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China Ascending

A Policy Update Paper

By

Derek Burney

Senior Strategic Advisor, Ogilvy Renault LLP

and

CDFAI Senior Research Fellow

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ABOUT THE AUTHOR

Derek H. Burney is a Senior Strategic Advisor for Ogilvy Renault LLP in Ottawa, the Chair of CanWest Global Communications, Chairman of the GardaWorld International Advisory Board, a Visiting Professor and Senior Distinguished Fellow at Carleton University, and a Senior Research Fellow with the Canadian Defence & Foreign Affairs Institute.

If nothing else, a visit to China confirms that the economic centre of gravity is shifting to Asia and that trend is being accelerated by the global recession. It is Asia, not the U.S., that is lifting the world out of recession and that has not happened before. The burgeoning economic growth of China is palpable in many ways, as is the entrepreneurial, deal-making zeal of many Chinese. Confidence and pride are rising too, fuelling strong nationalist impulses which, in turn, can be aroused from time to time to counter "splittist" tendencies, whether from Tibet or Xinjiang (Uighur country.) Despite the obvious benefits of strictly guided capitalism, there is unease in China about the underlying causes of the global recession. Major flaws in the West's financial systems and regulatory oversight seem to be quelling some reformist ardour in Beijing. At least that was the candid view of senior reform elements in the state apparatus who see their more conservative counterparts acting now with greater swagger. No longer is the prevailing objective to emulate the U.S. or the West on economic policy. Many senior Chinese are convinced that their approach and their system, even with its flaws, withstood the shocks far better and they are much less inclined to learn from those who have stumbled badly.

The main challenges for China are domestic, shifting more of the benefits from economic growth to hundreds of millions of Chinese still confined to rural regions and antiquated farming methods. Escalating pollution in major urban centres, notably Beijing where 4,000 new automobiles hit the streets daily, and corruption at all levels of the intrusive tentacles of government are chronic handicaps to China's growth. In the medium term, the demographic challenge of a population with 40 - 50 million more young boys than girls underscores a different kind of problem. The mix of issues like these could easily become volatile.

A persistent question mark is the longevity of the Chinese political system. Minimal outlets for dissent at local levels do provide safety valves of a sort and the global recession has done little to advance the merits of pluralistic democracy. But the degree of control that governs so much of life in China will be difficult to sustain as the middle class grows in size and the purely domestic challenges to the quality of life become more serious. There is some sense that Singapore may be a model to emulate in future – "guided democracy at an enriched level." What is more certain is that the Chinese leaders remain convinced that they were right to avoid the mistakes made in the USSR where political reform preceded economic liberalization. Change at the political level will be very slow in China, but maintaining strict control will be tougher, not easier in the years ahead.

Political influence extends from economic power and it is certain that China is destined to become more of a player on global issues, including on many which it has, thus far, essentially for selfish reasons, side-stepped. As *The Economist* observed recently, "China's own world view has failed to keep pace with its growing weight. It is a big power with a medium-power mindset and a small-power chip on its shoulder." The national interest will remain paramount but China's voice and involvement on global affairs will rise. This may prove to be a mixed blessing for them and for the West. For one thing, by becoming a global economic player and the dominant regional player, China cannot avoid adopting positions that will add complexity to decision-making and put more strain on its monolithic leadership; however, there is a cadre of leaders, the Foreign Minister (Yang Jiechi) and Central Bank head (Gov. Zhou Xiaochuan) to name a few, that are easily up to the task. An expanded role for China, among other emerging powers, at the IMF would be a salutary step in itself.

The Head of the People's Institute of International Affairs in Beijing described North Korea as the #1 foreign policy challenge for China today which may explain the recent visit to Pyongyang by Premier Wen. But it is a problem to be contained, not resolved. Unification on the Korean peninsula is not seen as the ultimate answer. For one thing, China would not want 25 - 30,000

U.S. military stationed that close to its border. Curiously, the same individual dismissed Afghanistan as a major concern. "That", he observed bluntly, "is being dealt with by NATO!"

The real concern for China must be the threat of protectionism from the U.S. in particular, but also from other developed countries and, more generally, the fragility of global recovery. Domestic stimulus has helped ride over the negative impacts of the global recession but infrastructure spending, however commendable, will not sustain economic growth. Efforts to simulate domestic consumption should be watched carefully. In the immediate term China will remain heavily dependent on exports for growth and, for that to continue, global economic recovery is vital.

It will be intriguing to watch, too, how the new Japanese government approaches China. The Japan-China economic partnership is huge for both countries but history adds a lot of lumpy baggage to bilateral diplomatic relations. Prime Minister Hatoyama has signalled a desire to pay more attention to regional affairs, and particularly with China, as a way of diluting Japan's customary obsession with the United States. It promises to be an interesting chess match with potential advantages for both China and Japan. The manner in which the U.S. responds to the increasing economic weight of China and other major Asian powers, and the quality of relationships Washington establishes with each, is likely to be the dominant foreign policy focus over the next decade.

One thing that is definitely evolving is the status of Taiwan in the broader equation of regional affairs. Political change in Taipei has already ushered in a more cooperative mood and constructive discussion on things like air links between the two, but the spectacular economic growth of China and the positive example of Hong Kong's integration suggest that progress towards a gradual accommodation of Taiwan's status vis-à-vis China is more likely than a major rift. And the more economic partnership takes hold, including direct investment from Taiwan, the less likely will be any confrontation. That would be good news all around.

On the surface, Hong Kong seems to be holding steady as a distinct entity within China. Housing values tumbled late last year but have stabilized recently. The infrastructure is impressive and the container port activity continues as #1 or #2 in the world. Hong Kong is thriving in part as a conduit for Taiwanese investment into the mainland. Political rumblings are muted by the more pervasive desire to generate wealth. With more than 200,000 Canadians in residence, Hong Kong is also the part of China where Canada's brand is solid. That is not as true in China as a whole where we lag behind notably Australia on trade, investment and broader exchanges. The Canada brand in China could use some neon, a sharper focus and more determined direction from the top!

Given China's need for commodities and for energy, as well as the complementary role China can play in global value chain enhancement, there is scope for much more with Canada. Besides, Chinese concern about the precarious value of the U.S. dollar means that their appetite for offshore assets that will support their economic growth is in the ascendancy. They may be somewhat wary about Canada's receptivity to investments of this kind, but they undoubtedly see clear advantages – the stability and reliability of Canada relative to many other sources of supply. An investment protection agreement, on which negotiations have languished for more than a dozen years, would be a good first step to improve the investment climate both ways.

Ministerial visits are welcome as will be the visit later this year of Prime Minister Harper. But Canada's approach to China, both from government and the private sector, needs more

persistent attention and more impetus. It is not without risks or difficulties but the scope for enhancement cannot be overstated (the success of Bombardier after years of persistence is a case in point). Above all, Canada should adopt a strategic approach to broader engagement with China recognizing the need for firm commitment as a basis for practical dividends. Spasmodic initiatives or trade junkets, buffeted by episodic political differences, are not a recipe for success. Taking a long view and working through differences in a mature manner while creating a stronger foundation for partnership would be more effective. Canada should commit time, resources and some creative, strategic thinking to determine more precisely how we intend to relate to a rapidly ascending China.

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CDFAI was created to address the ongoing discrepancy between what Canadians need to know about Canadian international activities and what they do know. Historically, Canadians tend to think of foreign policy – if they think of it at all – as a matter of trade and markets. They are unaware of the importance of Canada engaging diplomatically, militarily, and with international aid in the ongoing struggle to maintain a world that is friendly to the free flow of goods, services, people and ideas across borders and the spread of human rights. They are largely unaware of the connection between a prosperous and free Canada and a world of globalization and liberal internationalism.

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