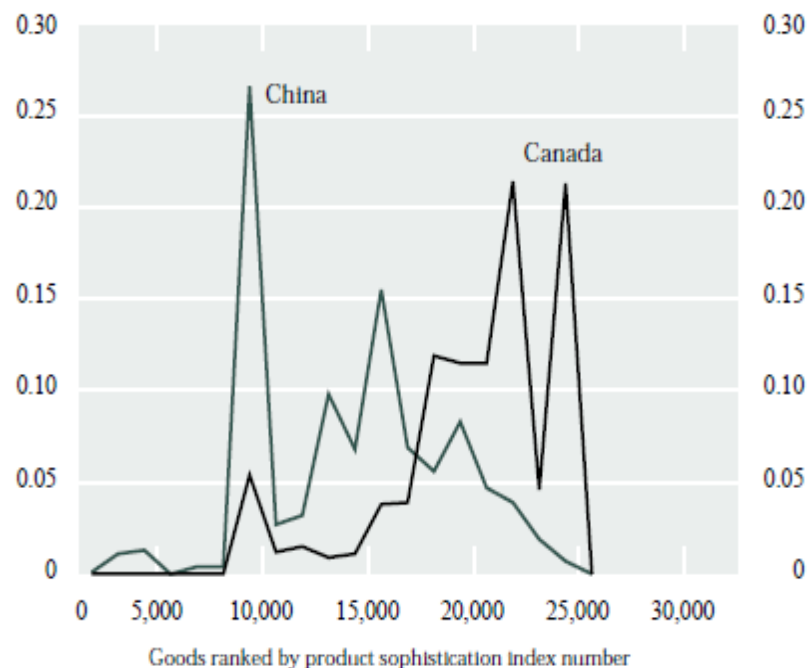
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Chart 2a

Canada and China: Share of Exports Ranked by Sophistication

1985

Share of country exports



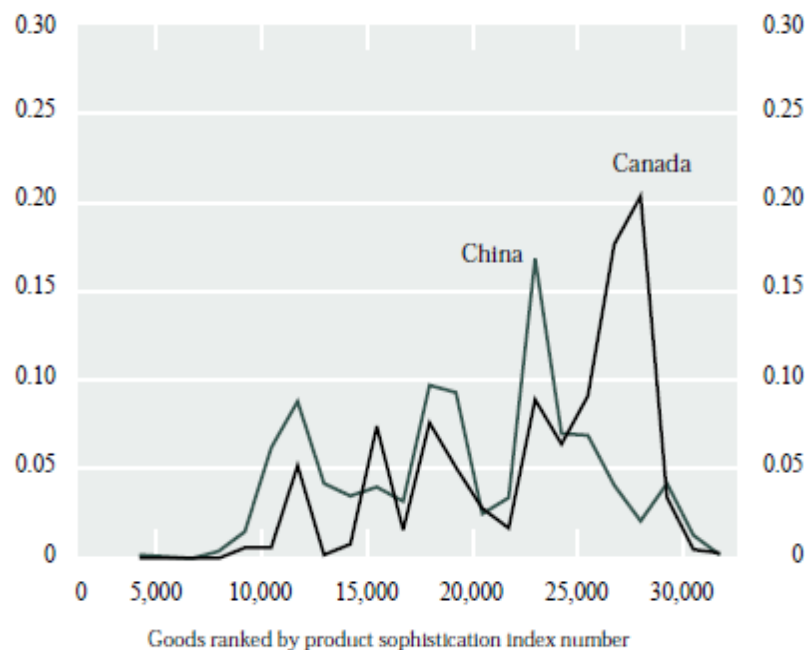
Source: DFP (2004)

Chart 2b

Canada and China: Share of Exports Ranked by Sophistication

2001

Share of country exports



Source: DFP (2004)

4. Some Advice

Dominic Barton – McKinsey & Co.

- Establish Asia Advisory Council;
- Increase weight of diplomatic activities to Asia;
- Raise cultural and educational ties with Asia;
- Create Minister and Cabinet Committee on Asia to drive agenda and accountability;
- **Select 5-7 key sectors** to develop Cdn ‘**global champions**’: infrastructure, financial services, aerospace, education, tourism, natural resources.
- “Foreign investment should be designed to support an environment that allows globally competitive Cdn champions to emerge (as opposed to protecting uncompetitive local players from global competition).”



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4. Reaching Consensus?

Jim Stanford – Canadian Autoworkers Union (CAW)

How to support Cdn Champions?

- Using every policy lever in the toolkit
- Favourable access to capital and tech;
- Alignment between public training and tech programs;
- Leveraging public procurement to give head start in home market;
- Strategic promotion of interests through trade policy.



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The North-South Institute
55 Murray Street, Suite 500
Ottawa, Ontario Canada
K1N 5M3

Tel.: (613) 241-3535

Fax: (613) 241-7435

Email/Courriel: nsi@nsi-ins.ca

Website: www.nsi-ins.ca

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