Financial Post: Comment
Canada has to rise to the Chinese challenge
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Financial Post
15 September 2004
National Post
National
FP15

China's emergence as an economic colossus has sparked worldwide enthusiasm about its role as a new locomotive of world growth and dismay at the potential for a train wreck. Canadians have benefited from the boom because the two economies are complementary: We sell China natural resource and agricultural products and buy a wide range of low-cost consumer and other goods.

Yet the fact that Canada does not share our NAFTA trading partners' worries about stiff Chinese import competition is itself cause for concern. It means Canadians are not participating in the basic source of China's trading successes -- its participation in global production chains. Almost half of China's manufactured exports are produced through ventures with foreign companies. Canadian firms are barely represented in this production because they have been slow to invest there.

If there were ever a time for Canada to have both a North American strategy and a long-term non-North American strategy, it is now. The latter approach requires significant changes in our thinking about the relationship between trade and investment. Our traditional approach of promoting exports and wooing foreign investment is outdated. To participate in China's export success, we must invest there, both to maintain cost competitiveness and to participate in global production chains.

We should also be aware that Canadian manufacturers can be priced -- or pushed -- out of their main U.S. market by low-cost, China-based producers. In 1998, China's two-way trade with the United States was barely a quarter the size of Canada-U.S. bilateral trade; five years later, it had doubled to nearly half the size of Canada-U.S. total trade. By then, China's bilateral trade was growing at a rate of more than 20%, compared with Canada's 6%. Indeed, Canadian policy-makers should consider the possibility that at some point in the future, Canada could be supplanted by China as America's largest trading partner.

China's recent spectacular and unsustainable economic growth now is slowing somewhat, and there are still major structural challenges to be overcome. China needs modern financial and public health care systems, as well as the means to deal with population ageing. Chinese authorities must also address the fallout from years of rapid development that includes power and water shortages, pollution and regional economic tensions over the income inequalities that have emerged as the coastal region surged ahead of the interior.

Despite these challenges, one thing is inevitable: Canadian manufacturers, and even our services producers, will face increasingly intense and direct import competition from those based in China because comparative advantage in most standard-technology labour-intensive production has now shifted there. Investing in China is one way to meet the challenge. Increasing the sophistication of what is produced in Canada, using the knowledge and skills that are found more intensively here, is another way. Producers of and investors in higher value-added goods and services that do not compete directly with China's labour-intensive offerings should identify market niches or participate in global production chains in order to market there.

Meeting the challenges posed by China's surging growth also demands clear priorities for Canada's domestic policies to ensure continued growth in our standard of living. First, we need a policy framework that moves us out of direct competition with more low-cost, China-based producers. Such a framework will facilitate productivity growth and expand the knowledge-based economy. We can no longer afford to temporize on a number of relevant microeconomic policy changes. At a minimum, investment in education and skills training and promoting labour mobility must become top priorities. As well, longstanding growth impediments must be removed through tax reform and deregulation. Third, we should build on our unique economic advantage of living next door to the largest and wealthiest market in the world by cementing Canada into the North American economic space in ways that reduce the risks at the U.S. border and ensure market access.

At the same time, we need a new China policy framework with at least three dimensions:

- A bilateral approach that addresses China's interests in correcting structural weakness in its own economy and supports the market-access needs of Canada's small- and medium-sized enterprises. Consistent high-level government-to-government contacts are essential.

- A multilateral approach that encourages China's participation in global economic management forums, such as the G-7 and G-20.

- A contingency plan for setbacks in the Chinese economy that could quite possibly occur in the months and years ahead.

China's policy-makers should be included in the official groups that manage the world economy and address crises. Prime Minister Paul Martin has already supplied some political momentum in that direction. Canadian policies should build on that foresight with an equally farsighted strategic framework for the overall bilateral relationship.

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