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Canada–China:

Building a strong economic partnership

July 2010

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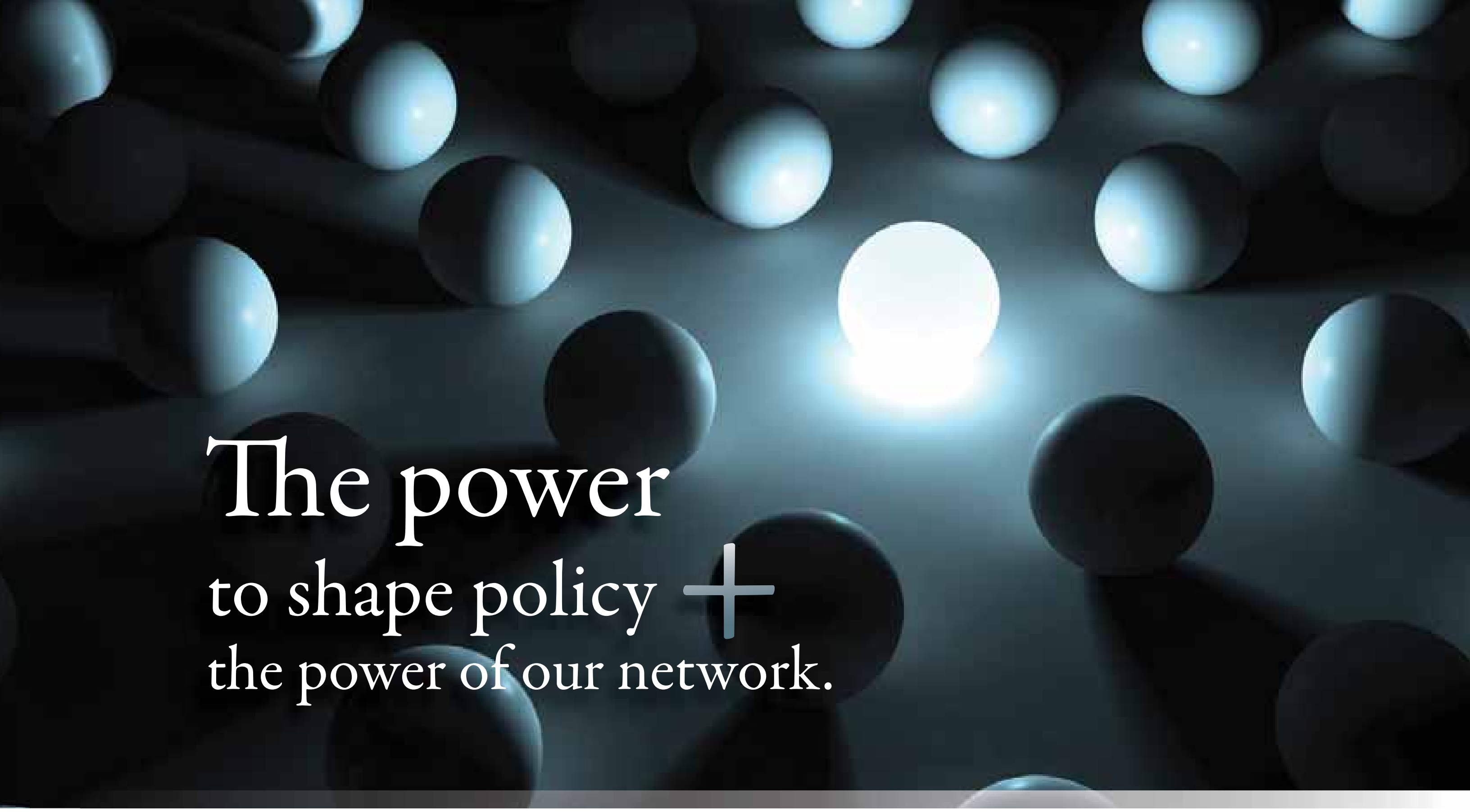

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Foreword

China is already a pivotal player on the international stage – economically, geopolitically and culturally – and its role continues to grow. And this growth comes at a time when, following the financial and economic crises of 2008-2009, the world's economic centre of gravity moves rapidly from the Atlantic toward the Pacific, where China, India and other Asian dynamos are becoming the second pillar of global growth in trade, investment, production and consumption.

China already matters greatly to Canadian businesses and households in so many different ways. It is a source of inputs and consumer goods, and a production and logistics platform. Most importantly, it is a vast market—still largely untapped—for Canadian resources, manufactured goods, technologies and services, and a font of investment in Canadian business projects.

We need to ask ourselves, in politics, business and society at large, whether we have maximized the Canada-China economic partnership. China is, after all, due to become the world's second largest economy this year, with markets representing 1.3 billion increasingly sophisticated consumers and deep pools of capital. Have we sufficiently engaged a nation at the centre of integrating regional and global value chains? Have we promoted our country's cross-sector value proposition in China under a consistent Canadian brand? Do we think of ourselves as a nation of the Asia-Pacific, which must have a strong presence and voice in that region, just as we are a nation of the Americas, Atlantic and Arctic?

The Canadian business community has told us that Canada needs to be more active in strengthening its economic partnership with China, as virtually every other country is.

Doing so requires continued robust political engagement with China to foster the economic partnership and remove obstacles to trade and investment in both countries. It calls for bolstering the visibility of Canada's brand in China, involvement of Canada's many excellent companies in pursuing real business opportunities there, and ensuring that foreign commercial investment—including from China—is welcome in Canada. It entails strengthening Canada's innovative capabilities and building bridges through people that will become bridges of trans-Pacific trade and investment and pathways to a more globally competitive Canada. Lying astride shipping and flight paths stretching between the United States—our largest economic partner—and China, Canada has a vast potential to become a value-adding business gateway and corridor between North America and Asia.

This discussion paper presents the Canadian Chamber of Commerce's ideas for dealing with some of the barriers to greater Canada-China economic interaction. Our extensive research and discussions with our members and Canadian thought leaders convince us that now is the time for both governments and the business community to reinforce efforts to realize the economic potential of Canada-China ties.

We hope this paper will assist both Canada and China to find new ways to boost their two-way exchanges in trade and investment. For both sides, the dividends could be huge. Let us ensure we take full advantage of the opportunities before us.

Perrin Beatty

President and CEO
Honourable Perrin Beatty
The Canadian Chamber of Commerce

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Executive Summary

China. An ancient and refined civilization, 1.3 billion people strong, all living in a vast territory stretching from the mountains and deserts of Central Asia to the Pacific Ocean. A country that for centuries has captivated the West. As we begin the 21st century, China is also a growing economic powerhouse that is restoring its prominent position in the community of nations.

In politics, in business, in the media, China is a topic of conversation almost everywhere. And for good reason. No matter what the subject—from global trade and investment, macroeconomics and geopolitics to climate change or the rules and institutions of the international system—China's role is pivotal.

China's re-emergence is occurring during a time of important change in the global economy. The financial and economic crises of the past two years will leave a lasting mark on global patterns of economic growth, consumption, trade and investment. The most significant change, even as the economies of the United States and European Union slowly recover, will be a more rapid shift in relative economic clout away from North America and Europe toward Asia, and from the developed to the developing world. Large developing economies, with China in the lead, have become an increasingly powerful secondary engine of global economic growth.

For trade-dependent Canada, learning how to navigate shifting global currents to ensure its increasing prosperity calls for a focused re-thinking of policy, one that looks well into the future. Stronger ties with the United States, the wealthiest and most innovative market in the world, must remain the first pillar of Canada's international trade and investment policy. However, Canada's economic well-being will need to rest on a second pillar that it must begin building now. That pillar will be greatly enhanced economic exchanges with other key markets such as China, India and the European Union.

In the interest of our future prosperity as a country, the time has come for political decision-makers and businesses to come together to pave a path forward. Canada cannot be complacent at a time when its business communities are being challenged by competitors from industrialized and developing countries as never before, in markets both at home and abroad. Canada has lost preferential status in the United States and it has not been sufficiently vigorous in pursuing opportunities beyond markets south of its border.

China's economy is expanding rapidly and is expected to become the world's second-largest economy later this year. Today, China has an enormous population of increasingly wealthy and sophisticated consumers and is a key global exporter and importer of high-quality resources, manufactured goods and services. China is also an active overseas investor with vast pools of capital and a huge, diverse constellation of markets that Canada cannot afford to overlook.

Indeed, some of Canada's most ambitious companies have long been active there, but Canada is behind other countries in terms of trade and investment with China. Many Canadian businesses are only beginning to explore the great opportunities China offers. We need a strong Canada–China economic partnership that mirrors our historic friendship, four decades of diplomatic relations and extensive people-to-people ties. Both government and businesses must step up to broaden and deepen Canada's economic ties with China over the coming years.

Achieving this will require that the federal government, together with the provinces and territories, provide overall strategic direction to move Canada's economic ties with China forward. Work must be done by both countries to remove the obstacles that stand in the way of enhanced, mutually beneficial two-way trade and investment. Yet, it is ultimately businesses that do business. More than ever, it is essential that Canadian companies of all sizes and across all sectors grow to become globally competitive players in China.

What are the ingredients that ensure success? In the discussions between the Canadian Chamber of Commerce and the wider business community, key themes have emerged:

- It is essential that a Canada–China economic partnership begin with a solid political relationship at every level. The Canadian business community is encouraged by the December 2009 visit to China by Prime Minister Harper, followed by the June 2010 visit to Canada by Chinese President Hu Jintao, a positive step that must be followed by ongoing two-way exchanges between Canadian political leaders—the prime minister, cabinet ministers, premiers and mayors—and their Chinese counterparts. The Canadian business community also calls for a formal Canada–China Strategic Dialogue.

- The federal government must raise Canada's profile on China's increasingly crowded international radar screen. Boosting trade and investment with China requires a consistent, overarching Canadian brand that ensures the visibility of Canada's commodities, manufactured goods and services in China, where its exports must compete for attention with the best the world has to offer.

- China is an ongoing economic development story and there are areas where Canada has the expertise to help China prosper. Canada must match its companies' products and expertise with the needs of China's diverse regions. The federal government, provinces and territories have a role in providing Canada's sectors with political introductions to local governments in China. They also have a role in assisting Canadian companies in identifying real opportunities through well-resourced Canadian trade-representative offices on the ground. Canadian businesses need to be willing to dedicate resources to understand the complexities of China's markets and develop ties with reliable local partners.

- Geography places Canada on what is emerging as the world's most important arc of two-way trade and investment: between the United States and a regional Asian economy centred on China. Through its *Asia Pacific Gateway and Corridor Initiative* and *Blue Skies* agreements, Canada can become a gateway for an increasing number of goods and people travelling between North America and Asia. By plugging their businesses into—and adding value to—this movement of people and products, Canadian cities can prosper as global business hubs. Canada can become China's gateway to North America.

- Canada must improve its record on skills and innovation to ensure it can continue creating the sophisticated products China and other large markets demand. Through its education system, Canada must ensure it has a highly skilled and motivated workforce able to work in a global business environment. Canada must also double its efforts to bring research to market. Even further, it must capitalize on the wealth of experience and skills that Canadians of Chinese origin bring to its labour force, and also maintain ties with Canadians in China. These individual relationships with China must be seen—and treated—as economic bridges for Canadian businesses.

- Canada needs to focus on its strengths in its mining and energy sectors, agricultural sector, high-value-added manufacturing and technological industries, and its commercial services areas, among others. Canada must deepen and broaden its goods-and-services trade with China. Not only does Canada need to increase the volumes of exchange, but it must also broaden it across all sectors to include more high-value-added products and processes. Canada must do this not only in sectors where it currently has niches of expertise, but also in budding sectors such as green technology. There is room to build strong partnerships with China in many of these areas.

- China has shown an interest in investing in Canadian resource, manufacturing and service sectors. Building on progress already made, it is vital for

Canadian businesses that Canada welcomes Chinese investment in word and in deed. Our two countries must also work to conclude the *Foreign Investment Protection Agreement* (FIPA) to ensure high standards of protection for investors on both sides.

- As trade-dependent countries, both Canada and China must collaborate through international institutions and fora and work with other international partners to stop protectionism and promote rules-based trade liberalization. Canada also needs to take the first step in exploring the viability of a comprehensive free-trade agreement with China.

- Education is another area where Canada and China can work together. Canada must continue to aggressively market its excellent education brand in China, where demand for world-class education is strong. Younger Canadians need to develop China-specific skills such as an ability to speak Mandarin. A Canadian population more knowledgeable of China, coupled with ties nurtured between Canadians and Chinese alumni who have studied in Canada, will strengthen the networks through which two-way trade and investment will flow.

- With China's granting of Approved Destination Status (ADS) to Canada in December 2009, the federal government must move to market Canada as a travel destination to China's growing population of overseas tourists.

To build on the progress already made, Canada must work earnestly with China, its international partners and the World Trade Organization (WTO) to address the challenges facing businesses in China. China has made great progress in bringing its legal system and its trade and investment regulations in line with international norms. Among the remaining issues are:

- insufficient enforcement of intellectual property (IP) rights;
- subsidization of industries;
- local content and technology transfer requirements;
- indigenous innovation rules;
- discriminatory treatment of foreign investors; and
- the general lack of clarity within the legal system at the local level in China.

Then there is the yuan, viewed by many as undervalued. A recent announcement by the Chinese government that it will loosen the yuan exchange rate is encouraging and needs to be acted upon.

China recognizes the importance of international norms as they relate to international trade and investment. Supporting China as it bolsters its role as a responsible stakeholder in the international system is in the interest of both Canada and China.

Canada must maintain a non-discriminatory stance toward inbound foreign direct investment in its sectors. Indeed, it must actively welcome such investment from China as from other countries. The federal government must also strengthen the enforcement of IP protection in Canada.

Canada and China must meet the challenges before them to grasp the full, mutually beneficial potential of a stronger Canada–China economic partnership. As China and the wider Asia–Pacific region continue to grow in economic, geopolitical and cultural influence, it is vital that all of Canada come to think of itself as a nation of the Pacific, just as it is also a nation of the Americas, the Atlantic and the Arctic. Beginning with a stronger economic partnership with China, Canada must strengthen its political and economic place and voice in that dynamic and increasingly powerful, economic region.

The consultations of the Canadian Chamber of Commerce have produced 38 recommendations that can be found throughout this document.

Section I: Introduction

1. Canada, China and the "new normal"

We are at a turning point in the global economy, even as it recovers from the severe recession that followed the financial crisis of 2008–2009. Signs of a return to growth are visible: expanding output in most major economies, stabilized volume of global trade, rebounding stock prices, rising commodity prices, an upswing in consumer and business confidence, and the thaw of credit markets. The International Monetary Fund recently predicted a global economic expansion of over four per cent in 2010 following a 0.6 per cent contraction in 2009.[1]

However, this is anything but business as usual. What differs from past years is that global growth will be driven mainly by large, developing economies in 2010 and beyond. Developing Asia is expected to see 8.7 per cent growth in 2010, led by China with an economic expansion of 10 per cent.[2] Growth in advanced economies is projected to be more sluggish, with that of the United States forecast to grow around three per cent this year.[3] A major, coordinated, international monetary and fiscal response has mitigated the economic downturn, yet a sustained recovery will require a robust increase in private consumption and investment as governments around the world begin to withdraw public stimulus spending.

For a country such as Canada, whose prosperity depends on its international economic exchanges, a question arises. Who will consume Canadian products and invest in Canadian businesses? Canada can no longer depend on North America alone. Most economists agree that we will not see a return to the normal global patterns of consumption, trade and investment of the last decade, and that, in fact, we are in a wholly different "new normal."

In the new economic context, there will be a difficult, yet necessary, rebalancing between major economies with large trade surpluses and those with large trade deficits.[4] The former, beginning with China, seek to reduce over-dependence on export-driven growth by fostering domestic consumption. Trade-deficit countries, notably the United States, seek to lessen their massive debt burdens through higher savings and export promotion. Even as growth returns, the United States will not resume its previous role as the world's consumer of last resort, and indebted U.S. households can no longer absorb the world's exports in the volumes they once did.[5] While it is vital that Canada continues to deepen its commercial and investment ties with the United States, diversifying Canada's international trade and investment must also be moved up the priority list.

This is a time for action. For a mid-sized country such as Canada whose well-being is closely tied to global trade, gaining access to both new markets for its goods and services, and to new sources of capital, is not an option–it is a necessity. Maintaining the dynamism of Canadian businesses, the strength of the Canadian economy, and the quality of life Canadians enjoy now requires an ambitious, comprehensive and forward-looking strategy to enhance our country's trade and investment ties with other major markets. The focus must include China, India, the European Union, Brazil, South Korea and Japan.

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1 International Monetary Fund, "*World Economic Outlook,*" also available online at www.imf.org/external/pubs/ft/weo/2010/01/index.htm [cited April 2010]

2 Ibid.

3 Ibid.

4 Olivier Blanchard, *Sustaining a Global Recovery* (International Monetary Fund, Sept 2009) Also available online at www.imf.org/external/pubs/ft/fandd/2009/09/blanchardindex.htm

5 *The "New Normal" for the U.S. Economy: What Will It Be?* (The Brookings Institution, Sept 1, 2009) Also available online at www.brookings.edu/opinions/2009/0901_economy_galston.aspx

As more global economic power shifts east, Canada will need to match its traditional north–south orientation by more ambitiously pursuing the new opportunities tied to a rising China. After all, China is the world's fastest-growing and soon-to-be second-largest economy. Its population tops 1.3 billion, and it is currently Canada's third-largest trade partner.

Many businesses have become global, relocating their production and service facilities to where gains in efficiency are greatest. These changes involve chains of corporate financing, manufacturing, sourcing, distribution and management, spanning countries and continents. More than ever, China is at the centre of these integrating global value chains. Seen by many as the world's workshop, China is the planet's largest producer and exporter of a vast number of low- and high-technology products. It is a global investor with an abundance of capital. China is also a regional nexus and gateway to the wider Asia–Pacific region. Its urban middle class is rapidly growing in numbers and wealth. Demand for many of the goods and services Canada has to offer is also increasing.

For Canadian businesses on the offensive, opportunities in China are available—but they are not always easy to pursue. Getting started in China and defining an appropriate business strategy can be daunting, especially for smaller companies. Will companies look to China to invest, to sell goods and services to Chinese consumers, to use China as a low-cost production base, or to integrate Chinese suppliers into their business platforms? China has become an important overseas investor and it has a real interest in Canada, an enticing prospect for many Canadian businesses.

Success in China will also require Canadian businesses to understand the challenges of China's markets, its business practices, and its regulatory and legal systems that are both complex and different from the familiar North American systems they have come to know. Many companies that have rushed in without understanding China's markets have failed. Canadian businesses, competing with their international peers for opportunities in China, must also be aware of the services provided by government and private consultants at home and overseas, to facilitate their success there.

Canadian businesses deal with defensive issues as well. Some of Canada's traditional sectors have shut down. Others have survived by adding value to their offers and sending production overseas. Canada exports large quantities of primary commodities to China while importing consumer goods and machinery from China. While Canadian businesses are right to be concerned about certain unfair trade practices, such as Chinese export restrictions and the undervalued yuan, closing the door is not the solution.

Canada's approach to China must be strategic. Our country must have a long-term vision. Building strong economic ties requires constructive, consistent and direct political engagement between the two countries at all levels of government. A formal, strategic dialogue between Canada and China needs to be part of its new approach. Other countries are working with China in this manner and so must Canada.

Canada's strategy to boost economic exchanges with China and other large economies must also see more work done at home to ensure that Canada's areas of expertise become more innovative and remain globally competitive. Canada must excel in new niches such as clean technology, a sector where Chinese and global demand are growing. To accomplish this, Canada must ensure its labour force is highly skilled and that it has the structures in place to bring innovation to market.

Canada is geographically located on an economic arc between North America and Asia. Canada is a country whose land, history and population tie it to the Pacific as well as to the Americas, the Atlantic and the Arctic. Trade and investment ties must match this reality. With the right comprehensive strategy, Canada can thrive in the new economic environment by enhancing its two-way economic ties with China and by plugging into the economic ties between China, Asia and the United States.

Canada vies for the attention of a China whose international presence, impact and influence continue to expand into politics, economics and culture. The Chinese government and Chinese business community have stated their interest in boosting economic ties with Canada. The onus is now on Canada to take advantage of this window of interest.

Canada–China: Building a strong economic partnership aims to contribute to this pressing task by reviewing key challenges facing Canadian businesses in China and by offering the policy prescriptions needed so that the partnership can prosper.

2. Understanding China today

Why does China matter? Canada recognizes that China is a rising economic superpower whose impact is felt in most economic sectors and in virtually every region of the world. Yet, it remains a mystery to many. It is the most ancient continuous civilization on earth with a history spanning five millennia. It has long fascinated Western explorers, missionaries and merchants, from the 13th century when Marco Polo travelled there and back, through the 18th century when European empires exchanged New World silver and furs for Chinese ceramics, teas and textiles. China fascinates—and perplexes—Canadians still.

How should Canadians gauge China? At times, it is viewed as home to a remote civilization. Unlike the West, it seems exotic and impenetrable. At other times, China is viewed as a threat, devouring industries and markets through a mercantilist approach to trade and through rampant intellectual property infringements. Other times it is viewed as a benign giant that is opening up, modernizing and seeking to build harmonious political and economic ties with the world, an image promoted heavily in the run-up to the Beijing Olympics in 2008.

The Chinese economic miracle

Beyond these clichés, the reality of China today is complex and contrasted. For most of the last millennium up to the industrial era, China was the world's largest and one of its most advanced economies, representing over one-third of global output. Then, from the early 19th century until 1978, its economic vitality disintegrated under the successive weight of foreign imperialism, political revolution, civil war, the Great Leap Forward and the Cultural Revolution. In 1978, China was poor and accounted for less than two per cent of the global economic output. The attempt of the People's Republic to achieve self-sufficiency had also left it a minnow in an ocean of world trade.

China's economy resurfaced under the reforms of its forward-thinking leader Deng Xiaoping—whose adage in 1978 was that "to get rich is glorious." This redefined his country. Over the past three decades, China has experienced the most impressive ongoing development story in modern times. It has moved from a closed, essentially rural and inefficient state-planned economy to a vibrant, rapidly urbanizing, globally integrated and increasingly open and modern market economy. China achieved in a generation what Europe and the United States took a century to accomplish.

While China remains a single-party state with an opaque, discretionary legal system and controls over politically sensitive information, the personal and business freedoms of Chinese citizens have increased tremendously over the past 30 years, and rule-of-law and the protection of property rights have made important advances. China remains a developing country; half of its population is rural and the divide between rich cities and poor countryside is deep and wide.

The success of its economic transformation to date is undeniable. China lifted over 600 million people out of poverty over the past three decades—twice the current population of the United States.[6] Its economy grew

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6 *UN and China mark International Poverty Eradication Day with major forum* (UNDP, Oct 17, 2008)

thirtyfold during the same period, from less than US$150 billion (current dollars) in 1978 to over US$4.3 trillion in 2008, an annual average of 12 per cent real GDP growth.[7] China's per-capita income today is US$3,200, or $6,000 when looking at real purchasing power.[8] China is expected to surpass Japan as the world's second-largest economy in 2010. While it is unlikely that China will continue to grow at current double-digit rates indefinitely, many economists expect the Chinese economy to surpass the U.S. economy by 2030.

A trade and investment giant

China has reached out to the world, and the world has responded. It has moved from being a closed and introverted economy to being a Goliath in world trade. In 2008, it leapt past Germany to become the world's second-largest trading nation after the United States. Its trade with the world increased more than a hundredfold during the past three decades, from US$20 billion in 1978 to more than US$2.1 trillion in 2007, with China exporting US$1.2 trillion and importing more than US$950 billion in goods and services.[9]

Its exports have quickly climbed up the technological and value-added chains, with manufactured goods representing 95 per cent of total exports in 2007. China's exporting prowess has fed into a growing Chinese trade surplus that has ballooned to over US$290 billion in 2008. Because of this surplus, many view China as more of a commercial threat than a commercial opportunity.

Three notes of caution here: first, a large part of China's surplus accounts for the fact that, as global value chains integrated, China became the final assembly point for many intermediate goods originating from other Asian countries and elsewhere. In many cases, only part of the added value of the finished product is captured in China. Second, in recent years, growth in imports and exports has evened out.[10] In 2009, China's imports grew faster than its exports. Third, the Chinese government has recognized the need to move its economy toward greater domestic consumption to reduce dependence on external demand.

While trade surpluses will remain a reality for some time, current moves to establish a welfare system, modernize the domestic financial sector and boost the role of the green sector in China, point to real efforts to stimulate consumption at home. These efforts must be encouraged.

For the past 30 years, China has been a magnet for foreign investment. New foreign direct investment (FDI) in China has risen dramatically from a mere US$10 billion in 1978 to over US$108 billion in 2008,[11] and it is now raising its profile as a major overseas investor in its own right. Between 2005 and 2008 alone, China's investment in other countries has jumped from US$12 billion to over US$50 billion.[12] Even as global FDI fell by around 20 per cent following the 2008 financial crisis, China's overseas FDI nearly doubled.[13] The value of China's overseas FDI was evaluated at US$170 billion at the end of 2008.[14] The country's sovereign wealth fund, China Investment Corporation (CIC), with nearly US$300 billion in assets in 2008, has become a key player overseas.

Urban China: hubs of production and consumption

Cities have driven China's economic modernization. They are home to more than 40 per cent of the country's population and 75 per cent of China's GDP. Twenty-five of these cities have populations greater than the Greater

7 World Bank

8 CIA World Factbook

9 National Bureau of Statistics of China

10 Raaj Tiagi and Lu Zhou, *Canada's Economic Relations with China* (Fraser Institute, Feb 2009); p 20

11 World Investment Report 2009, UNCTAD

12 Ibid.

13 Ken Davies, *While global FDI falls, China's outward FDI doubles* (Vale Columbia Center on Sustainable International Investment, No. 5, May 26, 2009)

14 Daniel H. Rosen and Thilo Hanemann, *China's Changing Outbound Foreign Direct Investment Profile: Drivers and Policy Implications* (Peterson Institute for International Economics, Jun 2009); p 3

Toronto Area, 100 are larger than Calgary, and one mega-city, Chongqing, has a population as large as Canada's. Many of these cities are sophisticated, serviced by high-quality infrastructure and well-connected to the world. Beijing, Shanghai and Hong Kong are first-rate global cities and others are joining their ranks. Their central business areas, industrial parks and logistics platforms are hubs of investment and production.

Moving forward alongside high-end manufacturing, China's foray into services is a cornerstone of its economic development. Much of this growth in services is based in cities. Shanghai and Hong Kong, which financial pundits have dubbed "Shangkong," have set a target of becoming, together, a top-tier global financial services hub to rival New York and London by 2020.

The cities are also the country's consumption hubs. The urban Chinese middle class stood at some 90 million individuals in 2005, and is expected to jump to 340 million just six years from now[15]—slightly more than the populations of Canada and the United States combined.

The economic aspirations and upward mobility of this population are fuelling demand for domestic and international resources, goods and services at all levels of the value chain. Average household disposable income in cities has grown by 140 per cent since 2000, to roughly US$1,800 in 2007.[16] In China's wealthiest metropolis of Shanghai, per-capita income is more than US$20,000 in terms of real purchasing power. Growth is also spreading to inland cities, to rising stars like Chongqing, Wuhan and Chengdu.

The McKinsey Global Institute estimates that over the next 15 years, China will add some 350 million people to its cities. Eight Chinese mega-cities will have populations above 10 million, and more than 200 will have over one million residents. To house and provide employment for these people, it will build 50,000 new skyscrapers—the equivalent of 10 New York Cities. The future of China's growth is clearly in the cities.

China and international norms

Since joining the World Trade Organization (WTO) in 2001, China has made substantial progress toward adhering to the international norms on trade and investment to which all WTO members are bound. This is a complex process and presents a steep learning curve for China as it moves from an economy controlled by the state to a more rules-based, open-market economy.

There are areas where progress remains inadequate. Tensions between China and certain Western countries have been exacerbated during the recent economic recession due to certain practices viewed by industrialized countries as trade-distorting and discriminatory. These tensions have strengthened protectionist pressures with some accusing the rising Eastern powerhouse of mercantilism, that is using unfair measures to maximize its surplus. This practice runs contrary to the wealth-creating trade upon which Canada and many other countries depend. The list of problematic practices includes the subsidization of domestic industries such as government loans for technology renovation, the protection of indebted state-owned enterprises, placing export restrictions on raw material inputs, putting in place local content and technology-transfer requirements for foreign enterprises, mandating technology licensing, discriminatory indigenous innovation rules and the undervalued yuan.

Grave concerns remain over the ineffective enforcement of intellectual property (IP) protection, notably at the local level. While China's legal system has improved, in many ways it remains opaque, even impenetrable. Foreign enterprises continue to face challenges in local courts on issues of partiality regarding the application

15 Kheehong Song and Allison Cui, Understanding China's Middle Class (Monitor Group, China Business Review, Jan-Feb 2009)

16 National Bureau of Statistics of China

of investment, commercial and IP laws, and other issues. There is deep concern in the international business community over the lack of transparency in recent Chinese court proceedings involving foreign enterprises and businesspeople.

Adherence to global norms and best practices is in China's interest as the country continues to grow, modernize and integrate with global value chains. China recognizes that the protection of intellectual property is crucial as China, with a labour force expected to peak this decade due to an aging population, strives to move away from labour-intensive industries to high-value-added, IP-centred manufacturing and services. It is also in China's interest to work closely with its international partners to renew global trust in the positive-sum benefits of free trade and investment by strengthening adherence to international norms.

3. Canada–China trade and investment ties

Where is Canada in this China story?

Two-way trade between Canada and China continues to expand, albeit at a slower pace following the 2008 financial crisis; the total value of two-way trade was C$50.8 billion in 2009 versus C$47.8 billion in 2007. A 2009 Fraser Institute study found that despite this growth, Canada's two-way trade with China remains well below potential.[17] Indeed, while China is Canada's third-largest trade partner and third-largest export market, Canada's trade with China still represents only seven per cent of our country's overall merchandise trade. Only three per cent of Canada's merchandise exports went to China last year, versus 75 per cent to the United States. It is clear there is room to achieve substantial growth in Canada's commercial exchanges with China.

Looking at Canada's composition of trade, its exports to China continue to be dominated by commodities and machinery. Canada's eight top exports to China are wood pulp, nickel, oil seeds and grains, organic chemicals, minerals (salts, sulphur, earths, stone and others), boilers and mechanical appliances, ores and fertilizers. This reflects China's needs in infrastructure development and in the manufacturing sector, where raw materials are transformed into higher-value-added finished goods, the bulk of which are destined for overseas markets.

Most of Canada's imports from China are made up of such manufactured goods, including electrical machinery and equipment, boilers and mechanical appliances, toys and sports equipment, furniture and knitted and non-knitted clothing, apparel and accessories.[18] Given the breadth of Chinese consumption, there is potential for Canada to complement its robust commodity exports with more exports in knowledge and technology industries.

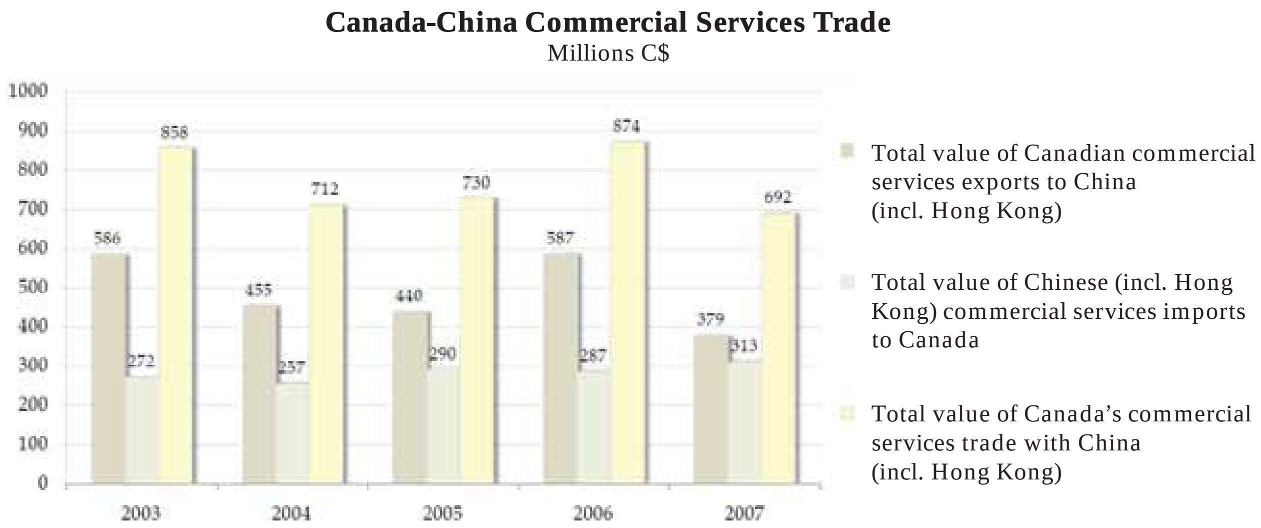
In terms of balance of trade, Canada has registered an increasing deficit in its relationship with China, which ballooned by 400 per cent from 1998 to 2007 to become the largest Canadian trade deficit with any single country. This deficit has stabilized at a little under C$30 billion since 2007. To strengthen Canada's trade ties with China, it must seek to improve performance on the export side. Part of that will mean doing a better job of matching its expertise with China's needs.

17 Raaj Tiagi and Lu Zhou, *Canada's Economic Relations with China* (Fraser Institute, Feb 2009); p 1
18 Industry Canada

Source: Trade Data Online (TDO), Industry Canada

Canada's commercial services trade with China (including Hong Kong), has also expanded over the past several years, from C$586 million in 2000 to C$692 million in 2007. Canadian commercial services exports to China fell from C$440 million in 2000 to C$379 million in 2007. Commercial services imports from China have risen from C$146 million to C$313 between 2000 and 2007, and Canada's trade surplus in this area has been reduced.[19] Given that Canada's commercial services exports to China represent less than one per cent of our country's worldwide commercial services exports, there is room for further expansion.

According to Statistics Canada data, while commercial services represent the bulk of Canada's total services exports worldwide, in mainland China and Hong Kong, these amounted to only 13 per cent of the total in 2007, well behind transportation, government services and travel. Here too, more needs to be done to facilitate and encourage Canadian service providers to pursue opportunities in China. Canadian commercial services in China, in particular, have room for expansion, especially in the areas of financial services and insurance.

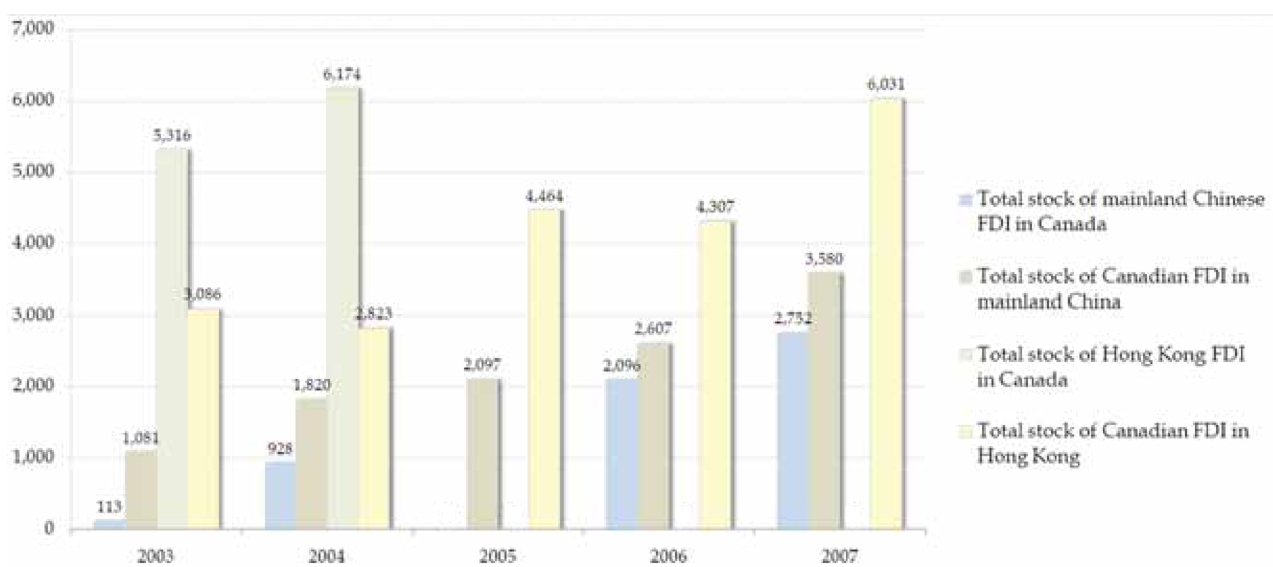


Source: Statistics Canada

19 Statistics Canada

On the investment side, both Canada and China have yet to tap into each other's vast potential. The Canadian stock of overseas foreign direct investment (FDI) in China, including Hong Kong, was a mere C$9.6 billion in 2008, out of a total stock of Canadian outward FDI of C$637.3 billion. In other words, Canada's stock of FDI in China represented just 1.5 per cent of its total overseas FDI. In comparison, that year, the United States and European Union held C$310.7 billion and C$137 billion in Canadian FDI, respectively. China's direct investments in Canada are relatively modest, but they are growing. The total value of mainland Chinese and Hong Kong FDI in Canada in 2005, the last year for which figures are available, was C$7.1 billion.[20]

Canada-China Foreign Direct Investment (FDI)
Millions C$



Source: CANSIM database, Statistics Canada

The potential for more two-way investment is significant. A recent survey conducted by the Asia Pacific Foundation of Canada found that our country is perceived by Chinese investors as being open to overseas FDI, and that Canada can serve as a useful platform to get access to U.S. markets.[21] Canada must build on this interest to attract more Chinese foreign direct investment.

20 Statistics Canada

21 *China Goes Global 2009: 2009 Survey of Outward Direct Investment: Intentions of Chinese Companies* (Asia Pacific Foundation of Canada, Sept 2009)

Section II: Issues and Policy Responses

Canada has the products, skills and expertise to match the development needs and sophistication of China's booming economy and the growing lifestyle aspirations of its 1.3 billion citizens. In the same way, China has the goods, services and skills that Canada needs. Given this and Canada's strong historical and personal ties to China, the two countries have the potential to prosper as natural economic partners.

However, to date the merits of such a partnership have been undersold to Canadians and Chinese alike, and the great trade and investment opportunities of a rising China remain overlooked or misunderstood by many. Canada must recognize that while China is keen on advancing economic exchanges with it, China will not wait. Others, ranging from the United States and the European Union to Japan and Australia, have long been actively marketing their product offerings in China. They have taken risks and have been learning how to do business there. Canada must catch up.

Virtually every country is vying for China's attention today. To be successful however, China must be approached with respect and pragmatism, and with ambitious and forward-looking proposals. Achieving the desired growth in trade and investment requires robust political engagement between our two countries. The Canadian and Chinese governments at all levels—and businesses—can then work to overcome the barriers that stand in the way of success.

Growing interactions must be beneficial to the businesses that make Canada thrive. But Canada's proposals must also be grounded in the reality that despite rapid modernization, China remains a continent-sized, developing nation. Canada must continue to encourage China's development. At the same time, China must fulfill its international commitments, adhere to international norms and work to remove barriers to business. This calls for a long-term vision and continuous efforts on both sides.

This report's emphasis is on the cross-cutting policy issues that affect industry broadly. These issues have been identified through the discussions of the Canadian Chamber of Commerce with Canadian business and relate to companies exporting or importing commodities, manufactured goods and services, as well as to investors. We look at the way these issues have evolved in recent years, and the challenges to overcome in pursuing new opportunities ahead. We offer recommendations on what businesses and governments, in Canada and China, need to do to enhance our economic exchanges in the long-term interest of Canada.

1. Canada's visibility in China: political and business ties

China is an immense and diverse country with different climates, terrains, cultures and economic profiles within its regions. To simply call it a "China market," a popular notion in the West, is faulty. China comprises dozens of regional markets and hundreds of sub-regional ones centred on cities large and small. Some 25 cities in China have higher populations than that of the Greater Toronto Area and more than 100 others have populations larger than Calgary. Achieving visibility and presence in these expansive markets is a huge task for both government and business.

While government has a crucial role in opening doors and demonstrating all that Canada has to offer to China, it is also essential for the Canadian business community to have a local presence. These businesses must promote their products to a Chinese clientele that is open, informed and discerning. Canada can draw lessons from what governments and businesses of other countries have done in China. It must understand what works and what is necessary. Canada's approach should include the following elements:

First, in China, other countries' areas of economic and cultural excellence serve as the visible national brands these foreign countries use to actively promote their entire product offering to Chinese businesses and end users. To many Chinese, the popular image of Canada remains that associated with Dr. Norman Bethune or Mandarin-speaking celebrity Mark Rowswell, in addition to being a vast country with a spectacular natural environment. While this image is important for tourism, it leaves out Canada's business excellence, resource wealth, knowledge base and technologies, openness to investment and entrepreneurial spirit. Our country now needs an overarching Canadian brand under which it can consistently market its entire cross-sector value proposition to China.

Second, enhancing Canada's visibility in China requires open channels of communication at various levels of government in both countries. Canada's economic relationship with China cannot thrive in the absence of strong political ties. In Chinese culture, fostering *guanxi* or connections between people, is the bedrock upon which trust, respect and a sense of mutual responsibilities are established. *Guanxi* between Canadian senior government officials and their Chinese counterparts, cultivated through regular reciprocal visits, is indispensable in securing Canada's place on China's increasingly crowded dance card.

Prime Minister Harper's December 2009 visit to China, followed by Chinese President Hu Jintao's recent visit to Canada, were positive first steps, and must be followed by regular two-way visits. The next step must be to invite Chinese Premier Wen Jiabao for a state visit to Canada. Cabinet ministers must continue meeting with their Chinese counterparts. The federal government needs to explore upgrading the Strategic Working Group to an annual cabinet-level Canada–China Strategic Dialogue, mirroring those between China and other jurisdictions such as the United States, the European Union and Australia. This level of dialogue will cultivate a constructive overall relationship and enable enhanced economic ties and an ability to share views on political subjects in an atmosphere of mutual respect. Annual meetings between Canadian federal parliamentarians and their Chinese National People's Congress counterparts through the Canada-China Legislative Association (CCLA) are also constructive in broadening two-way exchanges between Ottawa and Beijing.

The signing of the December 2009 Memoranda of Understanding on cooperation in culture, agriculture, resources, transportation and climate change must be seen as an ambitious step forward. Canada and China need to pursue this as well as similar cooperation on the economic side.

Third, political engagement between Ottawa and Beijing must be matched with political engagement at the local level. Several provinces and cities have led trade missions to China involving dozens of participating Canadian businesses. While the Team Canada approach was useful in its time to initiate contact with China, two-way exchanges today need to be sector-focused. Given the regional fragmentation of the China market, focused exchanges between groups of Canadian senior provincial officials, municipal officials and private-sector leaders, and their Chinese local level counterparts, are conducive to developing business partnerships. However, to ensure consistency under the Canadian brand, coordination of these exchanges between the federal government and provinces is imperative.

Reciprocal missions must be centred on specific Canadian sectors of expertise and must target areas in China with a real and identifiable interest in these sectors. Minister Flaherty's August 2009 trade mission to China, which included leaders of the largest Canadian insurance companies and banks, and the recent mission led by Mayor Miller of Toronto to promote environmental solutions in the mega-city of Chongqing, are good examples of the focused approach. China is not limited to Beijing, Shanghai and Hong Kong, and opportunities exist in China's numerous dynamic cities.

Fourth, it is vital that the government continue to play a key support role for Canadian businesses preparing to enter China through government-provided resources on the ground. This is especially important for small- and medium-sized enterprises that cannot afford to have a permanent presence in China. Canada has a knowledgeable and dedicated group of professionals on the ground in its Beijing embassy, consulates and trade-representative offices in China. They do superb work, but current resources are stretched thin.

Given the size and complexity of China, it is essential to deploy a Canadian official presence in areas beyond Beijing, Shanghai and Hong Kong. The recent opening of six new trade-representative offices in major Chinese cities is a good step forward. To be effective, it is important that these offices be equipped with sufficient human and financial resources to assist Canadian businesses in the areas of China they oversee, and to identify economic opportunities for Canada through contacts with local officials and businesses. It is also imperative that Canadian business keep the government informed of its priorities and concerns in China.

High-profile marketing initiatives and events go a long way in raising awareness among Chinese businesses and decision-makers regarding Canadian sectors of excellence. The United States, Japan, European countries and Australia among others, have held trade fairs, industry presentations and networking events for local political and business VIPs. At Expo 2010 Shanghai, where the world is being presented to China, Canada has a state-of-the-art pavilion to showcase its strengths and appeal. This is an excellent initiative as one part of Canada's visibility strategy in China.

It is ultimately companies that do business. The visit of a government-led business delegation to China or the reception of a delegation from China can bear economic fruit only if there is an active face-to-face follow-up between business executives on both sides. The trouble is that for many Canadian companies, global business outside the North American context is new. Trying to identify real opportunities and then approach and position themselves in the highly competitive Chinese markets is difficult. Challenges include China's physical size and complexity, the breakneck pace of change and the multiplicity of opportunities. The Chinese business culture and legal framework are completely different. Where to start? What is the first step? Canadian companies struggle with these questions.

Success in establishing a commercial presence in China requires Canadian companies to be long-term-oriented, ambitious and strategic. When done right, foreign businesses have reaped real rewards. Companies must be willing to dedicate resources to understand China's diverse and fast-changing markets. They must also become familiar with the Chinese legal environment so they can navigate through local regulatory standards and protect their intellectual property. They must be willing to find reliable Chinese partners connected to the right local networks. Because this entails developing *guanxi* with one's Chinese partners, contracts will not be signed on a first visit, as trust first needs to be built. This requires travel to China and receiving one's counterparts here in Canada.

Rushing into these new markets without preparation and a well-thought-out strategy will not work. But that does not mean Canadian companies on their way to China have to learn the rules of the game the hard way. Numerous private consultancies, many of which are part of Canadian law firms based in Hong Kong and mainland China, have years of experience on the ground and can help guide a company's first steps.

These experts can provide Canadian businesses with practical cultural advice and training, market intelligence and effective network-building skills. Canada's trade commissioners in Hong Kong and mainl and China can connect interested Canadian companies with a reliable roster of consultants matching sector needs.

The corporate profile of the Canadian business community is an important factor when going into China. Various large, diversified and successful enterprises have been active in China for many years and are comfortable in that environment—companies such as Bombardier, Manulife, SNC Lavalin and Barrick Gold.

However, more Canadian small- and medium-sized enterprises (SMEs) are now entering global markets with less experience, capability and visibility. Few such companies will be in the business of mass marketing to Chinese consumers or industrial partners. They will more likely be seeking niche markets or using a Chinese base for production, conducting research and development, selling, using the opportunity as a means to deploy niche technologies or systems, or to attract capital to their Canada-based activities.

From a Chinese perspective, the smaller size of some Canadian companies can be a hurdle to both recognizing and finding potential Canadian partners. It is important for Canadian SMEs to form sector-based coalitions under the Canadian brand, in cooperation with business associations, when meeting local decision-makers and business partners. SMEs need to realize that their true competition in China does not come from their Canadian peers, but from the vast number of global competitors in their sector that are already in China.

Going in with a united voice will increase the collective visibility and influence of Canadian SMEs and can allow for the pooling of limited resources to help with the costs of setting up business ties with Chinese partners. The federal government, in cooperation with the provinces, must strategically assist such sector-based coalitions by providing them with introductions in areas of China that are interested in the products the SMEs are selling.

Recommendations:

- **That Canada establish an overarching, visible Canadian brand under which all its sectors can consistently market themselves to China.** In China, other foreign countries promote their entire product offerings under a national brand of excellence.
- **That the federal government continue to engage with China, through regular two-way visits between the prime minister and cabinet ministers and their Chinese counterparts, and by upgrading the Strategic Working Group to a formal Canada–China Strategic Dialogue.** Canada cannot have strong economic ties with China without a strong overall political relationship.
- **That the federal government encourage two-way exchanges between same-level delegations of senior federal, provincial and municipal officials and Canadian business leaders and their Chinese counterparts, centred on specific Canadian sectors of expertise and under a consistent Canadian brand.** In China, introductions by government leaders pave the way to business ties.
- **That Canada ensure trade-representative offices in China have sufficient human and financial resources for Canada's presence there to remain effective.** A strong Canadian presence across China's many regions is essential to assist Canadian businesses in prospecting for opportunities in its diverse markets.
- **That the federal government assist sector coalitions of small- and medium-sized enterprises by providing them with introductions to officials in Chinese provinces and cities where business links can be built.**

2. Canada's infrastructure and gateways

Recent years have seen renewed efforts to enhance Canada's transportation, logistics and border infrastructure in response to the current and future needs of increasing two-way trade between Canada and China. The need is to move growing numbers of people and volumes of goods between points of departure and arrival in a manner that is faster, cheaper, safer, simpler and more reliable.

Efficient infrastructure is a cornerstone of the commercial prosperity and competitiveness of a trade-dependent country such as Canada. This requires a long-term vision to ensure that physical infrastructure, and the operation of that infrastructure, act as facilitators and catalysts of growth both in trade and in the number of jobs associated with trade.

Since 2006, the *Asia–Pacific Gateway and Corridor Initiative* (APGCI) has devoted over C$1 billion to refurbish and expand maritime ports, airports, rail, roads and pipeline infrastructure connecting Canada and the eastern United States with Asia by way of Canada's western seaboard. Major projects to date include South Fraser Perimeter Road, the widening of the Trans-Canada Highway, the opening of a container shipping terminal in Prince Rupert, the merging of Metro Vancouver's three port authorities and the development of Winnipeg International Airport as a hub. The APGCI is also being marketed in an effort to attract Canadian and foreign investors.

Important milestones have been achieved but more remains to be done to meet Canada's current and future business needs. Infrastructure must complement the dominant trade pattern out of Canada's western ports, with mineral and agricultural commodities on the export side and containers of manufactured goods destined for the North American market on the import side.

Canadian infrastructure must do more than simply get Canadian goods to China and Chinese goods to Canada. Canada's geography strategically places it on what is emerging as the world's single most important axis of two-way trade and investment, between the United States and a regional Asian economy centred on China. Considering distances alone, British Columbia's ports can provide the Midwest and East Coast of the United States with the most direct access to and from Chinese and other East Asian ports. The development of an integrated, multi-modal network connecting British Columbia's seaports and major airports across Canada, with transcontinental roadways, railways and pipelines spanning eastward across North America, can transform Canada into a key logistics gateway between the United States and China.

Becoming a gateway between China and North America is also about creating additional value—new products and expertise—around the growing flows of people, goods and capital moving between the U.S. and China through Canada. Canadian cities located along the transportation network can grow into global business hubs and prosper by plugging their business and knowledge communities and clusters into expanding U.S.–China value chains.

The strategy as captured by the APGCI is a crucial one for Canada's long-term prosperity. For it to work for Canadian businesses, the strategy must respond to several requirements:

- *Optimize the infrastructure*
  The quality of physical infrastructure, including seaports, airports, customs facilities, roadways and railways must be optimized to make the Asia–Pacific Gateway transportation network the best of its kind in North America. The standard of success for this transportation network is that it must be consistently faster, cheaper, simpler and more reliable for goods to transit between East Asian seaports and eastern and Midwestern U.S. locations through Canada than for these goods to transit by way of U.S. Pacific ports.

- *Enhance operations*
  State-of-the-art physical infrastructure must be matched by state-of-the-art operations. Canada cannot afford to have operational bottlenecks within the network cancel out the advantages of enhanced physical infrastructure. The most significant setbacks are inefficiencies in customs-clearing processes at seaports, airports and land crossings, and labour issues in Canadian seaports and railways.

As an example, an operational challenge at Vancouver ports with security inspections—conducted through a single inspection facility located several kilometres from the ports—can delay eastbound container movements for weeks. Labour issues such as strikes and threats of strikes by dock and railway workers have delayed cargo offloading and have caused serious damage to the reputation for reliability of Canada's ports and railways. This results in lost business. Therefore, it is crucial that customs-clearing and safety-inspection procedures be timely, cost-efficient and predictable, and that the operations of ports and railways be guaranteed during labour disputes. The aims of the *2010 Rail Service Review* are encouraging and should address labour dispute issues affecting railways in its final report.

Canada–U.S. land-, maritime- and airport-border procedures must ensure that the movement of goods and people between the United States and China through Canada is secure, swift and seamless. Without an efficient and transparent border with its southern neighbour, Canada's Pacific ports and airports will soon lose their competitive advantage to their U.S. rivals. The outcome will be U.S.–China trade largely bypassing Canada. Reversing the thickening of the Canada–U.S. border is an absolute priority to ensure Canada's place in China–U.S. commerce.

- *Improve the regulatory environment*
  To facilitate the participation of private investors in infrastructure projects and to guarantee the completion of these projects in a timely and cost-efficient manner, improvements to the regulatory framework governing infrastructure development must continue. Prior to taking on large investments in developing infrastructure, investors need assurances on project costs and completion timelines. Regulatory delays deter investors from financing future projects.

  Insofar as environmental review requirements overlap the jurisdictions of the federal and provincial governments, it is imperative that time-inefficient redundancies in the review process be eliminated. The tabled Jobs and Economic Growth Act (Bill C-9), if passed, will ensure that one robust environment assessment be done for each project. The federal government will accept the provincial assessment where it meets the federal standard.

- *Promote Canadian cities as global business hubs*
  Canadian cities must continue promoting themselves as global business hubs to capture economic benefit from growing flows of people, goods and capital between China and North America. Toronto, Vancouver and Montreal are recognized as global metropolises. Canadian cities rank high in international quality-of-life and smart city listings, and many have large multicultural communities. Numerous Canadian cities are actively developing international and Asia–Pacific orientations.

  With federal and provincial support, these cities need to develop manufacturing and services knowledge clusters that add commercial value to trans-Pacific trade flows and develop ties with similar clusters in China. They must encourage the integration of local businesses into global value chains, and raise awareness of China and the world in their communities through public education and cultural exchanges. Cities must actively market their economic advantages and promote themselves as meeting places for Chinese and North American businesspeople.

- *Expand Open Skies*
  Canadian airports straddle the transpolar flight paths stretching between American and Chinese cities. More frequent and affordable flights between Canada and East Asia will improve Canadian business's access to the Chinese market and help Canadian cities position themselves as convenient meeting places for North American and East Asian business travellers. The *Blue Sky* air transportation strategy has expanded international passenger and cargo flights since 2006. Open Skies Agreements have been signed with Korea, New Zealand and the European Union. Canada must build on progress by further liberalizing civilian and cargo air transport between it and East Asia.

While centred on Pacific ports, Canada's Atlantic ports can serve as hubs for container movement in light of changing transportation patterns. The role of Atlantic ports plugging into value chains between Europe and China must be explored as part of the mid- to long-term strategy.

Although the development of the APGCI network is a government-coordinated effort, open and transparent communication between governments at all levels, businesses and community stakeholders must continue on the Gateway's ongoing planning, execution and management. This will ensure that infrastructure and related operational processes remain responsive to changing business needs and realities.

RECOMMENDATIONS:

- **That the infrastructure of the Asia–Pacific Gateway, including seaports, railways, roadways, customs facilities and airports, be optimized to ensure it is the most efficient transportation network of its kind in North America.**
- **That the operations of the Asia–Pacific Gateway be optimized and the thickening of the Canada–U.S. border be reversed so that the movement of goods and people between the United States and China through Canada is secure, swift and seamless.** To ensure Canada's place in China–U.S. commerce, customs-clearing and safety-inspection procedures must be timely and predictable and port and railway operations must be guaranteed during labour disputes to ensure the gateway obtains and maintains a reputation of being timely and reliable.
- **That the Jobs and Economic Growth Act (Bill C-9) be passed into law.** The bill will eliminate redundancies in environmental assessments and allow the federal government to recognize provincial assessments for infrastructure projects receiving federal funding. This will improve the timeliness of projects.
- **That Canadian cities develop as global business hubs and continue promoting themselves as meeting places for Chinese and North American business travellers.**
- **That civilian and cargo air transport between Canada and East Asia be further liberalized.** This will allow Canada's cities to better compete with U.S. cities in becoming North American business gateways for China and Asia.

3. Canada's skills and innovation

Investment in physical infrastructure enables economic opportunities to develop around the movement of people and goods between Canada and China. The onus is then on Canadian companies to become globally competitive in pursuing these opportunities. To do this, they will need the best soft infrastructure they can get. In other words, people with the skills, knowledge and networks necessary to succeed in doing business with China and the world.

A global company's success ultimately rests on its productivity, its ability to innovate and its global business savvy. This requires a quality labour force highly adept at working in a competitive global business environment. It must also have the right structures for it to develop innovative products and processes that meet the increasing sophistication of Chinese consumers and investors. The Asia Pacific Foundation of Canada notes that Canada must invest in human capital to equip its labour force with the skills and knowledge to perform efficiently in trans-Pacific trade and investment.

Canadian companies cannot afford to ignore markets that comprise 1.3 billion people—markets that also have an immense pool of capital. China is seeking the most innovative inputs, finished goods, technologies and services foreign countries have to offer. Despite this opportunity, Canada trails behind its peers in the Organisation for Economic Co-operation and Development (OECD) in productivity and innovation, and our country's business experience is mostly limited to North America.

Canada needs to catch up. What must it do today to ensure that its companies can create and deliver the high-value-added products of tomorrow to China and other key markets? How can it develop niches of expertise as part of Canada's brand, and draw Chinese investment to these niches? There are several things Canada must do:

- *Prepare the workforce*
  Unless Canada can fill a shortage of highly skilled people in the labour force, it will be unable to create and deliver innovative products. Developing world-class skills begins with education, and since education is a long-term process, the time for action is now. Canada's education system has improved, but it must further strengthen the teaching of communications, problem-solving, advanced mathematics and sciences at the primary, secondary and post-secondary levels. The aptitude of Canadian students in these subjects must quickly reach and consistently remain at the top of the international rankings.

  Highly skilled workers include entrepreneurial, scientific and engineering talent. More must be done to encourage young Canadians to undertake post-secondary studies in sectors with real labour shortages and in sectors where Canada can develop commercially viable niches of expertise. It is important that students continue to acquire advanced skills in engineering and applied sciences through the excellent academic and vocational tracks in Canadian universities and colleges.

- *Get to know China*
  To do business with China, Canadian companies need people with knowledge of China and language abilities in Mandarin. Canada must ensure that students can acquire knowledge on China through its education system at all levels. Canada should offer Mandarin immersion programs from elementary to high school. Such programs exist in many countries, including the United States. Exchange programs with select schools in China could provide language-immersion opportunities for Canadians. Some business schools allow students to gain work–study experience in China to prepare them for their future careers. These initiatives must continue to be encouraged.

- *Promote continuous skills development*
  The acquisition of skills and knowledge for innovation does not end in school. Canada is notable among developed countries for its low scores in the area of continuous skills development in the workplace. More needs to be done to encourage the maintenance

and updating of essential and specialized skills in the workplace. Canadians working with or seeking opportunities in China will need to keep pace with the continually changing features of the Chinese business landscape. Canadian SMEs' successful ventures into foreign markets can be enabled through skills development in international trade. In addition, more should be done to encourage SME participation in the Forum for International Trade Training (FITT) training programs.

- *Make commercialization a higher priority*
  To date, Canada has done well in primary research, but has performed poorly in bringing that research to market. There is a missing link between the institutions that conduct high-quality research and the companies and venture capital that can transform the fruit of that research into new products and processes. The federal government is taking positive steps to remedy this problem through the launch of a new Small and Medium-sized Enterprise Innovation Commercialization Program establishing business-led Networks of Centres of Excellence, and supporting and directing the federal granting councils to accelerate the translation of knowledge into practical applications. These efforts need to be continued and companies need to bet ambitiously on promising discoveries.

- *Recognize the skills and knowledge immigrants bring to Canada*
  Immigration will become the only source of growth in the dwindling Canadian labour force by the middle of this decade. Many Chinese-Canadians have a deep knowledge of China's culture and dialects, and have links with Chinese regional business networks.

  These links can translate into real opportunities for Canadian companies. New Canadians of Chinese origin likewise tend to possess high levels of both education and work experience. Paradoxically, their economic standing relative to the Canadian-born population has declined over the past decade and their competencies are often underutilized. As a result, many would-be immigrants opt for other countries such as Australia where they believe their skills will be better used.

  It is important that Canada take advantage of the unique resources brought by new Canadians from China in developing business ties with China. Canada must continue to facilitate the integration of Chinese and other skilled immigrants into its labour force, through faster, streamlined processing and recognition of international diplomas and professional accreditation. Canada needs to do more to encourage employers to hire skilled immigrants.

- *Maintain Canada's bridges to China through Canadians in China*
  Canada already has bridges to China through its overseas missions and associations. These must be strengthened and maintained. As well, there are many Canadian expatriates living in mainland China and Hong Kong, many of whom are highly accomplished socially and professionally. These overseas Canadians can play a welcome role in the development of Canada–China trade and investment ties. In an age when human capital flows across borders, it is essential to recognize that Canadians in China and elsewhere can play a role as bridges for enhanced two-way economic exchanges as Canada goes more global.

Recommendations:

Recommendations:

- **That Canada's education system equip students with world-class communications, mathematics and science skills, that it encourage students to undertake post-secondary studies in areas where there are real skilled-labour shortages and where Canada can develop commercially-oriented niches of expertise.** Canada will need highly skilled workers to create and deliver the high-value-added products of tomorrow to China and to draw Chinese investment to these sectors at home.
- **That Canada's education system at all levels allow students to both acquire knowledge on China and enroll in Mandarin immersion programs.** To do business with China, Canadian companies need people with knowledge of China and proficiency in Mandarin.
- **That the maintenance and updating of skills in the workplace, including international trade training for SMEs, continue to be encouraged.**
- **That Canada continue to improve linkages between research and the commercialization of innovative products and processes, building on initiatives such as the SME Innovation Commercialization Program, business-led Networks of Centres of Excellence and the support of federal granting councils.**
- **That Canada better utilize the unique resources brought by new Canadians of Chinese origin, by further facilitating the integration of Chinese and other immigrants into the labour force.**
- **That Canada maintain its ties with Canadians in China.** Canadians in China and elsewhere can play a role as bridges for two-way economic exchanges as Canada goes more global.

4. Trade in goods

To enhance Canada–China economic ties, Canada needs to increase the depth of two-way trade in terms of volumes and the breadth of trade across sectors. It is important for Canada's future economic well-being that its businesses complement traditional trade ties with the United States by boosting trade with China and other key markets.

It is equally crucial that Canada have better trade with China. While Canada's traditional resource sectors are a vital component of its international trade, it is in our country's economic interest that it diversify its commercial exchanges with China. Most of Canada's lower-value-added manufacturing industries have already migrated overseas. The way forward is to produce and sell more innovative, *high*-value-added inputs and finished goods, something that requires a highly skilled labour force and structures to facilitate the commercial application of research. Canadian industries also need to be more willing to import technologies and capital that improve their productivity and innovativeness.

Some in Canada's business community have expressed concern about the potential impact of Chinese products on the competitiveness of Canadian manufacturing in both domestic and foreign markets. There are worries that competitive pressures on Canadian producers will force more of them to shut down or move production overseas. It is often tricky to distinguish between fair trade, where goods are simply produced more cheaply and sold at a lower cost, and unfair trade, where goods are sold at less than it costs to make them—often called dumping—or subsidized by government.

China has made considerable progress since joining the World Trade Organization (WTO). In less than a decade, China has gone from a closed economy to becoming a world-class player, an extraordinarily fast change with numerous positive outcomes for Chinese citizens. It speaks very clearly to what a more open China can mean in terms of economic development, not only for the people of China, but for the rest of the world, as well. It is recognized that long-term economic development needs to be driven by two key conditions: a free and fair market.

China is bound to conform to the norms and disciplines that govern all WTO members. Despite progress, there is concern in Canada, the United States, the European Union and elsewhere that China significantly understates the extent to which it subsidizes its industries. Mechanisms used include making available government loans and subsidies for technology upgrading, promoting foreign investment in state-owned enterprises, protecting indebted state-owned enterprises, and placing export restrictions on inputs. For example, a major WTO dispute is underway pitting the United States, the European Union and Mexico against China. Canada and numerous other countries are also challenging Chinese practices. The allegation is that China has erected an array of trade-distorting export barriers to keep raw materials within China, thereby subsidizing its own value-added sectors. There are also concerns that the undervalued yuan provides Chinese companies with an artificial competitive advantage.

Foreign-invested firms also face discriminatory trade policies in China such as having to abide by local content rules and technology-transfer requirements, compulsory technology licensing, mandated revelation of encryption codes and excessive disclosure requirements for technology patents. Recently, there has been alarm over China's *Draft Notice Launching the National Indigenous Innovation Product Accreditation Work for 2010*, which will list the types of products to be developed and used in China for government procurement purposes, thereby limiting access by Canadian and other foreign exporters to Chinese public-sector buyers, while limiting Chinese access to the technology- and productivity-enhancing benefits that foreign products and processes bring to China.

In capital-intensive industries, policies that artificially sustain inefficient facilities that would otherwise be commercially unviable can have a significant and long-lasting impact on global markets. Canada must work with its WTO partner countries, and directly with China, to do away with subsidies, trade barriers and discriminatory trade policies in China. Canada must encourage China to build on its achievements to date by further strengthening its market-based system and adherence to international trade rules. This is in China's long-term economic interest. Where trade practices are inconsistent with WTO obligations, Canada must be vigilant in defending its legitimate interests. It must continue ensuring that trade-remedy mechanisms work well, and that their use is timely and cost-effective for business.

At the same time, the government must avoid applying artificial market barriers that are self-defeating, since competitive pressures rarely diminish. When NAFTA was implemented, many Canadian companies, and the communities on which they depend, were compelled to make painful yet necessary adjustments, but in the end came out of the process stronger and more globally competitive. Transition assistance may be a more effective solution than short-term protective measures.

The measures in Budget 2010 that transform Canada into a tariff-free zone for manufacturers by eliminating all remaining tariffs on manufacturing inputs, machinery and equipment are positive steps toward bolstering the competitiveness of Canadian industries domestically and in international markets.

Short-term political imperatives can create significant pressure on governments to throw up barriers and protections. In Canada's manufacturing heartlands, the matter is politically sensitive. Though understandable, boosting competitiveness and innovation, and ensuring a supportive fiscal and regulatory environment for Canadian business are long-term solutions.

There are calls in some sections of the business community—most notably from Canada's foremost Sino-Canadian trade and investment facilitator and advocate, the Canada China Business Council—for a Free Trade Agreement (FTA), a broadening of the rules-based infrastructure to guide Canada's bilateral trading and investment relationship with China. Developed economies such as New Zealand have concluded an agreement with China, while Australia, Norway, Switzerland, Japan and Korea are either negotiating or scoping FTA negotiations with China. Canada needs to study the possibility of a comprehensive Canada–China FTA covering goods, services and investment.

Progress on the international trade agenda is lacking, the WTO Doha Round negotiations have stalled and the spectre of protectionism is looming in certain countries. Now is the time for Canada and China, as two trade-dependent nations, to collaborate in highlighting the win-win benefits of rules-based global free trade and in moving multilateral trade liberalization forward. This is in line with the pledge made by the G20 countries since the 2009 London Summit. That pledge needs to be turned into action.

Recommendations:

Recommendations:

- **That Canada work both with WTO partners and directly with China to ensure that China does away with subsidies, trade barriers and discriminatory trade policies, and that China strengthens its market-based system and adherence to international trade norms.**
- **That the government ensure trade-remedy mechanisms work well and that their use be timely and cost-effective for business where trade practices are inconsistent with WTO obligations.**
- **That Canada not apply artificial market barriers.** Transition assistance may be more effective than short-term protective measures.
- **That Canada study the possibility of a comprehensive Canada–China free trade agreement (FTA) covering trade in goods, services and investment.**
- **That Canada cooperate with China in the WTO and G20 to both move multilateral trade liberalization forward and roll back protectionist pressures.**

5. Investment

Two-way foreign direct investment (FDI) remains the undersold component of Canada–China economic exchanges. Canada and China must continue working together to move this facet of the countries' economic relationship forward.

Two-way FDI has risen little in recent years. Canada's stock of outbound FDI to China, including Hong Kong, expanded from C$4.6 billion in 2005 to C$9.6 billion in 2008.[22] Despite this, Canadian overseas direct investment remains overwhelmingly concentrated in the United States, Europe and Latin America, while opportunities in China and Asia beyond are overlooked. In 2008, the United States and Europe, respectively, held 49 per cent and 21 per cent of Canada's total C$637 billion stock of outbound FDI. Meanwhile, China held only 1.5 per cent of that stock.[23] At the same time, mainland Chinese FDI in Canada represented a mere C$2.7 billion of the total stock of inbound FDI in Canada, valued at C$505 billion in 2008.[24]

While the United States and the European Union will likely remain Canada's two largest sources of inward FDI for the foreseeable future, the financial crisis has constrained American and European capital markets and reduced their appetites for risk. On the contrary,

22 Foreign Direct Investment Statistics, Department of Foreign Affairs and International Trade

23 Michael Holden, *Overview of Canadian Foreign Direct Investment* (Parliamentary Information and Research Service, Library of Parliament, Jun 17, 2008)

24 Ibid.

Chinese enterprises are actively courting investment opportunities across the globe under the country's *Go Global* policy. With over US$2.4 trillion in foreign-exchange reserves and a volume of outward FDI that has doubled in the last year alone, China is now a key overseas investor.

Chinese interest in investing in Canada is real. A recent Asia Pacific Foundation of Canada survey of Chinese companies found that Canada ranked sixth out of 10 likely destinations for Chinese overseas FDI, and ranked highest in terms of perceived openness to Chinese FDI, alongside the United States and Australia. Chinese companies view Canada as a gateway to the U.S. market. They also see Canada's energy, natural resources, agriculture and biotechnology as promising sectors for investment.[25] The China Banking Regulatory Commission recently designated Canada as a destination for Chinese wealth management under China's Qualified Domestic Institutional Investor (QDII) program, which allows approved institutional investors in China, including banks, to invest in Canadian funds pooled from mainland clients.

Legitimate national security concerns about Chinese investment exist in sensitive areas and there is considerable sensitivity around investments by state-owned enterprises versus Chinese private companies. That said, it is a mistake to treat all Chinese capital as incompatible with Canada's interests. Though China has a geopolitical interest in reliable access to natural resources and foreign-asset diversification, much Chinese investment is commercially driven, with a focus on market access, the development of new technologies and higher returns in foreign productive assets.

Amendments to the Investment Canada Act in 2009 were a welcome step toward enhancing Canadian access to Chinese capital. Currently, direct acquisitions by foreign investors of Canadian businesses whose assets surpass C$299 million in book value, are subject to government review. This book-value threshold will be replaced with enterprise-value thresholds of C$600 million during the first two years, C$800 million during years three and four and C$1 billion in the fifth and sixth years after the new review thresholds come into force.

The amendments also include a new review process for investments that allows the federal cabinet to take any sensible measures to protect national security, including ruling out foreign investment in Canadian assets. There is some concern with the vagueness of this process as it does not define what would be deemed injurious to national security and could risk deterring investment by Chinese state-owned enterprises and banks. It is important to reiterate that Chinese investment is welcome in Canada, and that a measured approach be taken in reviewing the commercial versus political nature of Chinese investments. Canada does not want to dissuade legitimate, commercially-oriented Chinese investments.

It is vital for Canadian investors and China's own development that China maintain an open and non-discriminatory stance toward foreign investment. The *Draft Notice Launching the National Indigenous Innovation Product Accreditation Work for 2010* would not only affect foreign exporters (as noted earlier), but also close access to public procurement for foreign-invested ventures in China whose intellectual property is not developed and owned in China. There is concern that this will pressure foreign companies to transfer and license their latest technologies for appropriation and re-innovation by Chinese companies.

Moreover, foreign-invested ventures face restrictions in certain sectors that are dominated by Chinese state-owned enterprises. These sectors include aviation, coal, electric power and grid, oil and petrochemicals, shipping, telecommunications, automotive, chemical, construction, electronic information, equipment manufacturing, iron and steel, and non-ferrous metals.

Canada and China must conclude the Foreign Investment Protection Agreement (FIPA), under negotiation since 2004, to provide a solid long-term framework for two-way investment, with comprehensive, high standards

25 *China Goes Global 2009: Survey of Outward Direct Investment Intentions of Chinese Companies* (Asia Pacific Foundation of Canada, Sep 2009)

of protection for investors and recipients in both countries. The agreement will protect foreign investors against discriminatory and arbitrary practices, provide appropriate recourse in the event of a dispute, ensure the equal treatment of foreign and domestic investors and ensure the free movement of capital between the two countries. It will cover a range of investments, including movable and immovable property, portfolio investment, money claims, IP and intangible rights to undertake commercial activities.

Progress in the FIPA negotiations is gradual, with the tenth round of talks having been held in January 2010. The process must remain as transparent as possible so government negotiators obtain the necessary inputs on key obligations including expropriation, enforcement, exclusions, regulation, compensation, pre-establishment and due process. Following the conclusion of the agreement, Canadian authorities will need to monitor investment progress and be prepared to intervene in substantive fashion, if required, to protect Canadian business interests.

Recommendations:

- **That the federal government build on the positive amendments to the Investment Canada Act by reiterating that Chinese investment is welcome and that the federal government take a measured approach in evaluating the political nature of Chinese investment so as to not dissuade Chinese investment overall.**
- **That Canada work with China to ensure that China maintains an open and non-discriminatory approach toward foreign investment in China.**
- **That Canada and China conclude the Foreign Investment Protection Agreement (FIPA).**

6. Green technology

In 2007, China surpassed the United States as the world's number-one emitter of carbon dioxide—and its energy needs will continue to swell over the next decade. China's economy, powered by industrial growth, rising consumption and gargantuan urban and transportation infrastructure development, continues to expand, yet its efficiency with respect to energy use is well below that of developed countries. China is the world's largest producer and consumer of coal. Modern Beijing, like hundreds of Chinese cities, is often shrouded in thick smog.

China's limited freshwater resources are under acute strain. The country's dry north is already facing severe water shortages as groundwater levels drop, and the Gobi Desert is creeping southward. While abundant lakes and rivers do exist in the centre and south of the country, the water is often polluted by harmful industrial chemicals.

The need for material goods, transportation and utilities for Chinese at work and at home continues to grow in tandem with income levels, but mounting environmental pressures faced by China under the current model are clearly unsustainable. China acknowledges this. To ensure its own sustainable development, it intends to become a world leader in the green sector and it is acting on this with the most ambitious green technology investment strategy among G20 countries.

A recent report by the Pew Environmental Group found that China leads the world in clean-energy investment, at US$35 billion in 2009. China has set ambitious targets in areas ranging from wind and solar power to biofuels and nuclear energy. China is also reported to have earmarked investments in the tens of billions of dollars annually over the next decade to develop smart grids. It is spending billions of dollars to make its mushrooming cities and buildings greener, and to develop and deploy both fuel-efficient public transportation systems and private motor vehicles.

China lies at the centre of growing global demand for clean energy, water management, green architecture and urbanization, cleaner forms of public and private transportation, and other such technologies. The signing of a Memorandum of Understanding on Climate Change between Canada and China in December 2009 was a constructive first step, as are Canadian investments in new clean technology projects in China.

Given Canada's expertise in several green-sector niches, the federal government, together with the provinces, territories and private sector, must build on the 2009 Memorandum of Understanding by pursuing a green partnership strategy with China. Canadian clean-technology businesses and service providers in areas such as hydrogen technologies, waste-to-energy technologies, fuel cells, water management, clean mining and green architecture, can help China become greener by deploying their products and expertise, and by attracting Chinese investment to develop clean-technology niches in Canada. The government can introduce Canada's green-sector businesses to Chinese localities interested in developing partnerships.

Greening China is good not only for China's development and the health of our planet, but it is also a huge economic opportunity for Canada. According to the 2009 China Greentech Initiative, a collaboration involving over 80 predominantly large Western companies and organizations—including Export Development Canada (EDC)—with interests in the environmental sector, the value of the Chinese market for clean technologies is somewhere between US$500 billion and US$1 trillion annually.

Economists believe green technology is the next big thing, but Canada is already lagging behind ambitious competitors. For many provinces, including British Columbia, Ontario and Quebec, green technology is an opportunity to rejuvenate their economies after the loss of lower value-added manufacturing. Canada must re-double its efforts to provide research institutions, overseas investors and producers with incentives and structures that will spur development in existing and potential green-sector niches where Canadian businesses can become globally competitive.

RECOMMENDATIONS:

- **That Canada build on the Canada–China Memorandum of Understanding on Climate Change with a Canada–China green partnership strategy.** This strategy will assist Canada's green-sector in establishing partnerships with Chinese regions and cities that have an interest in Canadian green products and expertise. It will also draw Chinese investment to develop Canada's green-sector.
- **That Canada develop incentives and structures that will spur development in current and potential green-sector niches in which Canadian businesses can become globally competitive.**

7. Commodities

To maintain its strong growth trajectory, China's economy needs reliable access to high-quality natural resources from overseas. Following the financial crisis, China has become the main driver behind global demand for many metallurgical minerals, oil, gas and other commodities including key Canadian exports such as wood pulp, metals, oil seeds, organic chemicals and fertilizers. China sits on the largest capital reserves in the world and is interested in investing in Canadian resources.

Progress has been made in recent years with Chinese entities, including the China Investment Corporation (CIC), successfully investing in Canada's mining and energy sectors. Examples include the purchase of equity in British Columbia-based Teck Resources and in Consolidated Thompson Iron Mines Ltd. in Quebec, as well as PetroChina's majority acquisition in the MacKay River and Dover oil sands projects. The Northern Gateway Pipelines project currently under study will likewise help open new markets for Canadian oil in China and Asia. Canada's oil and gas represent a unique resource in an energy-thirsty world, and an important component of Canada's rise as an energy superpower.

Canada must continue to welcome foreign investment—including from China—in its resources sectors or those funds will go elsewhere.

In recent years, China has actively developed its domestic commodities sectors, notably in metal, mineral and coal mining, and oil and gas exploration, production and refining. This presents business opportunities for Canadian mining companies and mining service providers, many of whom have been on the ground in China for years. Canada's mining sector has world-class expertise of interest to China in the areas of exploration technology, project management, sustainable mining and mining-sector financing. As China seeks to improve the safety of its mining activities following recent disasters and improve its environmental record, opportunities for Canadian companies to export related services are increasing. These services include ventilation, underground communications, gas detection, mine management and green mining services.

However, challenges remain. First, foreign companies must enter joint venture agreements with Chinese partners to engage in mining exploration and production. Canadian companies are often small- and medium-sized enterprises (SMEs) lacking the scale to compete for projects where Chinese enterprises seek a single, major foreign partner. Minimal capital requirements effectively prevent these SMEs from getting involved. Second, foreign investors must grapple with restrictive, often unclear regulatory implementation at the local level. Third, there are issues around exploration-to-production license transfers, which have been used by local partners as a bargaining tool with their Canadian counterparts. Canadian mining firms also have trouble accessing local Chinese geological data. While China is making progress in improving its regulatory framework for the mining sector, more needs to be done to ensure that Canadian firms enjoy a level playing field in mining exploration and production.

Statistics demonstrating rapid export growth for certain commodities can be misleading, as generally rising commodity prices over the past decade tend to inflate these figures. The current imbalance between Canada's robust commodities exports and smaller volumes of higher-value-added exports may be a vulnerability should China's growth slow down. It is important to further strengthen Canada's commodities trade with China by adding value to Canadian commodities through additional processing in Canada prior to export.

Achieving higher-value-added commodities trade with China is a challenge. As mentioned earlier in this paper, a WTO dispute is underway right now involving the United States, the European Union and Mexico against China's use of export barriers to keep raw materials in China, thus subsidizing Chinese value-added sectors. This, compounded with lower Chinese wages, subsidized energy and increasing domestic consumer demand, has spurred large-scale investment in Chinese smelters, refineries and other value-added stages of the minerals and metals value chain. This has weakened the potential for competitive value-added production in Western countries, including Canada.

To encourage greater value-added activities in commodities processing and other forms of production in Canada, the federal government must develop measures that encourage Canadian investment in the exploration and development of our country's mineral reserves, and in smelting and refining facilities in Canada.

Recommendations:

Recommendations:

- **That Canada continue to welcome Chinese investment into its resources sectors.**
- **That Canada and China resolve obstacles facing Canadian mining companies in getting access to exploration and production opportunities in China, including minimal capital requirements on joint venture foreign partners that block out SMEs, the lack of clarity in legal and regulatory frameworks at the local level, the use of exploration-to-production license transfers as bargaining tools by local partners and the lack of access to geological data.**
- **That Canada develop measures to enhance the development of its mineral properties and encourage greater value-added commodities processing and production domestically.**

8. Commercial services

The consumer needs of China's burgeoning urban middle class and the business needs of its world-oriented companies are growing in number and complexity. This is fuelling demand for commercial services like never before in finance, insurance and wealth management services, legal services, telecommunications, real estate, architecture, engineering, construction, the environment, transportation, private education, entertainment and culture. It is a great opportunity for Canadian businesses to enter a gigantic market and foster economic ties with China.

The economic importance of services is often overshadowed by the primary commodities and manufactured-goods sectors. In Canada, commercial services are the fastest growing economic sector, representing more than two-thirds of its gross domestic product and 90 per cent of its job creation. Services are also an important component of Canada's international trade profile. Between 2000 and 2007, Canadian commercial services exports to the world grew by an annual average of 4.8 per cent. However, services count for only 13 per cent of Canada's cross-border trade versus some 20 per cent for the world. This suggests room for trade growth in services through the pursuit of new opportunities created by market liberalization of the service sector in China, particularly in areas where Canadian businesses have expertise.

The Canadian insurance and banking sectors, for example, have a presence in China dating to the 19th century and are among the most active sectors in the country. The arrival of foreign invested-life insurers in countries with an under-developed life insurance sector can be an important source of foreign direct investment and contributes to social development. In an aging and increasingly wealthy country such as China, citizens are turning to private companies to ensure their financial security because healthcare and retirement-financing solutions are not provided by the government. Canadian companies have an opportunity to bring world-class expertise and best practices to China in this sector.

Canada's financial industry is knowledgeable of Chinese culture and has a long-term vision of its partnership with China. By building mutual trust, Canadian banks have steadily increased their operations and presence in China, and wish to continue on this path. It is no coincidence that a trade mission to China in August 2009 included leaders of the largest Canadian banks. In the aftermath of the financial crisis, the resilience of Canadian banks is recognized and esteemed worldwide. By opening its markets to Canadian banks, China can benefit from financial expertise that has proven to work.

A number of larger Canadian companies with the means to maintain a presence in China are now finding success—and the assistance of Canadian government leaders and officials has been invaluable. For smaller businesses, having the ability to stay the course and deal with the barriers in place is more problematic. Since joining the WTO in 2001, China has made great progress in opening its market to services, but some key issues still need to be addressed to facilitate foreign companies' activities in China and to bring the country in line with its WTO commitments.

First, non-discrimination against foreign suppliers of services must be guaranteed through the principle of national treatment, transparency and advance notice for legislation and regulation. It is difficult for businesses to operate when laws, regulations and administrative practices constantly change without warning. In a recent U.S.–China Strategic and Economic Dialogue session, China committed to improve transparency by pre-releasing trade-related measures prior to their official implementation and to provide opportunities for public comment. Such a process will be beneficial for foreign businesses and for China because it recognizes public consultations are critical for anticipating and resolving problems tied to the implementation of laws before they come into force. Transparency in the regulation and licensing process is also a good way to fight corruption—and it is a requisite for a healthy, modern economy.

If transparency in the rule-making process is important, so too is the principle that enforcement of these regulations must be applied equally to both domestic and foreign firms. A discretionary application of regulations would be equivalent to a hidden subsidy for Chinese companies.

Second, the licensing process is a sensitive topic for the insurance industry. In October 2008, China stopped giving out new licenses for regional sales offices. The information as to why the moratorium is in place and when it will be lifted was not shared with the companies. At the same time, foreign-invested life insurers keep facing problems getting branch-expansion approvals. Despite assurances from the Chinese Insurance Regulatory Commission (CIRC) that companies are eligible for multiple branch approvals on a concurrent basis, they now can occur only on a consecutive basis. These measures favour domestic-owned insurance companies and are not in keeping with China's WTO commitment.

Becoming a multilateral player in the WTO is not an easy task and it is in China's interest to make the necessary adjustments—the benefits of playing by the rules clearly outweigh the consequences of not doing so.

There are great opportunities for a Canada–China financial partnership on many levels. For example, Toronto wants to become a leading financial hub specializing in commodities and retirement financing. Given global interest in Canada's sound financial enterprises and Toronto's image as a global city with a wealth of skilled labour, there is a real chance of Toronto reaching its goal.

Other cities, such as Calgary and Edmonton, have also announced plans to develop financial niches of their own. Canada has world-leading expertise in financing mining, metal and energy companies, with more than 7,000 financial services jobs supporting these sectors. Canada is also a leader in retirement financing with important players in the field of retirement financing based in Toronto.

Matching this, China has its own ambition to develop Shanghai and Hong Kong, dubbed "Shangkong," into top-tier financial centres rivalling New York and London. This ambition is underscored by China's participation in the International Monetary Fund's voluntary Financial Sector Assessment Program that will highlight the development potential of its financial sector. Canada must work with the provinces and territories, the financial sector and the wider business community to realize its goal of having a robust financial services presence in China. By developing strong ties between Toronto and other Canadian cities and Shanghai–Hong Kong, Canada could become a financial corridor between China and North America.

Recommendations:

Recommendations:

- **That Canada work with China, within the WTO and through bilateral agreements, to remove trade and regulatory barriers facing its services industries in China and to ensure that agreed-upon obligations are met.**
- **That services opportunities be on the radar screen of Canadian government representatives in China, and that there be processes in place to ensure Canadian companies are promptly informed of existing opportunities.**

9. Intellectual property

Intellectual property (IP) is a fundamental component of a company's assets. It is often the product of huge investments in training, research and development, and it can be at the core of a company's value. From a competitiveness standpoint, IP is also important in both maintaining a technological edge and in fostering investment. Because the creation of IP often takes many years and substantial funding, it is vital that the companies making these investments be protected from poaching. Infringements on IP result in knockoffs that compete with a business's legitimate products, erode its profit margins and dent consumer confidence in its brands.

The protection of IP in China is a long-standing concern for Canadian businesses. On paper, China has a reasonable IP legal framework and it has made some progress in recent years in improving its record of protecting IP. However, consistency and effectiveness in IP enforcement remains inadequate, and there is an alarming trend in substandard copyrighted or Chinese-made counterfeit products sold in Canada that create real safety risks for Canadians.

China's experience with IP protection is relatively new, beginning with trademark legislation in 1982, patent law in 1984 and copyright law in 1991. China did not issue regulations for the protection of computer software until 1997. With its entry into the WTO, China has had to pay far more attention to IP issues than previously and it has also had to conform to the requirements of the *Trade-Related Aspects of Intellectual Property Rights Agreement*. The lack of experience with IP protection is further complicated by the traditional Confucian view that materials and information must be in the public domain for general use and that knowledge is not to be owned or used as a tool for profit. This conflicts with the western view of IP as a proprietary right.

Adjusting to the notion of IP as a private good is a steep hill to climb for the Chinese government, its judicial officials and its private sector. China does not have a common-law system but rather a private system based on a body of codes. Further, judges are not necessarily bound by previous rulings, meaning that application of the law can vary widely from case to case. In addition, the effectiveness of its legal framework is hindered because laws and regulations prescribed at the national level are not necessarily followed by local jurisdictions.

The number of IP cases being dealt with in Chinese courts is increasing and IP-rights holders have seen success in dealing with infringements. In addition, Chinese authorities increasingly realize that better IP protection will foster innovations and brand development based on research and development as well as knowledge. It will move China's production from being made in China to being created in China.

However, penalties for IP violations are light, judgments are inconsistent, local protectionism persists, the threshold for criminal protection can be high, administration is uncoordinated and appropriate training for Chinese legal officials is lacking. There are examples where foreign IP receives a lesser degree of protection than domestic IP, notably at the local level, where officialdom is often more tolerant toward infringements on IP when it benefits regional economies.

China released a *National IP Strategy* in 2008, calling for a culture of IP protection, the revision of laws on patents, trademarks and copyrights, and enforcement practices that would make China a country with a high level of IP protection by 2020. In spite of intentions, critics say the strategy lacks teeth and has few concrete and innovative methods for enforcing Chinese IP laws.

Canada must continue to actively encourage China to enforce IP protection more effectively. If protection is ineffective, companies will be much less willing to use leading-edge technologies or conduct research and development in China, thereby undermining their own competitiveness and denying benefits to China's own economic development. Without strong IP protection, it will be difficult for China to pursue its transition to a high-value-added economy. Supporting China's efforts to achieve practical results with its *National IP Strategy* and to match international best practices on intellectual property is a win-win proposition.

In the meantime, Canadian businesses approaching China can better protect themselves by registering their IP in Hong Kong under local laws, which are long-standing and more robust than the IP regime in mainland China. IP infractions in China can be pursued through the Hong Kong legal system if rights holders register their products there.

Second, the Canadian government must continue enhancing enforcement of IP protection in Canada. Counterfeit products entering Canada can be difficult to detect and to stop. Canada does not take the problem seriously enough and the legal and enforcement tools it possesses to counter the problem are ineffective. The

Canadian Chamber of Commerce calls for legislative changes to provide a clear definition on prohibited activity. In addition, there must be better powers to search, seize and destroy counterfeit and pirated products.

Recommendations:

- **That Canada continue to actively encourage China to more effectively enforce IP protection for the benefit of both countries.**
- **That enforcement of IP protection be enhanced in Canada through legislative changes that provide a clear definition on prohibited activity and give authorities improved powers to search, seize and destroy counterfeit and pirated products.**

10. Currency issues

Currency issues remain a concern for Canadian exporters. Between July 2005 and August 2008, the Chinese government had somewhat loosened the value of the yuan when compared with the U.S. dollar, which saw the value of the yuan go from 8.22 yuan per U.S. dollar in July 2005 to 6.83 yuan per U.S. dollar in August 2008. The exchange rate has remained constant since then.

The yuan appreciated against the Canadian dollar between late 2007 and the first quarter of 2009. Since then, the value of the yuan to the Canadian dollar decreased significantly as a result of the latter currency's appreciation against the U.S. dollar. In March 2009, one Canadian dollar bought 5.4 Chinese yuan; nine months later it bought 6.5 yuan. In the minds of many, the yuan remains significantly undervalued, providing China with an artificial competitive advantage.

In Beijing, the currency peg is viewed as a necessary safeguard. China believes it offers job protection in its export sector and helps prevent potential social unrest by unemployed migrant workers, as the Chinese economy moves toward greater domestic consumption. Western governments (including Canada) and the International Monetary Fund have called for a stronger yuan to match China's strong growth in 2010 and to facilitate the necessary rebalancing of the global economy away from over-reliance on weakened U.S. consumption. Pressures are rising in the United States to brand China as a currency manipulator. Beijing has hinted that it may allow its currency to float a little, but it rejects foreign pressure and will take action only at a time of its choosing.

The undervalued yuan harms the competitiveness of Canadian exporters by rendering their products more costly to Chinese consumers, and by artificially increasing the competitiveness of numerous Chinese products compared with their Canadian equivalents both in Canada and abroad. Continued engagement with China is needed to solve this issue. There is a strong case to be made on the inflationary danger China might face by maintaining an undervalued yuan.

The Chinese government recently announced that it would loosen the yuan exchange rate. This is encouraging and must be acted upon.

While the Canadian dollar is highly valued and the value of the yuan remains low, it is important that Canadian companies whose competitiveness relies on their ability to import low-cost Chinese machinery and technology take advantage of this window of opportunity.

China's currency regime also poses challenges for offshore financial services entities by not allowing them to legally trade in Chinese yuan. To make payments to clients in China, offshore entities currently need to transfer foreign currency to a Chinese intermediary that is legally entitled to make foreign-exchange transactions. These intermediaries convert the funds into yuan on the basis of a rate of execution determined by the People's Bank of China; the funds are then transferred to the accounts of the offshore entity's client in China.

This harms offshore entities transferring funds to Chinese clients. Unlike many other countries, the Chinese legal framework does not have a time limit within which foreign-exchange funds must be converted into yuan by the intermediary. Chinese end-clients often receive funds on an untimely basis and are often unaware that offshore entities have no control over these delays. As a result, offshore entities incur costs in the form of undeserved damage to their reputations and lost business to Chinese competitors that do not need to operate through intermediaries. Foreign-owned companies cannot bypass the need for an intermediary by being incorporated in China, since legally they continue to be treated as foreign entities.

RECOMMENDATIONS:

- **That Canada work with China, bilaterally and through the G20, to remedy the issue of the undervalued yuan.** This is needed to rebalance the global economy and will help China stymie domestic inflation.
- **That Canada and China work to allow off-shore financial services entities to legally convert foreign currency into yuan to make payments to end-clients in China.** At a minimum, China needs to establish and enforce a clear, narrow time-frame within which the Chinese intermediary must execute foreign-exchange transactions between offshore financial services entities and Chinese clients.

11. Education

Until recently, the importance of attracting Chinese and other international students to Canada has been overlooked. Yet it is critical to Canada's short- and long-term economic well-being. The immediate contribution of international students to the Canadian economy is huge. According to a recent report commissioned by the Department of Foreign Affairs and International Trade (DFAIT), 178,000 long-term international students spent $5.5 billion in Canada in 2008—including paying for tuition, accommodation, and other goods and services—surpassing the value of Canada's coniferous lumber and coal exports. Short-term international students spent an additional $1 billion. Moreover, international students generated $291 million in government revenue in 2008 and created economic activity that sustained employment for 83,000 Canadians. Chinese students accounted for almost one-quarter of the expenses of long-term students in Canada, just ahead of the students from South Korea.

Attracting Chinese students to Canada can boost our country's presence in China. Students from China get to experience Canada's quality of life and its products. Opportunities for these students to work off campus during and after their studies can familiarize them with the Canadian business environment. These experiences then trickle back to the students' home country, creating goodwill and awareness of Canada as a place to visit and do business. Canada must do more to foster long-term contacts with Chinese alumni. In an age of global networks, connections between these alumni and Canada can help cement real ties between the Canadian and Chinese business communities down the line.

Also, Canada is an aging country whose future labour supply will rely almost entirely on immigration. Attracting international students to Canadian universities and colleges, combined with an immigration policy that actively encourages and facilitates their integration into the Canadian workforce following graduation, will ensure that the Canadian economy is equipped with the people it needs to fuel future growth.

Canada is not alone in the growing and lucrative education market. Australia, the United Kingdom and the United States actively compete in marketing their education brands overseas in countries such as China, India and South Korea, where demand for overseas education is strong. It is worrying that Canada is behind in this regard. In 2006, Canada attracted a mere 2.7 per cent of tertiary-level international students worldwide, compared to 7.2 per cent for Australia, 12.9 per cent for the United Kingdom and 22.8 per cent for the United States. Australia's more than 600,000 international students brought it more than C$16 billion in revenues, three times what international students brought to Canada. There are some 140,000 Chinese students in Australia compared with 50,000 in Canada.

Though many Canadian educational institutions—including McGill University, the University of Toronto and the University of British Columbia—enjoy high international rankings, initiatives to market Canada's education brand have been insufficiently coordinated. One of the obstacles to marketing a national education brand is the fact that education is the responsibility of the individual provinces and territories.

Recent initiatives have improved consistency in the marketing of Canadian education in China and elsewhere through federal–provincial collaboration. First, the Imagine Education in Canada brand was launched in 2008 through the Council of Ministers of Education Canada as a joint initiative of DFAIT and the provinces and territories. This new brand has helped make Canada more visible as a preferred destination for Chinese and other international students. Second, DFAIT's Edu-Canada unit is actively marketing Canada's education sector by reaching out to potential students through Canadian trade-commissioner offices in China and education fairs. Two key fairs are the China Education Exhibit, and PhD Workshop China where foreign countries advertise their PhD programs to Chinese graduate students, whose specialized skills Canada needs. It is crucial that Canada continue to actively promote its education brand in China.

Recommendations:

Recommendations:

- **That Canada continue to actively promote the benefits of a Canadian education in China under the Imagine Education in Canada brand and through education fairs.**
- **That Canada maintain and strengthen ties with Chinese alumni of Canadian post-secondary institutions.** In an age of global networks, ties with Chinese alumni will bring goodwill to both Canada and China and will strengthen ties between the two countries' business communities.

12. Tourism

The rapid growth of Chinese overseas tourism is an important aspect of the Canada–China relationship. A burgeoning middle class in China with the financial means to travel, coupled with reduced restrictions on overseas travel by its citizens, provide an opportunity for Canada to become a major destination for Chinese tourists. China is quickly becoming a giant source of tourists—according to the World Tourism Organization, more than 100 million Chinese citizens are expected to travel abroad as tourists by 2020. In 2008, some 160,000 Chinese travellers came to Canada.

A milestone was reached during Prime Minister Harper's first official visit to China in December 2009—Canada was granted Approved Destination Status (ADS) by China. This will allow the Canadian tourism industry, most of which is made up of small- and medium-sized enterprises, to capture growing Chinese interest in travel to North America. Chinese citizens will be able to travel to Canada on a tourist visa, whereas historically a business visa was required. Approved Destination Status will also allow the Canadian tourism industry to actively market Canada as a tourism destination in China and will permit Chinese travel agents to advertise and promote leisure travel packages to Canada.

As with Japanese tourism in Canada in the 1980s and 1990s, infrastructure and a range of tourist services catering to Chinese tourists will be needed to gain full advantage of this emerging market. Canada is a latecomer, and as Approved Destination Status has already been granted to more than 134 countries and jurisdictions, including the United States, the European Union and Australia. Canada's tourism industry must show a real desire to catch up to other countries.

Canada is still largely unknown to millions of potential Chinese tourists. Work needs to be done to determine the brand that will best attract them to Canada. For many Chinese tourists, a trip to North America is a rare experience and many head to the United States. Canadian tourism operators must highlight the uniqueness of Canadian travel experiences and the possibility of combining a trip to the United States with one to Canada.

The Canadian Tourism Commission (CTC), collaborating with Canadian overseas missions, the provinces and territories, and Canadian local tourist operators, has worked to promote Canada in China and in Asia. Other countries such as Australia, which a decade ago was little known in China, have aggressively promoted themselves to Chinese tourists. With Approved Destination Status, Canada's efforts must be substantially expanded to include the hosting of Travel Canada fairs and events in China and the publicizing of Canada as a tourism destination through the Chinese-language media.

Recommendation:

- **That the Canadian Tourism Commission (CTC), in collaboration with Canadian overseas missions, the provinces and territories, and Canadian tourist operators, expand efforts to promote Canada as a tourism destination in China.**

SECTION III: CANADA'S ASIA-PACIFIC FUTURE

This report has highlighted some of the key policy areas in which the Canadian Chamber of Commerce believes governments and business must act to ensure a strong and vibrant Canada–China connection, one that results in higher levels of mutually beneficial two-way trade and investment.

This is a time where, in addition to strengthening Canada's economic ties with the U.S. market, Canada needs to significantly increase and diversify its economic exchanges with China and other large—and growing—markets. The issues identified in this report require immediate attention and give rise to larger questions with long-term implications for Canada's economic well-being:

- Does Canada have an ambitious, comprehensive and forward-looking strategy that enhances its trade and investment ties with China and other major markets?
- What more must Canada do to bolster the visibility of its products and expertise in China?
- Does Canada have the long-term, strategic relationship with China at the political level that is necessary for two-way trade and investment to flourish?
- How can the government educate Canadians about the potential opportunities in China?
- What must Canada do to ensure that its commodities, manufacturing and services companies, regardless of size, successfully adapt to the challenges and opportunities presented by China?
- What must these Canadian companies do to emerge as robust global competitors?

- Given the current position of China within integrated global value chains, should Canada and China begin investigating the possibility of a comprehensive Canada–China free trade agreement, one that covers trade, investment and other aspects of two-way cooperation such as the environment, regulatory standards and the movement of skilled labour?

- Or, is it time to consider with the United States and Mexico—with whom Canada is highly integrated—looking at the first steps toward a NAFTA–China free trade agreement?

Now, more than ever, Canada needs a strategic plan—a comprehensive and long-term vision with respect to its economic place in the world. From coast to coast, Canada must collectively think of itself not only as a nation of the Americas, the Arctic and the Atlantic, but also as a nation of the Pacific.

As China and other countries of the Asia–Pacific region continue to rise economically, geopolitically and culturally, Canada must move decisively and deliberately to ensure its rightful political and economic place and voice in this dynamic region.

Virtually every country in the world has been working diligently to maximize mutually beneficial economic ties with China. Canada must do the same. It must be more aggressive in fostering an economic partnership with China.

Naturally, it is not government, but companies, that produce, trade and invest. Canada's economic interaction with China is the sum of the myriad corporate decisions and actions taken by Canadian enterprises, but these decisions and actions do not occur in a vacuum. Businesses react and seek to take advantage of both the policy directions taken and the doors opened by government.

The economic and financial crises of the past two years have left the world with a "new normal." The Canadian Chamber of Commerce calls for urgent action by business and the federal, provincial and territorial governments to work together to reconsider Canada's approach to the pivotal economy that China has become.

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