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China's Move up the Value Chain: Implications for Canada

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by

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Introduction

With the United States (US) economy stalled and the Eurozone ensnared in sovereign debt crises, there are increasing calls for Canada to engage more deeply with China and other emerging economies to counterbalance the weakness evidenced in those traditional trading partners. Indeed, two-way trade and investment flows between Canada and China have been growing rapidly, albeit from a low base. If Canada is to benefit, however, from booming demand in mainland China, a break in the current pattern of bilateral trade, investment and diplomatic ties will be needed. In the longer term, it is the active involvement of Canadian firms in more value-added manufacturing and service global supply chains, rather than a narrow focus on boosting exports of energy commodities that will allow Canada to better reap and balance the gains from globalization.

Calling for a shift in economic policy perspective and strategy is never easy. Owing to the highly integrated nature of the Canada-US economies, and the leading role of US multinational corporations (MNCs) in orchestrating global production chains, the role of Canadian manufacturers has increasingly been to supply inputs for US exports. This propensity for indirect trade linkages exposes the structural weaknesses of the Canadian economy, especially its reliance on US production networks (Barton, 2011; Stanford, 2011). This strategy might have been suitable in the decades leading up to the crash of 2008-2010, but the materially different global setting since then requires adaptation if Canada is to take a more direct hands-on approach to identifying and tapping into strategic opportunities in emerging markets. Developments in China, known as the most influential and dynamic of the BRICS¹ countries, may offer a few rare “game-changing” openings with which to address structural weaknesses in the Canadian economy.

The most overlooked *Black Swan* event in China’s historic rise is the country’s plodding but persistent process of moving up the value chain. As described by Taleb (2007), a Black Swan event is created when the gap between what we know and what we think we know becomes dangerously wide, leading to a possible turn of events: that lie outside the realm of regular expectations, that carry an extreme impact, and that are often given made-to-fit explanations in hindsight. While the conventional wisdom is to dismiss China’s efforts to move up the technological ladder, this paper argues that Canadian policy makers would do well, given growing empirical evidence, to actively and directly engage the Chinese as this process unfolds. With Chinese technological

¹ O’Neill, Jim, 2011. Panic measures will ruin the BRIC recovery. *Financial Times*, 10 August.

capabilities still evolving, ample opportunities exist for strategic and pragmatic partnerships that leverage China's ambitions to rise to the apex of global supply chains.

To seize this opportunity, a strong and committed Canadian presence in China's transformative process can be targeted to help alleviate structural weaknesses facing both economies, whilst also mutually bolstering national negotiating leverage. To be sure, this level of strategic engagement is not without risk and will not occur without significant political investment. Ultimately, however, such considerations will be crucial to Canada's long-term prosperity, welfare and employment prospects by preparing for and directly engaging in this next phase of globalization that is likely to be more Asia-centric.

This paper is structured to provide the broad contours of a more deliberate strategy by Canada to economically engage with China. To this end, the paper provides an overview of trends on bilateral Canada-China trade and investment relations, followed by a discussion that locates the relative positions of Canadian and Chinese firms in global supply chains, with emphasis given to China's increasing penetration into higher value-added activities. Two concrete policy areas are then used to highlight examples where Canada-China economic interests can strategically overlap. The conclusion offers some suggestions on Canada's policy options in light of its status as a middle-power country.

Overview of Bilateral Trade and Investment

Trade Flows

Canada-China trade flows have grown quickly, but remain relatively one-dimensional. According to Industry Canada statistics, in 2003 China became Canada's second largest trading partner (treating the Eurozone as individual countries), displacing Japan. While the US remains Canada's top trading partner, two-way trade flows with that country as a share of total trade have fallen, from 76.3 percent in 2001 to 62.6 percent in 2010. Over the same period, trade with China grew from 2.3 to 7.2 percent, while trade with Japan declined from 3.1 to 2.9 percent. As a recent report notes, from 1998 to 2007, Canada's trade with China increased by more than 350 percent while Canada's trade with the rest of the world (minus China) expanded at the more pedestrian pace of 33 percent (Tiagi and Zhou, 2009).

Canada's trade with China, however, appears imbalanced and skewed towards lower value-added items. While Canada has consistent trade surpluses with the US, the

situation with China is the reverse. Chinese exports to Canada have long been growing at a faster rate than Canadian exports to China: between 2001 and 2010, Chinese exports to Canada grew by 249.9 percent, while Canadian exports to China grew by 210.3 percent. As reported by Industry Canada statistics, by 2010, these trends resulted in a trade deficit (Canada's largest) with China of C\$31.3 billion, on the back of C\$13.2 billion in exports.

Table 1 contrasts the comparative trade performance of selected commodity exporters with China. The data, reported from China's perspective², indicates total Canada-China trade in 2010 at about \$37 billion, resulting in a Chinese trade surplus of \$7 billion. Over the period 1992-2010, Chinese exports to Canada grew by 3,301 percent, while Chinese imports from Canada grew by 674 percent. While these rates of growth are quite high, they do not compare favourably with the trade performance of other well-known natural resource or energy powerhouses such as Australia or Brazil. Although the trade levels do not match those of Australia, total Brazil-China trade in 2010 reached about \$63 billion, leaving China with a trade deficit of \$14 billion. Over the 1992 to 2010 period, two-way Brazil-China trade rose rapidly, with Chinese exports to Brazil growing by 37,677 percent, and Chinese imports from Brazil growing by 7,236 percent.

² The observed discrepancies in trade figures reported respectively by Canadian and Chinese governments are generally explained by the use of Hong Kong as a major conduit for China's imports. Canadian customs officials will record these as exports to Hong Kong, whereas Chinese officials will allocate this trade to Canada since trade data are compiled on a country-of-origin basis. While differences in reporting procedures are believed to explain much of the observed discrepancy in bilateral trade data, other factors may contribute to discrepancies as well. For instance, Canadian imports and exports are collected and published on a *free on board* (FOB) basis, while China publishes its imports on a *cost, insurance, and freight* (CIF) basis and its exports on a FOB basis. (Tiagi and Zhou, 2009).

Table 1. China Trade with Selected Commodity Suppliers, 1992-2010

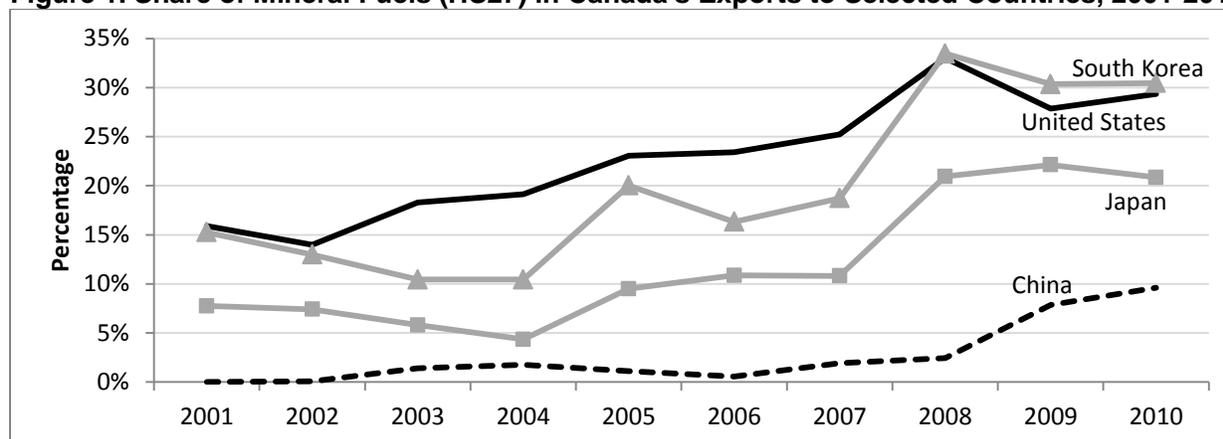
		2010 (\$m)	1992-2010 (% growth)
Australia	EX (to country)	27,220.26	4,019.29
	IM (from country)	61,105.17	3,556.56
	Balance	-33,884.91	
Brazil	EX	24,460.65	37,677.07
	IM	38,099.45	7,236.69
	Balance	-13,638.80	
Canada	EX	22,216.13	3,301.23
	IM	14,921.96	674.56
	Balance	7,294.17	
Indonesia	EX	21,953.57	4,556.80
	IM	20,795.19	1,237.98
	Balance	1,158.38	
Mongolia	EX	1,449.76	968.12
	IM	2,549.85	5,200.04
	Balance	-1,100.09	
World	EX	1,577,763.75	1,757.50
	IM	1,396,001.57	1,632.33
	Balance	181,762.18	

Source: UN Commodity Trade Statistics.

Based on the above, it should be no surprise that the potential for greater (commodity) exports to China is palpable. As seen in Figure 1, the percentage of mineral fuels (HS27) in Canada's total exports to China remains relatively low, 9.6 percent in 2010, as compared to 20.9 percent of exports to Japan, 29.3 percent of exports to US, and 30.5 percent of exports to South Korea.

More revealing, however, is a comparison between Canada-China and Canada-US trading patterns and the observable differences in the product structure of trade. In 2010, aside from the various natural resources contributing to Canada's export basket (mineral fuels and oils, natural gas, lumber and pulp, basic chemical compounds and agricultural goods, et cetera), Canada's top 25 exports (by HS6 codes) to the US also include relatively high-value items such as motor vehicles and parts, aircrafts, and pharmaceutical products. By contrast, in the same year, Canada's top 25 exports to China consisted only of natural resource and raw material.

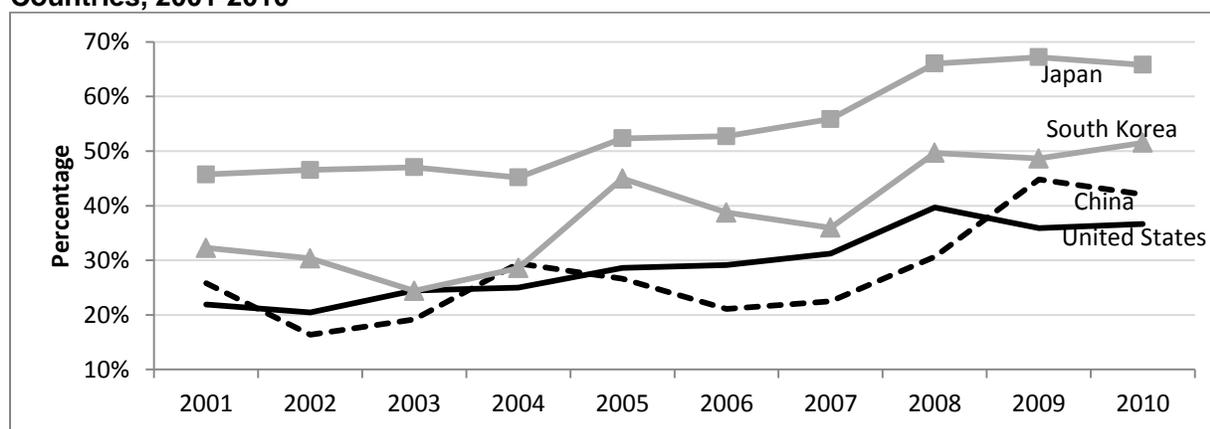
Figure 1. Share of Mineral Fuels (HS27) in Canada's Exports to Selected Countries, 2001-2010



Source: Industry Canada

This “regressive” trend of an increasing proportion of natural resources and raw materials in Canada’s export basket is further supported by data in Figure 2. The share of these lower value-added goods exported to China grew from 25.8 percent in 2001 to 42.1 percent in 2010, as a share of total exports to that country. Similarly, roughly half of Canada’s exports to South Korea in 2010 came from natural resource sectors, up from 32.3 percent in 2001. Exports to Japan revealed an even higher proportion, at 65.8 percent in 2010, up from 45.7 percent in 2001. With the lowest proportion of the countries selected, even Canada’s exports to the US have seen a greater share of natural resources at 36.7 percent in 2010, up from 21.9 percent in 2001.

Figure 2. Share of Agricultural and Mineral Goods (HS01-27) in Canada's Exports to Selected Countries, 2001-2010



Source: Industry Canada.

Investment Flows

Bilateral investment flows have also grown quickly, but again from a relatively low base.

As seen in Table 2, foreign direct investment (FDI) in Canada remains dominated by the US, although the share has fallen from 67 percent of total FDI stock in 1998, to 55 percent in 2010. Over this period, the FDI share of other industrialized countries such as the United Kingdom, Germany, and Japan have also declined, with Japanese FDI in Canada experiencing the largest fall from 3.8 percent in 1998 to 2.9 percent in 2010. Meanwhile, China's share of FDI in Canada has grown from 0.1 percent in 1998 to 2.5 percent in 2010, growing at a rate of 6,119 percent over the 12-year period, compared to growth of 108 percent in US FDI inflows. Thus, while Chinese FDI inflows are clearly on the rapid rise, they still only represent a small portion of the bulk of FDI inflows coming to Canada.

Table 2. Foreign Direct Investment in Canada, Annual Stock, 1998-2010

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
All countries (\$m)	219,389	252,563	319,116	340,429	356,819	373,685	379,450	397,828	437,171	510,139	542,732	547,578	561,616
United States	66.96%	69.70%	60.68%	64.60%	64.90%	63.71%	64.13%	63.21%	60.64%	57.04%	54.43%	53.21%	54.51%
United Kingdom	7.77%	6.05%	7.51%	7.91%	7.72%	6.96%	6.67%	7.42%	9.01%	11.10%	9.45%	8.17%	7.51%
Germany	2.31%	2.72%	2.31%	1.81%	1.90%	1.84%	2.00%	2.20%	1.92%	1.79%	2.21%	1.78%	1.81%
Japan	3.83%	3.27%	2.52%	2.31%	2.61%	2.65%	2.62%	2.65%	3.07%	2.67%	2.29%	2.63%	2.85%
South Korea	0.06%	0.07%	0.07%	0.08%	0.08%	0.09%	0.09%	0.10%	0.19%	0.23%	0.26%	0.40%	0.49%
China	0.10%	0.08%	0.06%	0.06%	0.05%	0.06%	0.03%	0.23%	na	na	1.04%	2.35%	2.50%
Hong Kong	1.35%	0.91%	1.06%	1.15%	1.16%	1.25%	1.40%	1.55%	na	na	na	na	na

Source: Statistics Canada.

Table 3. Canadian Direct Investment Abroad, Annual Stock, 1998-2010

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
All countries (\$m)	262,909	290,730	356,506	399,253	435,494	412,217	448,546	452,195	518,839	513,140	642,026	621,181	616,689
United States	50.69%	52.20%	49.91%	47.21%	45.92%	41.14%	44.25%	44.76%	43.18%	44.13%	45.00%	40.63%	40.52%
United Kingdom	9.49%	8.84%	9.87%	9.94%	9.36%	10.65%	9.89%	10.26%	11.28%	11.65%	10.14%	11.82%	11.38%
Germany	1.57%	1.06%	1.28%	1.53%	1.80%	2.19%	1.81%	1.65%	1.71%	1.72%	1.71%	1.56%	1.42%
Japan	1.24%	1.33%	1.57%	1.76%	2.23%	2.05%	1.87%	1.45%	0.73%	0.51%	0.66%	1.06%	1.19%
South Korea	0.21%	0.42%	0.21%	0.18%	0.17%	0.17%	0.30%	0.08%	0.09%	0.19%	0.15%	0.13%	0.07%
China	0.17%	0.24%	0.16%	0.18%	0.17%	0.20%	0.24%	0.40%	0.40%	0.51%	0.55%	0.56%	0.78%
Hong Kong	1.30%	1.24%	1.05%	0.76%	0.61%	0.74%	0.69%	0.62%	0.86%	0.85%	1.02%	0.98%	1.02%

Source: Statistics Canada.

Table 3 shows that the geographical distribution of Canadian direct investment abroad is similarly structured, with the US receiving the largest share, going from 51 percent in 1998 to 41 percent in 2010. Other industrialized countries have also experienced mildly falling shares of Canadian direct investment abroad, such as for Germany, Japan, and South Korea. The share of Canadian direct investment abroad going to the United Kingdom has actually been rising from 9 percent in 1998 to 11 percent in 2010. Over the same period, China's share has also grown rapidly, by 974 percent, albeit from a low base, from about 0.2 percent to 0.8 percent of total Canadian direct investment stock abroad.

Broadly speaking, the pace and volume of Canadian direct investments in China do not seem able to keep up with that of Chinese direct investments in Canada. Indeed, in 2010, the Chinese FDI in Canada amounted to C\$14 billion, while Canadian direct investment in China was only C\$5 billion. Insofar as investment flows tend to lay the foundation for further trade flows, greater direct investment imbalances are likely to perpetuate bilateral trading imbalances, but a detailed sectoral breakdown of Canada-China FDI inflows would be needed to better assess their trade-related impacts. The February 2012 conclusion of negotiations over the Canada-China Foreign Investment Promotion and Protection Agreement (FIPA) should bolster two-way direct investment flows, although it remains too early to assess FIPA's impact in this regard.³

Canada: A Junior Partner in Supply Chains

At this juncture, some analysts would point to the inadequacy of national statistics in capturing the value contribution of the various actors involved in complex, fragmented, multi-country production chains. For example, most of the value-added in the design, engineering, and marketing of an Apple computer takes place in California, but the product is manufactured using a myriad of suppliers across Asia, and finally assembled in China – counting as a Chinese export. This is all part of what has been dubbed a “new trade-production paradigm”. Under this paradigm, it is argued that Canada's trade performance with China is not as bad as it looks since Canadian firms are often junior partners in US-led value chains that use Canadian inputs for their own exports to China (Hart, 2011).

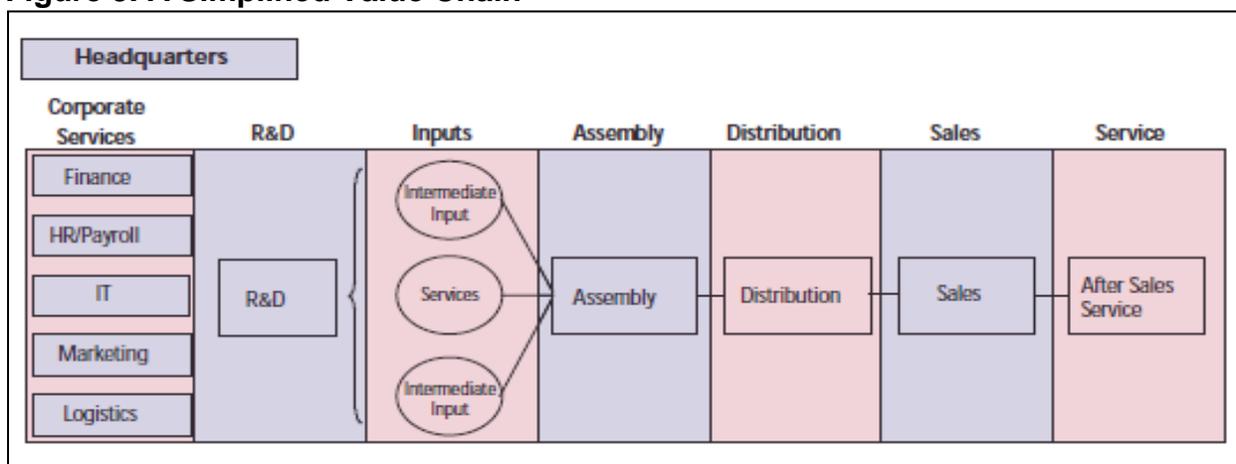
The fragmentation of global production chains (see Figure 3) is nothing new and its overall impact on the structural dynamics of production and trade should not be overblown. Although fragmentation certainly allows for greater degrees of specialization

³ Duggal, Sneha, 2012. Legal political hurdles ahead for China investment deal. *Embassy*, 15 February. Available from: <http://www.embassymag.ca/page/view/chinainvestment-02-15-2012> [Accessed 4 April 2012].

and economies of scale and scope, the fact remains, however, that a country's position along the value chain matters, and US companies largely occupy crucial roles as the lead firms in global design and production networks.

Take the case of the iPod value chain, another Apple product. Apple maintains superior bargaining leverage over its supply chain by controlling essential elements such as core software, a proprietary standard, and valuable brand image. As the lead firm, it is estimated to capture more than 50 percent of the value along the chain, based on a strong gross margin of 36 percent. In contrast, key input suppliers accounted for 18 percent of captured value, despite also having strong or above-normal gross margins. At the bottom of the chain, the value captured by iPod manufacturing (assembly and testing) which is outsourced to Taiwanese companies with factories in mainland China, is estimated at two percent, with producers operating with gross margins of under two percent (for this particular product) (Dedrick et al., 2009).

Figure 3. A Simplified Value Chain



Source: Sydor and Boileau, 2006.

More broadly, there are also increasing concerns about offshore manufacturing and its overall effects on innovation, income and employment inequality gaps, and social cohesion. While sending manufacturing activities offshore may lead to short-term productivity growth, efficiency gains and increase pressure on domestic producers to move up (or down) the value chain, it is not clear if these processes can provide a viable basis for longer-term national welfare and prosperity (Gomory, 2011; Levine, 2011). If taken too far, the assumption that advanced economies no longer need to manufacture and can focus solely on design and innovation can in fact precipitate a downward spiral of deindustrialization, as it ignores the fact that innovation in most high-tech industries derives not only from product innovation, but also from the manufacturing process itself (process innovation): “In the long term, an economy that

lacks an infrastructure for advanced process engineering and manufacturing will lose its ability to innovate” (Pisano and Shih, 2009).

Thus, although offshore manufacturing may have shifted jobs in advanced economies to the upper-end of the value chain and towards non-tradable service sectors, there are serious concerns whether this process can allow for full employment to be achieved and sustained, and whether it will be possible to deal with the associated growing disparities in income and employment.

In the US, for example, 98 percent of the 27 million new jobs created between 1990 and 2008 were reported to be in the non-tradable sector, where value-added and wage increases have been minimal. Non-tradable sector jobs produce goods and services that must be consumed domestically, including the health-care, retail, construction, hotel and restaurant industries as well as the public sector. Meanwhile, employment in the tradable sector of the US economy, the sector that produces goods and services that can be consumed anywhere, such as manufactured products, engineering and consulting services, barely grew at all, adding about 600,000 jobs between 1990 and 2008, and mostly at the high-end of the value chain where US firms continue to enjoy a competitive advantage in the global economy. The shifting employment structure of the US economy, away from the tradable sector toward the non-tradable sector, raises many serious concerns as the non-tradable sector is likely to create fewer jobs than expected, while also limiting the range of employment choices (and skill-sets) for US workers in the middle-income bracket. Moreover, fewer jobs at the lower value-added end of the tradable sector have led to increased job competition in the non-tradable sector, exerting further downward pressure on income growth and aggravating problems of income distribution (Spence, 2011).

With a high degree of integration with the US economy, it is not surprising to see similar structural trends in Canada’s labour market where post-crisis employment growth has stalled and slipped into a slow-growth mode due to ongoing economic weaknesses in the US and Eurozone economies. Making matters worse, the job growth that has occurred has been mostly in part-time positions and among the self-employed, replacing better paying full-time jobs.⁴ As one Scotiabank analyst remarked:

⁴ Beltrame, Julian, 2012. Job creation continues stall, despite dip to 7.4 per cent in February. *Canadian Press*, 9 March. Available from: http://www.huffingtonpost.ca/2012/03/09/canada-jobs-unemployment-rate-numbers_n_1334219.html; Boyd, Scott, 2011. The real story behind Canada’s employment numbers. *Huffington Post*, 12 October. Available from: http://www.huffingtonpost.ca/scott-boyd/canada-employment_b_1000350.html; Grant, Tavia (2011). “As confidence ebbs, so does employment”, *Globe and Mail*, 3 December [Accessed 4 April 2012].

The headline volatility from one month to the next should be dismissed, but it's the structural trends here that are disturbing. The trend on job growth and the weakening trend on hours and wages, all combined they suggest that Canadian paycheques are softening as a cyclical driver for consumer spending.⁵

Statistics Canada's 2011 labour force survey also reported that job growth in the service sector, 1.4 percent, outpaced the goods sector, 0.2 percent, with most job growth in the goods sector found in primary industries (mining, and oil and gas extraction). In the service sector, strong job growth was exhibited in high-paying positions such as professional, scientific and technical services, and in health care, as well as in lower-paying jobs like accommodations and food services, and in the retail sector (Wannell and Usalcas, 2012).

Troubling underlying trends in Canada's labour market, however, portend to a larger array of structural weaknesses afflicting the Canadian economy. For example, over the period 2001 to 2010, Canada ranked 30th out of 34 countries in the Organization for Economic Cooperation and Development (OECD) according to average annual growth in labour productivity. Perhaps more tellingly, the average labour productivity in Canada's private sector as a proportion of productivity levels in the US had fallen to 70 percent in 2010, after reaching a peak in 1984 when Canada's private sector productivity reached over 90 percent of US levels, just prior to entering a continental free trade agreement that was supposed to lead to convergence in productivity levels (Stanford, 2011).

Another associated structural weakness can be found in a report by the Canadian International Council (CIC) underscoring the Canadian government's apparent indifferent approach to intellectual property (IP) retention and accumulation. While such issues as competitiveness, productivity and innovation have received considerable attention from policy-makers, the CIC noted that the role of IP policies and its integration into a national innovation framework has been largely overlooked. Despite substantial investments in research and development, Canada thus remains a "renter" of technology with a total net loss in technology transfer payments (royalty and license fees) of \$4.5 billion in 2009, among the largest shortfalls in the industrial world. As the authors noted, "unless nurtured at home, our big ideas are destined to generate profits for others. In the future, the wealth of nations will be determined more by intellectual property than by resource extraction" (Mazurkewich, 2011).

⁵ Beltrame, Julian, 2011. Economy sheds 54,000 jobs in October. *Canadian Press*, 4 November. Available from: http://www.huffingtonpost.ca/2011/11/04/canada-unemployment_n_1075644.html [Accessed 4 April 2012].

Perhaps befitting a “junior partner” mindset, Canada’s free-trade-based economic strategy has historically permitted the sale of many natural resource companies to foreign ownership. Some analysts have lamented that despite, for instance, being a natural resource and agri-food super-power, Canada has built surprisingly few natural resource and food companies that are “global champions.” According to Barton (2011), “changing this is key to ensuring that the benefits from knowledge, technology and value-added in the natural resources industries flow to Canada.”

Some contend that government intervention to rectify these structural problems would be detrimental to longer-term prosperity by distorting incentives and reducing efficiency and innovation. However, given that the distribution of income varies widely across many advanced economies (and major emerging ones), the free-market option is neither the only approach, nor the best one: “many other advanced economies have flatter income distributions than the United States, suggesting that tradeoffs between market forces and equity are possible. The US government needs to face up to them” (Spence, 2011).

By extension, given the high degree of integration with the US economy, the Government of Canada also needs to face up to these public policy tradeoffs. It is in this context that Canada should closely consider China's evolving position in global value chains and the opportunities (and risks) from this process that could help address structural weaknesses relevant to both economies.

China: Workshop of the World, Forever?

The prevailing view about China’s role in global supply chains is not flattering. In the electronics sector, it has been summed up as follows:

Western and Japanese firms act as the designers and architects of electronic products, Taiwanese firms are the middlemen responsible for the hardware production and assembly, and China is the preferred location of assembly. The higher-value, proprietary aspects of the electronics products continue to be controlled by Western and Japanese firms, and as long as that remains the case, the competitive threat of Taiwanese and Chinese companies will be limited (Van Assche, 2006:82).

This assessment provides the broad structural traits under which China has joined the global economy on terms that reinforce its dependence on foreign technology and investment, thus restricting its potential to become an industrial and technological challenger to advanced industrialized economies (Gilboy, 2004). Pointing to research

showing that that roughly 80 percent of China's export value comes from imported inputs, with only 20 percent locally produced, it is presumed that, "China has been content to learn and find its place" (Hart, 2011). Efforts to give rise to national champion flagship companies, lead to outcomes where the firms "end up in reality as little more than local or regional players" (Steinfeld, 2004). Others see no reason why China will be any more successful than other large developing countries like Brazil, Mexico, and Russia have been, given that these countries have remained stuck at the middle-income level for generations (Babones, 2011).

However, given that China remains in the thick of economic reforms, such assessments are premature at best and ideologically blinkered at worst. The tendency to downplay Chinese upgrading efforts may be due to what Table (2007) refers to as the mind's penchant to "mistake the map for the territory," because of a tendency to rely on pure and well-defined forms and categories to conceptualize the world, privileging them over "other less elegant objects, those with messier and less tractable structures." A Black Swan event is born when the crisp stylizing of concepts – i.e.: received wisdom – comes into conflict with the "messy reality." For our purposes, in the traditional mainstream mindset, China is either a technological leader or laggard, and evidence is cast as either black or white, with little nuance in between. A more useful mindset, would look for sustained trends suggesting that China may be following a development path which recognizes that moving up the technological ladder is ultimately a dynamic, non-linear process that can accumulate and strategically evolve over time. Between black and white are many "shades of grey."

Much of this confusion stems from different interpretations of China's development model and its partial privatization process. With China's rapid growth and market-oriented reforms, including the rise of private entrepreneurs, many observers are quick to conclude that the country has been transformed into a conventional capitalist economic system dominated by private enterprise. This assessment is only half accurate as the private sector does represent a growing share of economic activity in China, but the Chinese government and state-owned enterprises (SOEs) continue to hold potent levers in strategic sectors of the economy in what is known as China's "commanding heights" state capitalism (Szamosszegi and Kyle, 2011).

For instance, according to Chinese official statistics, SOEs' share in gross industrial output value is 11 percent, but these firms still account for 33 percent of fixed asset investment. Moreover, the data do not reflect the dramatic restructuring of SOEs since the 1990s, leading them to understate the role of SOEs and the state by not fully capturing state involvement in ventures or sectors with mixed ownership. Thus, the

share of SOEs and state-holding enterprises (SHEs) in the manufacturing sector is only 20 percent, in part reflecting the government's reform policy of divesting from less strategic manufacturing sectors such as textiles and apparel, leather goods and other light industries. However, in more strategic manufacturing sectors, like petroleum and coal processing, ferrous metals and transport equipment, the state share is much higher than 20 percent (Szamosszegi and Kyle, 2011; Yusuf et al., 2006).

As remarked by Ravallion (2008), "it has no doubt helped that China did not make the mistake of believing that freer markets called for weakening of [state] institutions."

Broadly speaking, a more accurate description of China's approach to reform has been characterized as a form "model uncertainty," in which leaders treat policy advice taken from advanced economy models with great caution, instilling a form a pragmatism in considering risks, and thus resulting in policy-makers taking gradual and experimental steps in areas such as the timing and sequencing of opening up the current and capital accounts, as well as in proceeding with export diversification (El-Erian and Spence, 2008). From this perspective, the desire of the Chinese state to retain influence in the process of industrial upgrading from simple consumer goods to increasingly sophisticated capital and high technology goods is not surprising, nor inconsistent with similar experiences in Japan, South Korea and Taiwan (Province of China) (Lin, 2011; Weiss, 2005).

Nonetheless, due to difficulties in making clear "judgments" on policy trends that are hard to measure and that have high degrees of uncertainty, perhaps it is not surprising to find contradictory evidence and opposing views. Nonetheless, in addition to various analysis indicating rising cost pressures facing low value-added Chinese producers (Wright et al., 2011; Lett and Banister, 2009),⁶ other recent reports appear to confirm that dynamic shifts are taking place within the Chinese economy with growing signs that home-grown Chinese companies are indeed moving up the value chain, albeit perhaps not as quickly as desired.

For instance, the Economist Intelligence Unit (EIU) finds evidence that the traditional division of labour between China and developed economies is becoming less distinct. For example, the share of overall Chinese exports produced by foreign-invested manufactures is forecast to fall below 50 percent by 2012 as domestic producers of mid and high-range products take on an increasingly prominent role in driving exports. This

⁶ Jacob, Rahul, 2011. Chinese look overseas in move to cut costs. *Financial Times*, 9 November; Jacob, Rahul, 2011. China wage rises bring shift in production. *Financial Times*, 6 September; Jacob, Rahul, 2011. Leading supplier calls time on era of cheap products from China. *Financial Times*, 25 March.

has been particularly true for capital equipment and related parts, reflecting improvements in precision and quality levels of metal-cutting/shaping facilities and in metallurgical processes. Similarly, having initially secured a foot-hold in the production of cranes, cement trucks and pumps, China's construction equipment makers are now shifting their focus into the coveted earth-moving equipment market, hitherto dominated by American, South Korean and Japanese firms (EIU, 2011).⁷

In general, China's construction equipment sector is different from most other exporting industries. It grew on the basis of domestic demand, and was not primarily driven by foreign investment or joint ventures. As a result, growth in this sector has been more organic as production is based on a relatively comprehensive domestic supply chain, in stark contrast with the vertically specialized assembly operations of most export processing industries. At this stage, this sector is competing directly with advanced nations in their overseas markets, if not yet in their domestic ones: in 2008, for example, 71.5 percent of all machinery imports in the BRICS countries (minus China and including South Africa) came from OECD countries. By 2010, their share had fallen to 63 percent, while China's share had risen from 17.5 percent to 21.8 percent (EIU, 2011).

Box 1. Carlyle Group bid for Xugong Group Construction Machinery⁸

A key turning point in the development of China's domestic construction equipment sector was the October 2005 bid by the Carlyle Group, a US private equity firm, to invest \$375m for an 85 percent stake in Xugong Group, China's largest construction machinery maker at the time. Controlled by the local government of Xuzhou city (in Jiangsu province), Xugong received approval at the local level, but was blocked by the Ministry of Commerce of the central government. Carlyle revised its offer twice; restructuring the deal as a 50-50 joint venture, and later agreeing to a minority stake of 45 percent to allay Beijing's fears of foreign ownership in a "strategic" industry. After three years, however, Carlyle ultimately dropped its bid for Xugong in 2008, in what was seen as a touchstone case of Beijing's stance towards foreign investment in sensitive sectors (Mattlin, 2007; Wang, 2007).

Certain facts surrounding the case are intriguing. For one, Beijing's blocking of the Carlyle-Xugong deal came only two months after the failed takeover bid of the US firm Unocal Oil Company by the China National Offshore Oil Company (CNOOC) in August

⁷ Economist Intelligence Unit (EIU), 2011. Moving up the value chain. *EIU*, 3 October.

⁸ Hagerty, James R., 2011. Chinese rivals win ground in key Caterpillar battle. *Wall Street Journal*, 20 July; Hammond, Ed and Jamil Anderlini, 2011. China builds way to top of construction league. *Financial Times*, 3 March; Carew, Rick, James T. Areddy, and Gordon Fairclough, 2009. China denies protectionism in Coca-Cola ruling. *Wall Street Journal*, 21 March; Tucker, Sundeep, 2008. Carlyle learns bitter Chinese lesson. *Financial Times*, 24 July; Tucker, Sundeep, 2007. Carlyle backs down on size of Xugong stake. *Financial Times*, 19 March.

2005. Moreover, pressure to halt the Carlyle-Xugong deal was heightened by a nationalist internet campaign to stop the sale of state assets at knock-down prices. The campaign was led by Xiang Wenbo, chief executive of Sany Heavy Industry, a rival to Xugong that would later surpass it as the country's biggest construction equipment maker.

Today, China's three largest players in the sector (Xugong, Sany Heavy and Zoomlion) dominate the domestic market in cranes, cement mixers and earth movers, while also gaining market share in one of the most important product categories, hydraulic excavators. Indeed, with Chinese players growing on the back of the country's continued construction boom, a recent PricewaterhouseCoopers report forecast that China will account for a fifth of the world's building industry by 2020 (compared to 14 percent today), these players are now also making inroads into the US and European markets.

In examining seven large equipment industries in which Chinese firms are global players, or have the potential of becoming so, the Boston Consulting Group (BCG) found that only one sector, civilian aerospace, had no Chinese firm among the top five global players. Indeed, four of the top five suppliers in the solar panel sector are Chinese. In coal-power equipment, three of the top five firms are Chinese. In both the rail-rolling-stock and wireless telecommunications sectors China has two companies in the top five. And the wind power and power transmission sectors have one Chinese player each. The BCG identified five key drivers behind the Chinese players: domestic market demand, cost advantages, government support, access to critical technology, and state-coordinated export strategy (Bouffault et al., 2011).

In surveying Chinese industrial development in three heavy industry sectors – motor vehicles, construction equipment, and machine tools – Brandt and Thun (2009) detail a phenomenon they call the “fight for the middle [market]”. Domestic firms aim to upgrade their product through improvement in design and manufacturing methods in order to meet the intense competition at the bottom of the market. Meanwhile, foreign firms set out to decrease costs in order to target the same rapidly growing middle segments of the market. As a result, “the cost-cutting efforts of foreign firms lead them to localize their operations more aggressively than would otherwise be the case, and this provides a new range of upgrading opportunities for Chinese firms” (Brandt and Thun, 2009).

In light of the evidence provided above, it is not inconceivable that China might one day dominate its own set of global supply chains as the US and other industrialized economies have done for the past several decades. Attracted to the huge domestic market, foreign MNCs are key players in China's industrial and technological ambitions,

but are also well aware that not effectively operating in the Chinese environment may precipitate leakages of key technologies and intellectual property that will erode competitiveness and lead to market exclusion and significant financial losses. The following section contemplates the approach and policy issues with which Canada and Canadian firms can strategically engage their Chinese counterparts.

Forging a Real Win-Win

More direct and deeper links with China will allow for opportunities for carefully crafted strategic partnerships based on common interests to resolve structural economic weaknesses. Given the current stage of China's development, openings for foreign firms and actors persist, but they must keenly develop and leverage strategic assets with which to improve their negotiating positions vis-à-vis Chinese counterparts. Engaging China at this level will require a greater appreciation for economic development dynamics than is often the case with government officials from developed economies (El-Erian and Spence, 2008), and even among members of the private sector. Indeed, under ongoing global crisis conditions, it is recognized that China's policy makers may even offer some valuable policy lessons for industrialized countries.⁹

To expedite this necessary change in mindset on the Canadian-side, two key and inter-related flashpoint policy issues, intellectual property and the Trans-Pacific Partnership (TPP) trade agreement, are briefly discussed to emphasize how overlapping Canada-China strategic interests can be harnessed to better identify and capture mutual benefits from areas that could otherwise lead to possible confrontation.

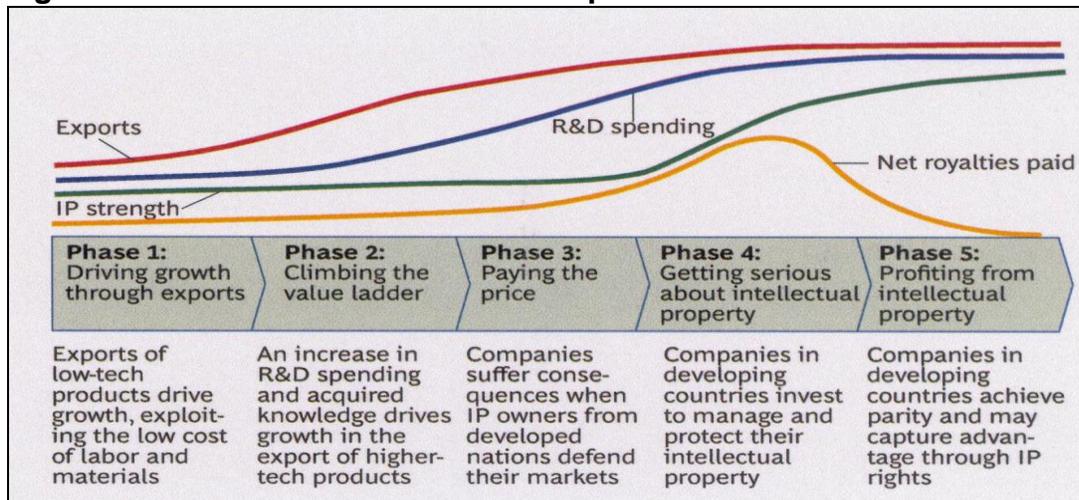
Intellectual Property (IP) and “Indigenous Innovation”

The Chinese government explicitly fosters homegrown technologies and offers broad support to national champions so as to ultimately better nurture domestic IP, as is becoming of an innovation-based economy. In a report aimed at corporate audiences, the BCG outlined five common phases of IP development (see Figure 4) through which developing countries must or have undergone in moving up the technological ladder, and contends that China is following a similar pattern. Having passed through phases 1 and 2, China's evolving IP ecosystem appears geared for phases 3 and 4: “Chinese policymakers and executives, having come to understand the value of intellectual property, are forcing foreign rivals to raise their IP game inside China.” Failure to do so,

⁹ Roach, Stephen S., 2012. Beijing's lessons for central bankers. *Financial Times*, 5 March; Harding, Robin, 2011. Bernanke tells US to heed emerging economies. *Financial Times*, 29 September.

they suggest, can lead to “significant risk of financial loss, high royalty payments, and the ultimate penalty: market exclusion” (Chai et al., 2011).

Figure 4. The Five Phases of IP Development



Source: Chai et al., 2011.

Formally introduced in 2006, China’s multi-faceted “indigenous innovation” campaign is a case in point of the country’s more pro-active stance on IP development. At the heart of the campaign is the linking of government procurement preferences to products whose IP is owned and originally trademarked in China. Other aspects include active support for Chinese technological standards that are bestowed to state-owned or state-backed enterprises, increased research and development spending in targeted sectors, and the trading of domestic market access to foreign firms based on their willingness to share technology (Segal, 2011; USCBC, 2010; Suttmeier et al., 2006).¹⁰

In high-speed rail, for example, the industry’s leading manufacturers and suppliers – Siemens, Alstom, Bombardier, and Kawasaki, among others – transferred technology to local Chinese joint venture partners to gain access to the domestic market. In a span of a few years these junior partners used the technology to compete on price against their partners in international markets, particularly in developing countries.¹¹ In the energy sector, foreign companies like Westinghouse Electric have agreed to share documents and blueprints of the latest generation of nuclear reactor in exchange for winning government contracts and securing a place in the world’s fastest growing nuclear

¹⁰ Inside US-China Trade, 2011. Chamber analyst flags WTO’s limited impact on Chinese industrial policies. *Inside US-China Trade*, 12 October; Otteman, Scott, 2010. Chinese agencies lay out new policies to favor ‘indigenous innovation’. *Inside US-China Trade*, 6 January.

¹¹ Areddy, James T. and Norihiko Shirouzu, 2011. China’s bullet trains trip on technology. *Wall Street Journal*, 4 October; Shirouzu, Norihiko, 2010. Train makers rail against China’s high-speed designs. *Wall Street Journal*, 18 November; Dickie, Mure, 2010. Japan Inc shoots itself in the foot on bullet train. *Financial Times*, 9 July.

market with 23 reactors under construction and a further 120 proposed at the time.¹² In a slight variation, a new automotive policy seeks to compel technology transfer by linking the approval of new production capacity for foreign automakers to an agreement to develop an indigenous brand of new energy vehicles for sale in China.¹³

Faced with a pushback from foreign governments and business lobbies after the release of a “Guidance Catalogue of Indigenous Innovation” in late 2009, Chinese officials have made some mollifying changes with subsequent draft regulations. However, critics have been cautious over whether such changes have been genuine or simply cosmetic, likening the process to a game of “whack-a-mole” whereby a new manifestation of the indigenous innovation issue will pop up the moment an earlier one is seemingly addressed.¹⁴

As discussed in Section III, in light of what appears to be a parallel inability for Canada to overcome phases 3 and 4 of IP development to derive net profits from IP, rather than stifle China’s indigenous innovation efforts, Canada could seek to strategically leverage these ambitions to address its own structural weaknesses in this regard. Selective bilateral cooperation may in fact help lay the groundwork to address Canada’s own “junior partner” structural constraints; it is perhaps no surprise that BCG highlights “partnering” as a critical lever in overcoming hard-to-reverse IP deficits (Chai *et al.* 2011).¹⁵

Barton (2011), for example, suggests that Canada identify and actively support strategic sectors that can help drive greater ties with Asia, including in infrastructure, financial services, aerospace, education, tourism, and natural resources. While such a strategy is not without risk, it is a rare opportunity for Canada to strategically transform itself into a nation of what the CIC calls, “hewers of patents and drawers of rents” (Mazurkewich 2011).

¹² Hook, Leslie, 2010. Westinghouse gives China reactor technology details. *Financial Times*, 24 November.

¹³ Otteman, Scott, 2011. China automotive ‘indigenous brands’ policy well underway, hard to challenge. *Inside US-China Trade*, 16 March.

¹⁴ Inside US-China Trade, 2011. USCBC cites China progress on cutting innovation-procurement link. *Inside US-China Trade*, 17 August; Otteman, Scott, 2010. Chinese rewrite of ‘indigenous innovation’ criteria draws cautious business response. *Inside US-China Trade*, 14 April.

¹⁵ Terlep, Sharon, 2011. GM deepens China auto alliance. *Wall Street Journal*, 20 September.

The Trans-Pacific Partnership (TPP)¹⁶

The current list of TPP participants does not involve China, but includes nine Pacific Rim countries: Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, the United States, and Vietnam. During the November 2011 Asia Pacific Economic Co-operation (APEC) summit, such other countries as Canada, Japan, and Mexico also joined the trade talks. While the goal is to create an Asia-Pacific free trade zone, the partnership is viewed as an alternative multilateral route to the stalled Doha Round negotiations of the World Trade Organization (WTO).¹⁷

Although TPP negotiations are still in early stages, private sector and labour groups increasingly view the initiative as a chance to establish strong rules regarding SOEs and SSEs with a particular eye on China, where the state still plays a significant role in the economy. From this perspective, strong enforceable SOE guidelines in the TPP would provide a regional counterweight to China in the Asia region, while also forming the foundations for trade negotiations with China bilaterally, regionally, and even globally, and shaping the future direction of US trade policy in Asia.

The main principle at the core of the SOE/SSE guidelines is the concept of “competitive neutrality,” initially developed by the Australian government, which “requires that government business activities should not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership.” The concept is viewed as compensating for and upgrading the current WTO/General Agreement on Tariffs and Trade (GATT) rules that do not comprehensively discipline SOE/SSE commercial behaviour. For example, provisions in GATT Article XVII on “state trading,” considered to contain the most specific disciplines on SOE/SSE behaviour, are criticized for being limited in scope and ambition as they focus on the actions of state trading enterprises as opposed to targeting “structure or behind-the-border barriers, and [they do] not deal at all with trade in services.” To this end, the US-Singapore free trade agreement is often cited as containing stronger SOE/SSE disciplines that could be further enhanced in the TPP.

¹⁶ Unless otherwise indicated, this sub-section is based on: Davis, Bob, 2011. US targets state subsidies. *Wall Street Journal*, 26 October; Inside US-China Trade, 2011. U.S. fixes future-SOE ‘loophole’, sends TPP partners proposed text. *Inside US-China Trade*, 19 October; Inside US-China Trade, 2011. Expert: China’s push to invest abroad may aid effort to discipline SOEs. *Inside US-China Trade*, 27 July; Inside US-China Trade, 2011. OECD paper tallies progress, limits of ‘competitive neutrality’ rules for SOEs. *Inside US-China Trade*, 1 June; Otteman, Scott, 2011. Closely held business initiative spurs focus on SOE threat to U.S. firms. *Inside US-China Trade*, 18 May; Otteman, Scott, 2011. U.S. efforts to craft state capitalism TPP rules raises defensive interests. *Inside US-China Trade*, 27 April.

¹⁷ Fekete, Jason, 2011. Canada seeks to join new trade group, *Ottawa Citizen*, 14 November; McKenna, Barrie, 2011. PM stands by Obama, but looks to Asia. *Globe and Mail*, 14 November.

Having only just agreed to join the TPP talks, and with a grounded understanding of China's strategic developmental ambitions, a Canadian policy position consisting of more than a legal and regulatory game of "whack-a-mole" could be rendered into a pragmatic tool to help build confidence among trading partners and unlock structural barriers facing both economies. Such a posture could, for instance, help to temper questionable tactics such as those suggested in the economic plans of US presidential candidate Mitt Romney, which include as a key instrument the creation of a "Reagan Economic Zone" of market-friendly countries to leverage against Chinese trade and industrial policy practices.¹⁸

A more nuanced Canadian posture towards China could in fact plainly recognize the need for both pressure and flexibility when dealing with domestic political and developmental dynamics. In the US, reports have noted some resistance within the Treasury and Justice departments to developing airtight rules for SOEs/SSEs, because of questions about whether such rules could restrict "defensive interests" like US government responses to global economic crises or be applied against US government-backed enterprises such as the mortgage firms Freddie Mac and Fannie Mae, or other state-controlled entities such as the US Postal Service and the Tennessee Valley Authority.

Nor are "defensive interests" unfamiliar in the Canadian context. For example, supply management systems for dairy and poultry producers have already created a stumbling block to joining the TPP talks, as well as in EU-Canada trade talks underway.¹⁹ Other institutional arrangements, such as the monopoly over grain marketing by the Canadian Wheat Board, are also clearly aimed at boosting the bargaining leverage of domestic producers.²⁰ The Canadian government has also recently been under scrutiny for blocking BHP Billiton's proposed acquisition of Potash Corp. of Saskatchewan in 2010, the second time in two years that the government applied a law that had never before used in its 25-year history (the other instance was in 2008 when Alliant Techsystems Inc. was blocked from purchasing MacDonald, Dettwiler and Associates Ltd.) (Burney and Ackhurst, 2011).

China, for its part, appears much more upfront with its need to gain buy-in from domestic interests and to make compromises on sensitive issues. In this way, China seems more attuned to trade deals that amount to "managed trade" agreements as opposed to the standard "free trade" agreements, and Canadian trade negotiators

¹⁸ Inside US-China Trade, 2011. Huntsman knocks Romney's tough-on-China trade plan in GOP debate. *Inside US-China Trade*, 14 September.

¹⁹ Simon, Bernard, 2011. Canada under pressure to dismantle food quotas. *Financial Times*, 14 November.

²⁰ Simon, Bernard, 2011. Fight to reap benefits of wheat reform. *Financial Times*, 17 August.

should seize this opportunity. Such flexibility was seen in the China-Association of Southeast Asian Nations (ASEAN) free trade deal in 2010, which nonetheless allowed countries to register hundreds of sensitive goods such as various types of electronic equipment, motor vehicles and parts and chemicals, on which tariffs will continue to apply, many until at least 2020.²¹

Conclusion: Preparing for Pax Sinica

What's a Middle Power to do?

With Canada's main trading partners under severe economic and political duress, the pre-crisis strategy of engaging globalization primarily intermediated by multinational US firms and production networks is ill suited for the next stage of globalization, in which emerging economies like China are playing a larger role. The materially different post-crisis global setting requires adaptation if Canada wishes to better harness and balance the gains from globalization. Such a strategy is not without risk and will not be accomplished in the short-term, but will ultimately prove to be a crucial factor in Canada's long-term prosperity, welfare and employment prospects in a less US-centric world order.

The prevailing discourse of bilateral relations tends to view Canada's policy options as stark choice between bandwagoning and balancing against a rising China. A shifting balance of power is seen to likely disrupt the existing global order and disproportionately decrease the relative influence of middle powers such as Canada. Moreover, given weak direct Canada-China economic linkages, it is suggested that Canada should maintain its international status by leveraging and managing its traditional ties with the US and other allies in order to contribute to socializing China into global liberal norms (Gilley, 2011). As has been remarked: "just as China can hedge its international engagements, so the West and other major emerging countries can hedge in engaging China" (Chin and Ramesh, 2010).

At the same time, although Canada-US ties should and will remain strong, accepting the advice that the best trade and economic policy approach to relations with China is one of "benign neglect" and that Canadian exporters should "continue to concentrate on the markets with which they are most familiar" (Hart, 2011) would be a glaring strategic oversight, for at least three main reasons.

²¹ Brown, Kevin, 2010. Biggest regional trade deal unveiled. *Financial Times*, 1 January.

First, the idea of leveraging our relationship with the US to bolster Canada's global role depends critically on the vitality of the US economy. In the case of China, it is not clear the US is negotiating from a position of strength. "We have no leverage at the negotiating table," asserted ex-US ambassador to China and former 2012 Republican presidential candidate Jon Huntsman, who suggested that fixing the US-China relationship meant "fixing our core right here at home, because our core is weak, and it is broken".²² In a similar vein, a special report by the Asia Society recommended that getting "its own house in order" was the most important factor in ensuring that the US maximizes the benefits of rising Chinese outward investments: "Only a country with a healthy economy, political stability, and clear vision for the future will be able to attract foreign investors that contribute to its long-term prosperity" (Rosen and Hanemann, 2011).

Second, given Canada's role as a reliable junior partner in US-led global supply chains, it is not clear we hold sufficient leverage vis-à-vis the US to help "bridge-in" other like-minded nations under US global leadership, or even to staunchly maximize the welfare prospects for Canadians. Suggestions that "Canada's China policy should be run from its embassy in Washington" (Gilley, 2011) convey the sense that Canada is merely a handmaiden of US interests. And how can Canada effectively help socialize China into the international system if Canada is seen as too cozy with the US and holds few direct bargaining chips with China? What is trumpeted as the "splendid isolation from the geostrategic rivalries of east Asia" (Gilley, 2011), is really only a reflection of the fact that Canada has little direct "skin" in this diplomatic game, which will lead to difficulties in concentrating policy-makers' minds on the challenges and opportunities presented by China's historic rise.

Third, rather than siding with one superpower over another, it makes perfect sense to perform multiple pragmatic hedging strategies to maximize national room for maneuver. Such a strategy is hardly novel, and can be found quite commonly in Southeast Asian countries (Bower, 2010; Dalpino, 2010). Not surprisingly, it was Lee Kwan Yew, former Prime Minister of Singapore, who implored last year: "There is still time for the US to counter China's attraction by instituting a free-trade agreement with other countries in the region. This would prevent these countries from having an excessive dependence on China's market."²³ In Vietnam, the once fierce war-time US adversary is now emerging as one of Washington's most important allies in countering China's growing

²² Inside US-China Trade, 2011. Huntsman knocks Romney's tough-on-China trade plan in GOP debate. *Inside US-China Trade*, 14 September.

²³ Fontaine, Richard, 2011. America's not-so-strategic trade policy in Asia. *Wall Street Journal*, 26 October.

clout in the region. Meanwhile, Vietnam has also improved ties with India.²⁴ An Australian economy more closely linked to China than ever has not stopped Canberra from building closer security and intelligence ties with the US (Johnson, 2011).²⁵ Indeed, some of the country's leading analysts actively argue that "kowtowing" or "muscling up" are equally flawed strategies in dealing with China (Dupont, 2011).

Even Myanmar, often perceived as a client state dependent on trade and investment flows with China in exchange for access to its natural resources, has sought to balance its relationship with China through overtures aimed at re-invigorating ties with the US (Barta, 2011; Johnston and Johnston 2011).²⁶ Under these circumstances, leading opposition figure Aung San Suu Kyi proffered eminently pragmatic advice when asked whether Myanmar should welcome Chinese investments:

We should always look at what it involves, whether it's China or India or any other country. It's nothing to do with the country. It's got to do with the kind of investment, the kind of terms related to the investment. I know that nobody comes in unless they hope to benefit from what they are doing here. But alright, it's got to be fair, we've got to benefit too, and it's only fair that we think perhaps we as the host country should benefit a little bit more (Wall Street Journal, 2011).²⁷

Borrowing from this perspective, Canadian policy-makers need to adopt a hedging strategy among great powers (and regional groupings) that better aligns common strategic interests with national economic objectives. The contours of such a hedging strategy would include:

- Fostering and strengthening direct trade and investment linkages with China (and other emerging markets) so as to better understand, identify, and respond to opportunities and challenges emanating from China's evolving domestic development circumstances. China's rise is about much more than just exporting more energy commodities.
- While China's climb up the technological ladder is far from assured, there are signs the country's ambitious efforts are starting to pay-off. Given the present development stage of Chinese technological and industrial capabilities, ample opportunities exist for carefully crafted strategic partnerships that leverage

²⁴ Hookway, James, 2011. Old U.S. foe proves useful. *Wall Street Journal*, 18 November; Pant, Harsh V., 2011. The India-Vietnam Axis. *Wall Street Journal*, 22 September.

²⁵ Johnson, Keith, 2011. Clinton says 'Center of Gravity' shifting to Asia-Pacific. *Wall Street Journal*, 11 November.

²⁶ Barta, Patrick, 2011. A pariah regime courts West in China's shadow. *Wall Street Journal*, 17 November; Warrell, Helen and Tim Johnston, 2011. Burmese junta grows wary of China's ever closer embrace. *Financial Times*, 7 April.

²⁷ Wall Street Journal, 2011. Transcript: Aung San Suu Kyi. *Wall Street Journal*, 24 October.

China's policy initiatives and ambitions to rise to the apex of global supply chains. By delineating its own strategic sectors and pragmatically supporting Canadian-based "global champions," Canada has a rare "game-changing" opportunity to engage China by targeting cooperation that can help alleviate chronic structural weaknesses relevant to both economies.

- Strategic decisions will arise in sensitive policy areas related to intellectual property and proposed free trade agreements like the TPP. Here, Canada can carve a niche role for itself in speaking frankly and plainly recognizing the need for both pressure and flexibility within trade rules to deal with domestic political and developmental dynamics. Such a forthright alignment between trade policy principles and practices will likely be warmly received by other small to medium powers in Asia, thus constructively meshing Canada as a reliable voice of reason within the geostrategic rivalries found in the region.

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