

# Managing Canada's Relations With China<sup>1</sup>

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I'm delighted to have the chance to interact with this distinguished group. I'll try not to ruin your lunch.

I'm not going to tell Canada and China what to do with each other. Much of the world is tired of Americans telling them what to do. Perhaps I can illuminate the context within which decisions must be made.

We're at a fundamental turning point in world history. After a half century of extraordinary peace and prosperity, especially in Asia, economic, security and political relations now threaten to turn sour. A rising power, China, is demanding a larger role in the global system and accommodative changes in that system. The established powers react and overreact to China.

At this great turning point the principal protagonists have unusual leadership.

In the fractious and polarized U.S., President Trump governs by fickle policy tweets and has backed away from what we thought were established Western principles, including alliance solidarity, rule of law, economic integration, and concern for the environment and climate. He has dismissed or abandoned his most competent economic, military and diplomatic advisors. Like Obama his administration has no Cabinet-level expertise on China. He relies heavily on an economic charlatan and a political charlatan for advice on China.

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The result of Trump's policies is a fragmentation of the West, a decline of U.S. leadership, and a failure to address issues critical to the future of the world economy and indeed to the future of the human race.

In China, Xi Jinping came to power with a mandate to implement what was probably the most carefully crafted economic reform plan in world history. That plan was developed because China's elite believed that the country's future was endangered by the previous decade's cessation of market reforms and by increasing control of the economy by corrupt and inefficient enterprises and interest groups. Xi Jinping's implementation of that plan has been indecisive in the manner of Teresa Mae and has repudiated his predecessors' priorities for economic development.

- He had a choice between fast reform with slow growth and on the other hand fast growth with slow reform. He proclaimed that he would achieve both. The result will be neither.
- The axiomatic principle of the planned reforms was market allocation of resources but the core of actual policy has been \$1.7 trillion of subsidies to inefficient state enterprises.
- The plan, and current rhetoric, envisage decisive opening to foreign investment, but the reality has been a nightmare of protectionist regulation.
- The plan prefigured a level playing field, but state enterprises are exempt from competition policy and propped up by massive subsidies.
- The plan, and current rhetoric, promise marketization of state enterprises, but the reality has been the tightening of Communist Party control over strategic business decisions in all kinds of enterprises.
- The plan was rule of law, but the reality is tightened control of the judiciary by a Communist Party Commission.

The overarching principle of these economic decisions is that, whenever there is a conflict between economic efficiency and political control, the priority is political control. The predictable result of these policies will be the decline of the Chinese

economy into an era of relative stagnation, exactly what Xi Jinping was hired to prevent. Chinese growth has been steadily declining. It is less than the published statistics say. It will continue a trend of decline. Growth is maintained only by inefficient investments paid for with borrowed money. The Chinese elite understands this and is becoming restless. The Chinese public understands this restlessness and is trying to get its money and its children out of China.

Into this inauspicious leadership environment comes the trade war. Some of the substance of the trade war is important and necessary. The scale of the Chinese economy has made continued theft of intellectual property, forced transfer of intellectual property, and exclusion of foreigners from most of the services economy intolerable. The West has opened itself to what China is good at, namely manufacturing, but finds itself excluded by China from what the West is good at, namely services. The West must belatedly and firmly address these issues.

At the same time, Trump's version of the trade war embraces extraordinary nonsense. His demand that China fix the U.S. trade balance defies the algebra of first-semester economics. His continued obsession with the currency exchange rate ignores most of a decade of Chinese currency reform.

There is, moreover, a weird paradox in the trade war. If China were to do the things Trump requests, it would have a stronger economy and become a more formidable competitor. The Chinese elite understands this and quietly cheers for Trump. Because Trump's minions do not understand this, they succumb to a paranoia based on the assumption that, if the Chinese declare an industrial policy, then it is sure to work.

More importantly the trade war has merged with national security and human rights concerns to create a bipartisan cold war mentality in Washington. China's maritime sovereignty claims do indeed overreach. Its attacks on Christian and Muslim religious institutions, and above all its concentration camps in Xinjiang, are morally unacceptable.

Having said that, the new cold war mentality too often inculcates a zero-sum military-style mentality that everything China does is bad, that any gain for China is a loss for the West. To counter this we need to remind ourselves that China has gone very far, and made great sacrifices, toward joining most of the Western system and that the consequences have transformed our world for the better.

- Over two billion people have had their poverty alleviated.
  - For the first time in world history, we have a surplus of basic goods like food and clothing. Millennia of scarcity have been replaced by surfeit.
  - Chinese progress has tipped the global balance from an economy based primarily on backbreaking physical labor to one based primarily on services. We live longer and more healthy lives as a result.
  - Chinese manufacturing efficiency, producing high quality goods at very low prices, has brought exceptional benefits to the poorest part of Western populations and indeed to the poor of the world.
  - When China passed the threshold of environmental consciousness, it tipped the world in the direction of environmental alleviation and some chance of addressing climate change. From having been the world's worst in these respects, China has become the world leader in green energy and concern about climate change.
  - Chinese demand, the Chinese economic example, Chinese investment, and Chinese-built infrastructure save us from huge national security risks. Bangladesh was so hopeless that it seemed destined to become a failed state, a giant jungle Somalia spewing instability and terrorism. Instead, the textile and garment industry spilled over from China, funded by U.S. investment, and have created a viable society. Likewise, violent, famine-ridden Ethiopia became the world's fastest growing country.
- I could go on. Instead, I will just ask you to look around Canada. Almost everyone in Canada is more prosperous because of China's rise.

As we address the problems in our relationship with China, we should never forget the enormous benefits we and the rest of the world reap from China's contributions to the

world economy and to global stability. Our experience with Japan and South Korea shows that the same problems we have with China can be successfully addressed through firm negotiation without a cold war mentality. We particularly need to remind ourselves that China today is far more open to Western trade and investment than Japan is.

The Chinese Belt and Road Initiative (BRI) embodies the complexity of our relationship with China and the perversity of some of our reactions. Many U.S. commentators denounce BRI as an attempt to subvert global norms. But the BRI vision is a moderately amended copy of the Bretton Woods vision of a great development bank funding infrastructure in poor countries, alongside institutions designed to facilitate trade and investment by creating common standards. The space for new development banks and the need for a new BRI vision were created by U.S. refusal to expand and modernize the Bretton Woods system. The BRI vision is a constructive Chinese intellectual property theft from Washington.

The implementation of BRI has severe flaws, including corruption, predatory behavior by large state enterprises, and accumulation of excessive debt in some countries. But our interests would be better served by praising the inspiring vision, negotiating standards as we did with the Japanese (whose early behavior was quite similar), and competing.

Take Indonesian power plants as an example. China initiates a project, offering second class technology at a high price, huge loans, and poor feasibility studies, along with a demand for a state guarantee. Then along comes Japan then with first class technology, quality feasibility studies, a track record of superior reliability, sensible financing, and as a result no need for a state guarantee. The big winners are the Indonesians. Our goal should be to duplicate that outcome as much as possible and to offer our own inspiring vision, not just denounce China's.

The core geopolitical and geoeconomic problems of the world today come down to two issues.

First, the U.S. must accept the reality another equal or nearly equal power. Contrary to some of the louder voices in the U.S., God has not given the U.S. an exclusive grant of permanent global leadership. The U.S. Congress has crippled the Bretton Woods system by refusing to expand it and to accommodate the emergence of new powers. The U.S. Navy has been bitter that it can no longer control the beaches of China, and the U.S. Navy and Air Force have caused unnecessary tensions by insisting on their right to gratuitously provocative surveillance of China. The U.S. has emphatically demanded that China accept the Hague standards in the South China Sea while refusing to apply the same standards to islands claimed by ally Japan, not to mention islands around Hawaii. The U.S. must learn to live in the world of the 21<sup>st</sup> century rather than furiously resenting the loss of late 20<sup>th</sup> century hegemony.

Conversely, China must decide whether it is a victim or a great power. It cannot claim to be a great power and global leader while adopting the posture of a victim because of Western depredations a century ago. It does not have the right to victimize its maritime neighbors because Western powers behaved badly a century ago. It cannot claim infant industry protection of its banking sector when it has four of the world's ten largest banks. It cannot claim a right for subsidized Huawei do dominate the global 5G market when it would never allow a Western company to achieve similar dominance of a critical technology in China.

If Canada and other countries can nudge these two huge but not always smart elephants toward acceptance of these two basic truths, they will have done the world a great service. In the meantime there is a great deal of money to be made by serving the Chinese market and exploiting the skills of talented Chinese who would rather live here. The center of gravity of the global consumer market has been the American and European baby boomer. It is shifting to the relatively young Asian, especially Chinese. Any country that decouples from that destroys its own future. There is a fad among

right-wingers in Washington for decoupling from China. That's a perfect recipe for economic decline.

Finally, we would all be well-advised to avoid locking ourselves into a rigid cold war mindset. China is on the cusp of generational change. That change can be delayed but not avoided. China may get better or it may get worse, but each Chinese generational change is transformational. Xi Jinping is a failing leader. The younger generation is much better educated, much more familiar with the West, much better acquainted with markets. We must continue to engage them, with firmness where necessary.