CANADA-CHINA FRIENDSHIP SOCIETY

"China and its Asia Pacific Neighbours"

7:30 pm, June 22, 2015

Sandy Hill Community Centre, Ottawa

• Distinguished guests, friends, ladies and gentlemen, good evening. I would like to thank our hosts, the Canada-China Friendship Society for the opportunity to participate in this dialogue on one of Canada's most important bilateral relationships.

• Tonight, I would like to discuss the decline in China's growth rates and the ensuing economic slowdown, and what it means domestically and internationally. I would also like to offer some reflections on the status of Canada-China relations today.

• Anyone who reads the news today cannot help but encounter one of the major stories of our age: China's economy is slowing down, after decades of breakneck growth.

• Every day we hear new reports on the state of China's economy – lower growth rates, a decline in manufacturing output, a decrease in exports, and whatnot. Chinese leaders, policymakers, academics and commentators have all described the phenomenon of slower growth as the "**new normal**".

• What does this "new normal" mean for China and the rest of Asia?

• China's economy grew by 7.4% in 2014, its lowest rate in 24 years.

• By most standards, this is still a healthy growth rate. The World Bank, for instance, says the fast-developing economies of East Asia are projected to grow by 6.7% in 2015 and 2016, slightly down from 6.9% in 2014.

• For China, however, 7.4% is considered critically low -- even lower than its own conservative target of 7.5%.

• The slow down has been attributed to a number of factors, including:

- an ageing demographic,
- a lower demand for Chinese products in North America and Europe following the global financial crisis
- the shift from an investment-driven growth model to a consumption-based one
- an appreciating currency
- and rising wages resulting in decreasing Chinese competitiveness.

• The slowdown has hit the Chinese real estate sector particularly hard. A major driver of demand across different industries, the real estate sector remains unresponsive to the government's policy support measures.

• As supply outstrips demand, China has been left with a deflating housing market. This is particularly problematic for debt-ridden local governments, many of which rely on land sales for a big proportion of their revenue.

• The slowdown has also incited fears of a dangerous deflationary cycle in China. As investors hold off from investing in the belief that prices will drop even further in the future, China risks replicating Japan's recession woes.

• Many observers claim that a slowdown in China's economy threatens its political stability. For decades, strong economic growth has provided legitimacy to the political regime. The ruling party enjoys a monopoly on political power as long as Chinese citizens continue to enjoy the benefits of rising standards of living and general prosperity.

• A slowdown in China's economy risks undermining the source of political stability for the current regime — creating temptations for leaders to divert the population through increased nationalism.

• But the news is not all bad, and it is important to put China's slowdown into context.

• **First**, while China's 2014 growth rate is the lowest in a quarter-century, the size of China's economy has grown considerably in the past several decades. Even at a 7.4% growth rate, it led to a 4.8 trillion Renminbi increase in GDP. That's similar to 2007, when China's growth rate peaked at 14.2%.

• China also created 13.2 million jobs last year – 1.2 million more jobs than it created in 2007.

• And China's economic output in 2014 exceeded US$10 trillion, an accomplishment matched only by the U.S. in 2000.

• Although the IMF has projected growth in China to decrease to 6.8% in 2015, its lowest in 25 years, China's economy will be worth US$11.3 trillion, more than 25 times its size in 1990.

• **Second**, China's slowdown, to a certain extent, has actually been engineered by the Chinese government as it seeks to achieve more balanced growth.

• The government wants to redirect growth away from an unsustainable growth model dependent on exports and investments, and towards a growth model built on domestic consumption. Figures from 2014 show that the government is achieving considerable progress on this front, with just over half of the country's growth last year based on consumption.

• **<u>Third</u>**, an increase in wages also signifies that the share of labour in China's economic output is increasing. Household income is estimated at US$ 5 trillion a year. Household incomes rose by 8% in 2014. Figures also show a narrowing of the gap between urban and rural incomes, with rural incomes increasing by 9.2%, and only 6.8% in urban areas

• This increase in household income supports the government's efforts to boost domestic consumption and has contributed to a significant increase, from US$50 billion in 2000 to US$1.4 trillion in 2010. Discretionary spending is also increasing.

• Moving to the international stage, China's economic slowdown has sparked fears of deflation globally. The OECD projects that "a two-percentage-point decrease in the growth of Chinese domestic demand for two years would reduce world GDP by 0.3 percentage points a year." Concerns that growth in the Asia Pacific region will languish as a result of China's declining growth abound.

• As the second biggest importer in the world, China's slowdown is likely to have a detrimental impact on exporters in the Asia Pacific region.

• China became **South Korea**'s largest trading partner in 2014, and has been **ASEAN**'s largest trading partner since 2009, with trade in goods comprising the bulk of total trade. China is also the biggest export market for **Thailand** and **Japan** (by a slim margin), and the second biggest export destination for **Indonesia**.

• Several sectors are particularly vulnerable to the effects of a Chinese slowdown. South Korea is one example. Its exports of chemicals, equipment and machinery — driven to a large part by Chinese imports — are particularly vulnerable to a drop in Chinese imports.

• Just as China's boom years drove up commodity prices globally, its slowdown is creating a sharp decline in commodity prices presenting serious economic challenges to countries that export commodities such as coal, crude oil and natural gas.

•Similarly, the prices of iron-ore and steel have plummeted as a result of a decline in Chinese demand.

• One country that has been drastically affected is Australia, which accounted for 57% of the global iron-ore trade in 2014.

• While Chinese demand for steel has buoyed iron ore prices in the past, the Abbott government predicts that the "collapsing iron-ore prices have cut a projected US$23 billion from revenue over the next four years."

• The continuing decline is also expected to slash 1.3 per cent off Australia's GDP this year. And as smaller mining companies struggle to survive, the drop in iron ore prices will transform the market into one dominated by larger mining companies.

• China's slowdown, which has prompted the government to cut interest rates twice, has also increased the pressure on the global real estate market.

• As lower rates of return domestically prompt Chinese investors to search for higher returns elsewhere, capital outflow from China has created inflationary distortions in the property market not only in North America and Europe, but also in countries such as Australia and Singapore.

• However, there is a silver lining here for countries in the Asia Pacific region that import commodities and energy. They stand to win from the drop in prices. They include Japan, which imports US$250 billion worth of energy every year, South Korea, which meets 97% of its energy demand with imports, India, the world's third largest oil importer, and Pakistan, where oil comprises 35% of total imports.

• The decline in prices is also a boon to countries like India, Indonesia and Malaysia, which all subsidize fuel and energy costs substantially.

• At the same time, with rising wages in China, many companies are choosing to relocate labour-intensive production to other Asian countries with lower wages, such as Vietnam, Bangladesh and the Philippines.

• Rising domestic consumption in China also presents new opportunities for producers of consumer goods in the region.

• China's slowdown is always perceived in a negative light, but there are shades of grey here, with some countries emerging as winners and some as losers.

• Similarly, China's relations with its Asian neighbors cannot be described in simple terms. Territorial disputes in the East China Sea and South China Sea have lead to fears of an increasingly aggressive China that is intent on achieving its goals with the use of military force.

•Such fears have given rise to worries of an escalating military tension that would draw in major military powers and force Asian countries to choose sides between the U.S. and China.

• At the same time, however, China's relations with other Asian states also indicate its willingness to engage its neighbors constructively, either bilaterally or multilaterally.

• Traditionally wary of multilateral initiatives, China has taken the lead in establishing the Asian Infrastructure Investment Bank, reflecting a belief in China's policy circles in the value and importance of multilateralism.

• China has also made an effort to strengthen its relations with key players in Asia. The recent visit of President Xi to India lead to the signing of a five-year agreement on trade and economic cooperation, focusing primarily on trade infrastructure and connectivity in the region.

• Similarly, President Xi's visit to Pakistan in April culminated in the establishment of the China-Pakistan Economic Corridor, a US$46 billion investment.

• China's relations with Taiwan, long considered one of the most important and tense relationships in the world, have also improved as both sides seek to solidify their economic relations and promote people-to-people exchange through tourism.

• Negotiations between China and Taiwan in May indicate that China welcomes Taiwanese participation in the Asian Investment Infrastructure Bank, and both sides are currently exploring the possibility of establishing representative offices.

• In light of these developments, I would also like to offer some of my own insights into the state of Canada's relations with China today.

• Canada and China began their often-tumultuous relationship in 1970, when Canada was one of the first Western nations to officially recognize the PRC. Since that time the relationship has evolved as both nations have undergone changes in leadership.

• Over the past 15 years, however, the relationship has been an inconsistent engagement that has settled into an unfulfilling, economic arrangement.

• I say 'unfulfilling' with two levels in mind. . .

• On an economic level, we have really only scratched the surface of the opportunities China presents for Canadian business.

• On the people-to-people level, simply engaging economically remains deeply unfulfilling – Canada needs to engage in other facets, such as culture and education.

• **<u>In economic terms</u>**, the ratification of Canada's FIPA with China in 2014 and the establishment of a RMB transaction hub in Canada is good news. If we want to prosper in our relationship with China, these are types of engagement tools we will need.

• Still, Canada seems reluctant to move forward in this relationship.

• The Chinese government has indicated an interest in beginning FTA negotiations, and yet Canada has shown no interest in moving forward on that front.

• Although I discussed the ramifications of China's growth slowdown earlier, it is still important to note that by 2022, 56% of China's households will be considered middle class. Or to put it another way, there will be a market of 777 million people with money in their pockets and a hunger for consumables.

• Canada needs to be able to access that market.

• There is much that could be done to improve trade relations with our second largest export partner.

• My Foundation's recent National Opinion Poll shows that Canadians are wary of the levels of Chinese investment in Canada, but these fears seemingly arise from a significant overestimation of Chinese economic activity in the country.

• Educating people on the actual levels of Chinese investment in Canada (3% of all FDI) might go some way to assuaging this wariness among Canadians, opening the door for the government to promote an FTA.

• Another way we can promote trade with China is to highlight what we can offer to China beyond natural resources.

• Chinese current interest in Canada’s experience with public-private partnerships is a perfect example of what we can offer, showing that trade with China can be multifaceted.

• And we need to have a clear and open dialogue with the Chinese explaining that our own open investment environment depends on the support of Canadians. That support will inevitably weaken if Canadians come to believe that the advantages are all one sided.

• **At the people-to-people level**, fulfillment is perhaps more difficult.

• For example, while we have had significant numbers of Chinese students in Canadian universities (more than 84,000 in 2013) and even high schools, the reciprocity has not been there.

• In 2013, Canada had a meager 3,760 students in China. While both nations have pledged to reach the goal of 100,000 students studying in each other’s countries by 2017, it is clear Canada has a long ways to go.

• Education links can do much to boost a country’s profile abroad, an especially important consideration for second-tier markets such as Canada. And while Australia and the U.S. seem to get this, Canada doesn’t.

• Culturally as well, Canada needs to revisit its exchanges with China. In 1974 the University of British Columbia sent its men’s hockey team on a journey to China to demonstrate the sport and promote cultural exchanges. That was four decades ago. . .

• With the recent surge in hockey interest in China — the state broadcaster shows NHL games, and the Toronto Maple Leafs are engaged in a program to build the sport there — Canada should once again consider a cultural engagement on this level.

• Promoting Canada as a top tourist destination for the Chinese is another avenue of cultural exchange that could be enhanced. While many Chinese will know of Niagara Falls and Butchart Gardens — former Ambassador David Mulroney says they are the bucket-list destinations for Chinese visitors to Canada —there are many more beautiful destinations Canada can, and should, promote.

• The Yukon has had a wonderful strategy to promote Japanese tourism for the Northern Lights, and it has been very successful. More initiatives along those lines should be explored and encouraged.

• The reason cultural exchange is important is simple: Positive experiences of exchange build upon a nation's reputation, strengthen its global brand, and enhance its ability to participate in and influence regional or global outcomes.

• This is ultimately the essence of soft power. If Canada wants to play a role in the Asia Pacific, that role needs to start with China, a country so central to the new global economy that minor fluctuations in its growth or consumer spending sends shockwaves around the world.

• As a middle power, this soft power is Canada's competitive advantage.

• As the world pivots to Asia, and its largest economy, we need to be willing and prepared to engage.

• Thank you for your time and attention this evening. I welcome your questions and comments.