

EDC'S 'LET'S TALK ASIA': PRESENTATION NOTES *March 2, 2012*

CHINA

- The Chair has accorded me 600 seconds to bring you up to speed on China;
- easier to give a 30 minute speech than a 10 minute commentary on such an important and nuanced subject; try to bring together a few ideas, hoping that they are not too disjointed;
- especially so when followed later by a panel lead by Martin Cauchon, and including people like Tony Gosling, Ken Baker and others;

Let me make thee sets of points:

First Point: China's power to transform itself

- First went to China in 1982 with PCS: very much post-Maoism but still finding its way; transformation due to '4 Modernizations of ag, industry, defence and S&T' 1978 (ZEL/DXP);
- succession of transformation, with DXP 'Southern Tour',
- WTO 2001;

Determination when leadership is effective: WTO story in Nanjing;

- much of the life time of people in this room, **China will be a moving target**: economic growth itself is a mover and shaker, but policies can be too; have to take this into account as you plan to sell goods or services to China or invest there, or import goods and services and seek Chinese investment here; you have to plan for constant adaptation and change;

- we are now facing the next, potentially transformative period: 12th Five Year Plan, 18th Party Congress, Fifth Generation leadership; XJP/1953, LKQ/1955, from engineers to people with finance and experience in practical politics, such as Wang Qishan, former Mayor of Beijing; they were teenagers during the Cultural Revolution, e.g. Bo Xilai; the fanaticism of that era may temper their enthusiasm for mass movements contesting the status quo;

- still, will these new leaders be transformational?

- consensus on the need of transition from the existing development model; WJB: 'unsteady, unbalanced, uncoordinated and unsustainable' (great, alliterative English!)

- what has to be done: transition from low wage, low income, export and infrastructure investment (50%) led economy to one more domestic market oriented – and equitable – led by consumption (now 33%); further development of social welfare system (unemployment, health, education, old age income protection etc); creation of services market to provide employment alternative to that based on exports;

- second economy in \$ terms, but 2011 IMF PPP GDPpc: 90th, at \$8,400;

- experience is one of visionary transition: DXP and ZRJ;
- but China is a huge ship, no matter from what angle it is viewed, so shifts in any direction take time and resources, and inevitably combine elements of continuity and change; unclear that change of personnel at the top is enough to guarantee change;

Second Point: as businesses, you depend on policy predictability and continuity, but that can become stasis;

- yes, there have been the ZRJs, but also the and incrementalism of Hua Guofung, Li Peng, HJT/WJB;
- good continuity: GDP growth rate/9.2% last year, 8.9% Q4; World Bank predicts 8.4% in 2012; but over time, WB also predicts that annual GDP growth will gradually decline from 8.6 percent during 2011-15 to 5 percent during 2026-30; industrial production well above 10%/12.8% in Dec; need this, but how to transform?
- but there is bad continuity: the development model dependent on state and directed investment increasingly entrenching financial distortions (e.g. dependence on low interest rates, to detriment of savers and providing subsidized capital to investors), creating crony capitalism, entrenched interests and corruption, very difficult to overcome;
- China is on the horns of several dilemmas:
- for example, it must on the one hand pursue concerted effort to increase wages and domestic consumption of,

especially, low income Chinese and reduce urban/rural disparity; e.g. in 2011, 24 provinces and municipalities raised minimum wages by an average of 22 percent; all the while keeping its exports competitive;

- China must provide sufficient return on savings to limit the costs of social safety nets, but at the same time keep the cost of capital low to promote more investment and prevent heavily leveraged and indebted companies from going bankrupt;

This is a real challenge to policy coherence: so are other Chinese realities:

- for example, China is several economies: until the 1980s, 1990s, the reality was that China was a combination of remarkably autarchic administrative zone economies, defined by its 22 provinces, 4 municipalities, and 5 autonomous regions, not including today's 2 special administrative regions (HK and Macao), or Taiwan; some of this regionalism remains very powerful and local officials work hard to try to retain a certain amount of autonomy;

- as the Chinese say about Beijing: the mountains are high and the Emperor is far away;

Point three: Be aware! Tension between need to transform and the need for social and political stability and protecting the interests of today's winners:

- dissatisfaction over growing inequality, corruption (Li Jinhua/AG, PBoC/\$124B in 15 years, 17,000 officials flee abroad), inflation, house prices, pollution etc:

- the Party is all powerful, there are no authentic representative institutions but the Chinese public is not without its own means of expressing its according to Reuters last December, number of cellphones 987,580,000, plus internet connectivity (500mm+) and huge number of micro-blogs;
- the desire for more accountability and toleration of dissent;
- even within the Party, there are very different views on how to proceed; I would frequently ask myself how the individual Party members I met would react to the loss of their monopoly on power; some of the best conversations I had with Chinese about the need for representative institutions were with Party members;
- be ready for anything: political stability issues: for public companies in particular, have your communications plan and press releases ready to deal with how you are engaged apolitically in China, if pictures from China are bad;
- these comments are meant to be cautionary;
- IMHO, you have to have a strategic approach to China, whether you intend to sell to, buy from, invest in or partner with Chinese enterprises or not; the Chinese are coming to your markets for goods and services in Canada, in NA, and just about everywhere else – maybe not the Vatican.
- you have to base your strategic planning regarding China on the expectation that China will be able to address the most egregious of these issues; pragmatism will rule;

- you have to base your strategic assumptions on continuing Chinese growth: from an economic point of view, China is the United States of 1870 to 2000;

- you have to assume that at least some of the Chinese Government's objectives listed in the 12th Five Year Plan of 'inclusive growth' will be pursued, and offer both business opportunities and growing competition in such areas as environmental technologies, biotechnology and health care, renewable resources and so forth.

You can question these assumptions, but you are probably better off planning your business on the expectation that China will continue to achieve some of the success that it has experienced over the last generation.

Joseph Caron
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