

THE IMPACT OF CHINA ON NORTH AMERICA

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Assumptions:

- 1.1 China will continue to grow at 8-10% per year
- 1.2 FDI will continue to flow to China during the medium term
- 1.3 China will focus on manufacturing for now
- 1.4 China context and strategy will be vertical integration and clusters within many or all industries
- 1.5 China competence will increase rapidly to better quality and more sophisticated products
- 1.6 Internal issues of power production, transport etc will be resolved to permit growth to continue
- 1.7 End of textile/garment quotas will be aggressively exploited by China
- 1.8 Financial system in China will manage to survive bad loans and other sources of stress
- 1.9 The stress of the US/China trade deficit will not result in a significant change in the US/renmimbi relationship.
- 1.10 Political tensions with Taiwan will not increase to the point where business is seriously disrupted
- 1.11 North Korea nuclear issue will be resolved to the point where there is no major crisis
- 1.12 Internal social and political tensions will be managed successfully

If these assumptions do not hold the impact of China could be very different. It would be speculative to assume that China will fail to manage these major issues.

- 2.0 The impact of China may be very different on each of the three North American economies and this difference may affect relationships among the three NAFTA partners. The following list suggests areas where the impact of China has been felt, is being felt and likely to be felt in the future.

- 2.1 Trade balances – The impact will be different for each country with potentially the least negative impact on Canada because it will benefit from the demand for commodities. The US will continue to be the target market and Mexico is being impacted by the shift of cost-based production from Mexico to China.
- 2.2 Impact on jobs and labor – All three countries will be impacted in the area of job loss or at least disruption in manufacturing and possibly some services. The impact may create regional and political stress particularly in Mexico and parts of the US. Certain industries may be affected in Canada but the political impact may be less severe.
- 2.3 Shift to Commodities – Canada may discover that its economy is shifting back to a larger reliance on commodities. The demand from China is part of the reason but as China creates demand on the rest of the world the US may rely more on Canada. The re-opening of the iron mines in the Mesabi Range of Michigan (shipped by rail through Canada to the Pacific) is an interesting example of this phenomenon.
- 2.4 Protectionism – There is already a climate that encourages applications for anti-dumping or other forms of interference with increasing success. This may be an activity at the fringe or it may create a political climate in all three NAFTA countries that makes open trade less desirable. There is always a danger that Canada and Mexico are side-swiped by US action in this kind of climate.
- 2.5 Intellectual Property – The greater tolerance for abuse in China may be exploited not only by Chinese companies but by foreign investors or customers of China.
- 2.6 Environment – The huge demand by China for commodities like oil and steel will undoubtedly have a negative impact on the global environment. First, there is an increase in emissions from these industries by virtue of volume, second, China may adhere to lower standards and third this creates conditions where other countries are inclined to reduce their own standards to compete. An interesting example is the inability of Europe to access Coke for steel from China. Europe has reduced Coke production in large part for environmental reasons but purchasing it from China may well be worse from a global perspective.
- 2.7 Impact of removal of Textile Quotas - This may have a huge impact globally as the industry re-deploys its production. The greatest negative impact in North America may be on Mexico which has the most to lose. It is less vertically integrated than China and will struggle to compete. Canada and the US may be neutral or a positive as they have access to lower cost materials with less complexities. On balance this will favor China rather than North America.

- 2.8 Transportation distortion – The Asian trade and China in particular are creating major stresses on the traditional flows of goods and the access to transport capacity. The impact on bulk carriers generally and container capacity in many areas is well documented. Ships are being built with the result of a possible glut in 2006 and beyond. The potential lower freight prices may impact NA negatively to the extent that this increases the competition for certain industries. There is a secondary impact in areas such as East-West rail capacity in Canada. The container freight from Vancouver East is becoming unreliable as increasing Pacific container volume meets a relatively fixed rail capacity. The impact is identical out of the Los Angeles basin. The impact is also felt in secondary markets. Shipping from certain Brazilian ports as an example has become very difficult since ships are being presumably given other priorities.
- 2.9 Taxation – The increase in trade between countries creates situations where tax can be reduced or avoided. An increasing number of the competitors North American companies face even when importing may have different tax circumstances creating another aspect of competition that is not helpful.
- 2.10 Access to new markets – This is always viewed as a benefit of trade. In the case of China with its vertically integrated industries and somewhat structured economy the opportunities may be limited. When external companies gain access to the market for products other than commodities it may well be with products produced inside China with marginal benefit to their home country.
- 2.11 Security – There are three kinds of threats to security and they are all different;
- Terrorism – East Asia is generally not a source of this kind of problem although the increasing flow of goods and people make this a vulnerability.
 - WMD or nuclear proliferation – This has potential impact to the extent that China will have an important influence on how the North Korean problem is or is not resolved.
 - Military challenge or instability – The relationship with Taiwan remains a risk as does the potential competition between the US and China in East and Central Asia.

The combination of China-related security risks may result in pressures by the US on its continental partners to act in concert with US perceptions of preferred policy.

- 2.12 Relationship of NA to Europe – The rise of China complicates the historic centrality and purpose of that relationship. The future impact is as yet uncertain.
- 2.13 Currency Values and policy – The impact of China may be very important and complicated. The increase in the Canadian dollar and the relative drop in the peso may in part be related to the differential impact of China on our countries and currencies. This has a corresponding impact on relationships within NAFTA since it changes the economic and industry balances.
- 2.14 Chinese industrial policy – There is increasing evidence that China's success is based at least in part on the promotion of certain sectors and strategies. The example of the restriction of Coke exports to Europe to the benefit of China and the detriment of European industry is an interesting example.

2.15 Values and Ethics – There is a clear assumption that operating in China requires a different view of acceptable practices. To the extent that this drives market forces, companies and industries feel compelled to operate within that less ethical framework.

3.0 What are the questions raised by these assumptions and impacts?

3.1 Will the impact of China on the three North American economies be different to the degree that it changes political and economic relationships within North America? In which way?

3.2 Should North America have a single strategy or policy relative to China or is it appropriate to have three potentially very different approaches?

3.3 Does the potential return to a more commodity-based economy matter to Canada?

3.4 Are the interests of Canada and Mexico vis-à-vis the US converging or diverging as a consequence of China?

3.5 Does the current model of increasingly open trade serve North America well and will it do so in the future?

3.6 What policy would Mexico need to adopt to become a preferred production location given its geographic advantage?

3.7 Is the future of Canadian prosperity based on denser economic relationships with the US or more strategic but limited relationships?

3.8 Will security considerations alter the cross-ocean trade routes anytime in the future?

3.9 What is the impact of Chinese demographics when the age structure changes in a drastic manner 20 or so years from now?

3.10 Will the industrial and job structure changes in North America affect immigration flows and pressures?

4.0 Global implications of China/North America relationships

- 4.1 How will the trade, currency and fiscal pressures impact more global considerations such as the Doha trade round.
- 4.2 What is the greater impact of China's commodity demand on international politics. For example the impact of oil demand on prices and the consequent politics in the Middle East and around the Caspian Sea?
- 4.3 Will China alter the geopolitical balance to the degree that the US Government begins to act differently.
- 4.4 Will the role of China enhance or minimize the potential role of the UN?
- 4.5 Will the rise of China marginalize many of the smaller and less well organized emerging countries since China can do almost everything they can do and do it better.