

China: Outlook for International Trade

Remarks for

Sarah Kutulakos

Executive Director & COO

Canada China Business Council

To

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International Trade Outlook for the Western Hemisphere:

A timely discussion of a range of factors impacting trade including: economic conditions/expectations, pending trade agreements, the growth of China; the Panama Canal expansion, etc.

Thank you, Kurt.

It is a great pleasure for me—on behalf of the Canada China Business Council—to join you for this Spring Conference.

Being invited here takes me back to my roots a bit. Although I am far from being an expert on infrastructure or logistics, in 1992 I had a job running a center for integrated logistics at the University of Wisconsin. A donor in the industrial supply business had given the business school \$5 million dollars, claiming that he needed MBAs who understood not just trucks and trains, but how IT,

marketing, and other disciplines came together to create advantages in logistics. I had no students and a lineup of companies already wanting to hire our grads, so I had to sell students on the program. It was a lot of fun, at a pivotal time for the integrated supply chain management field. But today I'm here representing the Canada China Business Council, which is Canada's premier organization focused on trade and investment with China. I hope that I can provide some **oversight** into the issues that we all face as businesses in the West as we contemplate the substantive challenges of China, and the extraordinary opportunities.

As I was thinking—earlier this month—about what I wanted to explore with you, I happened on a newspaper article that crystallized it for me. The article in Canada's Globe and Mail newspaper, was written by a senior economist named Todd Hirsch. The slug read “Globalization”—in red ink. Then the header--“A knowledge economy can't afford to be smug.”

The Globe is the journal of record for Canadian business and the political sphere. It's like the New York Times and the Washington Post combined. This article said—in essence—that North America—the Western Hemisphere,—should not rest on its laurels as the rightful site for the global knowledge economy. Globalization—it said--is not about manufacturing jobs going to China any more.

The knowledge economy is even more mobile than manufacturing was. We cannot depend on anything but cutting edge innovation; Canada—or the West—faces two choices. We can fear globalization and throw up barriers destined to fail or we can embrace uncertainty and embrace globalization.

To sum up the article--with apologies to Susan Jeffers--the West has to “feel the fear and do it anyway.”

The article made the compelling point that in 1950, the phrase “human resource specialist” didn't exist and in 1980 neither did the phrase “web-designer.”

I'm not so sure that I share the writer's uncertainty, but I absolutely believe that the West will have to embrace globalization and innovation.

One of our members —Diane Gray, the CEO of CentrePort Canada—could tell you a lot about innovation. CentrePort is about as in-land as any “port” is ever going to be. It's in Winnipeg, just a few miles north of Fargo, North Dakota.

Not what we used to consider “port” territory.

CentrePort has established an inland port at the centre of the continent that is at the hub of rail and highway networks that lead east to Europe, south to the U.S. Midwest and west to Asia. CentrePort sees itself as a vital logistical **resource** in the global supply chain. In fact, CentrePort is working –as we speak--with a Chinese enterprise to expand identity preservation and

containerization for agricultural commodities. This is a direct example of innovation in international trade.

To be China specific—which is why I was asked to join you—I can say with absolute conviction that understanding China’s needs will be essential to success and prosperity for every port authority in this room.

One of the topics for today’s panel is trade agreements. We find China tends to want to participate in **bilateral** agreements, despite a trend toward more multilateral agreements. We actually like multilateral – look at what China’s entry to the WTO has done for its growth and for North American companies operating in China. But China’s proclivity to bilateral is particularly evident in areas involving China’s sovereignty, where its Asian neighbors are pushing for regional agreements that might include some territorial disputes, while China prefers to resolve them one by one. There are several international processes underway in the Asia-Pacific region aiming at

regional or trans-Pacific FTAs (the APEC Leaders' Declaration at Yokohama in November, 2010, of which China was a signatory, supported three possible routes to trans-Pacific trade: ASEAN+3, ASEAN+6 and TPP). But the agreement we are watching most closely is the Trans-Pacific Partnership. Negotiations now involve 9 countries including the United States but not China or Canada. Key for both countries is that the 'entry ticket' is a willingness to talk about 'everything', however, neither the United States nor New Zealand, as gate keepers, are interested in Canada's involvement because they do not see Canada as willing or able to talk about everything (don't get me started on our dairy monopoly system).

What is crucial is that a country know what it wants to get out of a trade agreement with China, and our Council has an effort underway to evaluate this – do we want a free trade agreement? What's in Canada's best interests? We are attempting to answer that from the business community's perspective. This extends to investment as well as trade, and in many cases involves the extent to

which a country welcomes foreign investment to help it grow. Chinese investment interest in North America is definitely growing – at PDAC, the Prospectors and Developers of America Conference in Toronto two weeks ago, which is the world’s largest mining conference, Chinese attendees had ballooned to 700, up from about 60 a few years ago. They are investing all over North and South America, and of course any of these investments on the ground create opportunities to build infrastructure that leads to ports, as the minerals being mined are in most cases going straight to China. Canada has so far been quite welcoming to Chinese investment, a subject that is a bit touchier in the US (think Dubai Ports World controversy from a few years back). We’ve not had any Chinese offers to buy Canadian ports so far, but as someone with a Greek connection, I noted with interest the welcome mat that was laid out for COSCO and China’s investment in the Greek port of Piraeus.

What China does, in investing or trade, is **directly** related to its own interests – it understands them very well, and

while the steps it takes to promote and protect them are sometimes different than other countries, you can't deny that from a trade perspective, it will take actions that are linked to the five-year plan.

Fortunately, China—of all countries with whom we trade—is the most forthright about its needs and priorities. Every five years China's government publishes a Five Year Plan that lays out in considerable detail what lies ahead. Given China's place—now—as a key engine for global economic growth, having that roadmap is a tremendous advantage.

It's a “free” look at the future for China's economy. It's as close to “set-in-stone” as you're ever likely to get with any government planning exercise.

In fact, we have a member in merchant banking that invests in Chinese companies to ready them for listing overseas. The first question he asks them is “how does your business align with the FYP?” If they can't answer, he shows them the door.

So, what does the current Five year Plan identifies as priorities? Inclusive growth, plus key themes of:

- Rebalancing the economy
- Social equality
- Protecting the environment

Really, stable balanced growth is the watchword, with stability being key.

China is setting out four priority sectors that will get considerable spending:

1. health care
2. the environment
3. energy
4. technology

These sectors will get a major boost.

The Plan also identifies 7 “strategic emerging” industries it hopes will become the backbone of the economy. These—too—should be examined for opportunity. These sub-

sectors remain multi-billion RMB targets for China's government and they are HUGE for foreign investors.

These SEI's include:

1. biotech
2. new energy (nuclear, solar, wind)
3. high-end equipment manufacture
4. energy conservation (waste recycling, clean coal)
5. clean energy vehicles (battery cell tech, 1m elect vehicles by 2015)
6. new materials
7. next-generation IT.

Related to the plan, I want to highlight two specific examples that may impact you. First, I mentioned how two of the plan's key themes are Rebalancing the economy and Social equality. The rebalancing involves a number of things, particularly moving from investment-led growth to consumption-based growth. Mind you, investment-led growth has done fabulous things for China's logistics infrastructure, which benefits us all. But they understand

the need to drive more domestic consumption. To do that, they need to raise standards of living throughout China, particularly in inland areas – thus the Go West policy from a few years back, which is still going strong. Chongqing, a sprawling metropolis with a population of 34 million people, is one of the prime beneficiaries of this. Like Winnipeg, an inland port is a key part of Chongqing’s development (it’s on the Yangtze River). I toured the port in 2008, and as the guide explained how we were viewing just phase one of its construction and that the completed port would have a container capacity 4x what we were seeing, I asked him where all the product was going to come from. He motioned to the surrounding, as-yet-undeveloped area, and told me how it was all going to be from organic growth, from new industrial parks going up all around. But in those parks, they’re not looking to just make cheap trinkets, which leads me to the other part of the rebalancing equation. China wants to move up the value chain in terms of manufacturing. But there is also a fear that this will send lower-cost goods mfg to countries like Vietnam. When this involves something that is particularly

polluting or low value, China tends to say “good riddance.” But Chongqing is doing something very interesting to ensure that inputs to its manufacturing stay in country. They have built the Chongqing-Duisburg rail freight line, linking China’s largest inland port with the world’s largest, in Duisburg Germany. The route covers more than 11,000 km, goes through Kazakhstan, Russia, Belarus and Poland, and reduces delivery time to 13 days, which is one half to one third of currently delivery times. Not only does the freight line make it faster to send goods to Europe, it takes less time to import components from the region as well.

Europe is a huge shipping destination for China, and the line is designed to provide advantage to China’s burgeoning IT industry. Recently key manufacturers such as HP and Foxconn have built factories in Chongqing. Relevant for electronics products is that faster delivery time reduces currency risk for both customers and suppliers, and a dry, stable environment prevents damage to electronic parts and ensures performance is not affected.

The advantages both inbound and outbound help guarantee China (and Chongqing) a position in the supply chain, even as other products might flee to lower-cost countries. “Let them go,” China’s leaders say, “we’ll create the conditions that make the products we WANT to manufacture stay in country.”

And that’s really the key message here – China knows what it wants, and it builds the systems to make it happen.

Example #2 is even more interesting. For this, let’s return to the topic of technology, and the Strategic Emerging Industry of Next-gen IT. A key concept embedded in the new FYP is called the “Internet of Things.” Not everyone is talking about it yet, we think it’s worth some early consideration. Wikipedia describes this concept as “the networked interconnection of everyday objects, a [self-configuring wireless network](#) of sensors whose purpose would be to interconnect all things. Although the idea is simple, its application is difficult. If all objects in the world were equipped with minuscule identifying devices, daily life on our planet could undergo a transformation.”

So the more commonplace application of this would be using your cell phone to turn on the heat at home before you leave the office, for example. But here's a more eye-opening one. China has recently piloted a 10-city quality-assured pork program. Pork is a key staple in the Chinese diet, and China has an understandable concern about the quality of its domestic food supply. You may remember the milk powder scandal from a couple years ago. In fact, in Hong Kong, the best-selling soy sauce brand advertises on its label that it's made from CANADIAN soybeans, rather than Chinese. So in these 10 cities, when consumers purchase pork, they can use mobile phone to scan the package, in which is embedded an RFID tag, and learn on what farm the pig was raised, and in what abattoir it was slaughtered. So suddenly you have a very interesting solution to a domestic problem. Now let's think about another domestic problem that China has been tackling for the last few years – environment. China has become a world-beater in the solar and wind industries in a very short number of years, because the government looked at the situation and said – well, we've got a disaster on our hands,

so why don't we build an industry to overcome it, and at the same time, develop a sector that can compete globally. They said it, they funded it, and they did it. Just like that. A few weeks ago a vice minister of commerce told me the pork story, and how China has the perfect foundation for development of the Internet of things. >800m mobile subscribers, and 450m people on the internet. They see a wide application of the IOT not just for cities, but for ag/rural, services, and environmental protection. It's a concept that has the right hi-tech attributes for China's growth, plus positive externalities – to improve people's lives, to build big data processing centers, to develop a giant computing cloud. It also has massive implications for the global supply chain, and I think that ports should take notice. Again with my Canadian hat on, I think about the valuable exports of Alberta beef and canola from the prairies, both of which have been plagued by certain trade barriers. If such a program can be used, for example, to guarantee that beef exports to China are from cows who have not been exposed to BSE, in a trackable way, it's great for the industry. So I advise port authorities and

logistics providers to pay close attention to this emerging concept, as it will have an impact on trade.

Finally, I'd like to end with a cartoon that we've been laughing about ever since it was published earlier this year (*put up Dilbert cartoon*). It's a reminder to us that no matter how much you might want to ignore China, you just can't. China is an integral part of the global value chain, will continue to grow its role, and for any of you who want to remain relevant, it pays to understand China a bit better.

Thank you.