THE STANDING SENATE COMMITTEE ON FOREIGN AFFAIRS AND INTERNATIONAL TRADE

EVIDENCE

OTTAWA, Wednesday, April 16, 2008

The Standing Senate Committee on Foreign Affairs and International Trade met this day at 4 p.m. to study the rise of China, India and Russia in the global economy and the implications for Canadian policy.

Senator Consiglio Di Nino (*Chairman*) in the Chair.

[*Translation*]

The Chair: Honourable Senators, welcome to this meeting of the Standing Senate Committee on Foreign Affairs and International Trade.

The Committee is studying the new influence of China, India and Russia in the global economy and the policies that Canada has adopted in reaction to this influence.

We are pleased to welcome before us today Professor Wenran Jiang, Acting Director of the China Institute of the University of Alberta, Mr. Peter Clark, President of Grey, Clark, Shih and Associates Limited, and Mr. Glen Hodgson, Senior Vice-President and Chief Economist of the Conference Board of Canada.

Welcome to the Senate, gentlemen. I would invite Professor Jiang and Mr. Clark to make their opening statements, after which we will have a question and answer period.

[*English*]

Wenran Jiang, Acting Director, China Institute, University of Alberta, as an individual: I would like to take the opportunity to thank you for inviting me to appear in front of this very important body. I feel privileged to have the opportunity to speak on the subject matter.

I have followed the rise of China and its impact on the Asia-Pacific Region and the rest of the world for well more than 10 years, both in my capacity as a professor of political economy and, more recently, as an active participant in efforts to forge closer ties between Canada, North America, China and the Asia-Pacific Region.

As part of the China strategic working group initiative of the Department of Foreign Affairs and International Trade, I have organized a large-scale annual Canada-China energy conference since 2004. We put together private sector, government officials and academics from both sides to discuss annually common concerns regarding energy and other trade and economic relations. That has been growing even bigger as of last year, with Americans coming to participate.

I have been serving as the acting director of the China Institute at the University of Alberta for two years. The institution has $37.2 million of endowment from the provincial Government of Alberta and thus we are now the best funded China research and activity centre in Canada and one of the best in the world.

In the past two years, I have also served as the special adviser on China to the Energy Council, which represents 11 U.S. energy producing states, five energy producing Canadian provinces and the nation of Venezuela. I led a delegation of legislators, 49 members, to Beijing last summer to dialogue with the Chinese side.

While these experiences gave me insight on the subject matter, I want to say that the following views are my own and I do not speak as a representative of these organizations with which I am affiliated.

Let me focus primarily on China. That is my area of focus. Due to the time constraints, I will leave India and Russia aside but I would love to answer questions on those countries because I have done comparative studies on those areas as well.

In the next few minutes I will make four observations in terms of questions regarding the rise of China and its impact on the world and on Canada, and on China itself. The first question I would like to put into perspective is what qualifies China as an emerging global power. That is a very important issue to put into context, even though we assume we know quite a lot about that.

When talking about China's growth story, the number one point I would like to emphasize is really the re-orientation of the state from an ideologically-driven Communist state into more of a state-oriented capitalism. It started the reform process exactly 30 years ago. We are looking at China today having a very competitive, cutthroat market economy. We are looking at China being deeply integrated into the world economy. It is very different from the other so-called East Asian “growth tigers” that are Japan, South Korea and others, in that China has a huge stake in the world trade and integration of the world economy, especially in the past five years since they entered World Trade Organization.

All of this was driven by the “four modernizations” program of the Communist Party, which is the modernization of industry, agriculture, science and technology and of defence.

However, on the sociological level, we see China's growth story also means this very strong desire by the ordinary Chinese people to have a better life. They long for the kind of life that we have in North America. This has great impact potentials for the growth story and its impact on the rest of the world.

I put that into the perspective of the past 30 years of China's emerging growth. This is where China is. To refresh your memories on the China story: It is the largest foreign direct investment inflow country now and it has the largest trade in goods and service ratio to its GDP of all the major economies. It has the largest foreign reserve — something like $1.7 trillion. Three- or four-hundred billion of that has flowed back to buy U.S. Treasury bonds. That continues today on a large scale, virtually financing the U.S. deficit economy.

Of course, China is the second-largest energy consumer, the second largest-energy producer and the second-largest power market. I mention these because of their relevance to Canada. At the same time, China is also now the first or second, depending on the statistics, of the largest emitters of CO_2 greenhouse gases. It is the third largest trading nation. It is soon to overcome the United States to become the second-largest exporter after Germany in the world. It is the fourth-largest economy. It is also home to 16 out of 20 of the most polluted cities on earth.

China is what it is and has many challenges, including being a one-party state. It faces further market reforms. They perceive they have a less favourable international environment. That is very different from how the outside perceives the rising China. They need a huge amount of energy and resources to continue to drive their economy because they want to quadruple this economy by 2020. They did that between 1980 and the mid-1990s.

With an economy of this size growing at about 10 per cent a year, it doubles every seven or eight years. On the power purchasing parity level, it will catch up with the United States sometime around 2020. Around 2030 or 2040, even on the U.S. dollar basis, they will be taking over or being on par with the United States. This is where we are in terms of qualifying to look at China's emergence.

The second question is to see what the structural impact of all this growth is on both China and the rest of the world.

China is a huge trading nation. It is a driver of global trade, especially in developing countries and the developing world. I did a rough calculation. Between 2001 and 2005, China's trade with all the regions of the world had grown between 163 per cent — that is with North America — and about 370 per cent with the Middle East. In other regions, it falls somewhere in between.

It displays a pattern of moving the trade growth rate in the areas where the lower the trade volumes with China, the higher the growth rate of those trade ratios. Whereas the larger the volume originally, such as in North America and Europe, the slower the rate.

However, overall it is amazingly high. No other countries have grown in trade relations with other parts of the world the way China has done in the past five or 10 or more years.

Aside from trade, the second point on the impact: Many countries are forced into trading with and depending on China. In Latin America and Africa, they talk about China's super-cycles of energy- and resource-driven demand. In the economy in Africa, an increase of 4 to 5 per cent in the growth rate over the past five last years is primarily due to China's demand.

This trade and production made China a huge factory of the world. That means China, at this particular stage, consumes a huge amount of energy, produces a huge amount of raw materials and imports a huge amount of materials. China is one of the largest or the largest of the global producers and buyers of materials such as cement, steel, aluminum, copper, nickel, zinc — you name it. It ranges anywhere from 20 to 50 per cent. China is eating these up.

In conclusion, China is having the traditional modernization development model, but in the past 30 years on steroids. It is developing very fast with a high input of capital, capital incentive, labour intensive, low wages, heavy use of materials, heavy industry and manufacturing, and heavy use of energy and resources. It is sucking it all in. There is a saying: “Whatever China buys becomes expensive and whatever China sells around the world becomes cheaper.” That is the situation in a sense.

The result is huge damage to its own environment and many problems in terms of inequality; the gap between rich and poor is widening. The emerging issue I want to emphasize in terms of the impact of China is that it not only damages its own environment. It causes acid rain and global warming and these are global problems. On top of that, China is the dumping ground of 80 to 90 per cent of the world's electronic waste. It ends up in China with very little regulation.

More than 60 per cent of China's foreign trade is being produced by foreign multinationals, mostly American companies who move their production bases to China. They count all these productions with good price, with low cost and they export them back into advancing industrialized countries. Those countries then say that China is polluting itself and the world. The pollution transfer factor is not being discussed that much. It is a serious issue. I am saying that China's growth story, China's impact on itself, is a global problem. The industrialized countries especially have a share of all those global warming and pollution problems. What China faces today is what the world faces.

The third question I would want to deal with is where Canada fits into all of this. In my interactions with both sides — private business, government officials — I think the Chinese perceive Canada as a very large country with very little population, huge resources of energy. They perceive it as a dream land and want to have better trade relations and better investment and interaction. However, I can characterize what we see in Canada's economic relations with China in recent years, which I have documented, especially tracing the resource and energy side, as “much thunder, little rain.” We talk all the time about economic cooperation and energy and this and that, but the numbers do not add up. We have just over $30 billion of annual trade. While it is growing on an annual basis, in comparison with other trade growth with China, we are losing proportionally. We are losing in both directions, either Canada's trade investment in China or the other way around.

For example, in Alberta's oil sands energy sector, China invested in two projects of about $300 million. In the total picture, of $50 billion invested so far, and $100 billion to be invested, projected, $300 million is really 0.6 per cent of the $50 billion, or even less, when you look at the further $100 billion.

The issue is now is not what is being talked about in the popular press, that somehow China is having too large a share of investment or will have. It is the opposite. The challenge is, we actually have too little. This is the situation. We do not currently have the political climate to frame the bilateral relations to forge a better economic environment.

The political relations between the two countries are at its lowest level since 1970. I believe neither the current government nor the former Liberal government has a clear China strategy. This is an issue we have to deal with. Which party is in power is not the issue but currently politically the climate is very cold. That is the issue that we are dealing with here. I think this dimension needs further discussion.

I do not want to take too much time, but I want to move quickly to the last question: What should Canada do in meeting this China challenge? It is coming around the world. We have a problem here with China's competition. Many people see China's challenge as somehow remote. Yes, it is our second-largest trading partner, but 80 per cent of our trade is with the United States so China should not matter all that much. It is across the Pacific. However, it is not. China's challenge is coming right here and right to the south of our border.

China is very competitive with a large trade growth rate with the United States over the years. It has overtaken Mexico and Japan as a large trading partner with the United States. In the foreseeable future, China will overtake Canada to become the largest trading partner of the United States. Our daily $1.5 billion bilateral trade between Canada and the United States will be overtaken by the Chinese. That is the reality we are dealing with.

Therefore my first recommendation is in the short term we need to revive summit diplomacy with China. Since the fall of 2005, when the Chinese president, Hu Jintao, visited Canada, we have had no summit visits. It is our turn to go back. That will not happen it seems in the foreseeable future. This is extremely abnormal, given the size of Canada’s trade and bilateral relations and how important China is to Canada’s economy. I have not had the chance to even touch on the political dimension of all this but I would love to do this during the question and answer session. Cold politics and warm economics will not work. The engagement is very important.

Kevin Rudd, the current Australian Prime Minister, just went to China to challenge on the Tibetan issue, giving a rousing lecture in Mandarin Chinese. Of course, he is given credit for that. However, he directly challenged the Chinese side on the Tibetan issue. His predecessor, John Howard, a Conservative, had all sorts of issues on human rights and espionage with China, yet they signed $24 billion to $40 billion of long-term energy contracts. For them it is not an issue of whether they wanted Chinese investment or not; the issue is how much more they can get. They engage, they criticize, they are welcomed and they do business at the same time.

The French president went to China several months ago, delivered a lecture on global warming, criticizing them, turned around and at the stroke of a pen, there was $30 billion on Airbus combined with a nuclear reactor. That is the size of our annual trade with China.

In our annual trade with China where is CANDU? Without high level contacts we cannot forge larger, strategic relations on both the political and economic sides. It will not do the job sending Minister of International Trade David Emerson over, although he is doing a good job, but it is just not high enough.

My second recommendation, in the medium term we need to focus on a range of important political and especially economic opportunities and challenges. What about the competitiveness in the auto sector? What do we do on the energy side and in terms of global warming? We cannot call upon China to reduce its greenhouse effects when it has a per capita emission rate of perhaps one eighth of ours. They just will not listen. We need to tell them they have a problem but we want to work with them and help them because we have strength in those areas.

As far as investment, China has a lot of spare cash. How do we create a good environment to have them invest here without fearing losing our sovereignty? We need to work with the private sector and the provinces. By the way, provincial governments are going way ahead — especially the Western part of Canada — to deal with China and they are not following the federal lead although they are constrainedby it. Those are the medium-term issues.

We need a non-partisan China strategy to be developed in dealing with a range of comprehensive issues.

The Chairman: Before calling on Mr. Clark, I have to apologize to Mr. Hodgson. I certainly had not intended to leave you out of the discussion. The briefing note that was prepared was prepared before you were asked to join us today and we are happy that you did. After Mr. Clark, you will have your chance.

Peter Clark, President, Grey, Clark, Shih and Associates Limited: The perspective that I have of China has been developed over having visited China many times over the last 20 years. I have been there more than half a dozen times over the last year and twice this year already.

It is an exciting, vibrant place and my advice in doing business with China is three words: Patience, patience, patience. The opportunities are there, and the way that we will develop them is through patience and understanding.

I am pleased to see that Canada will be opening additional local trade offices in China, with five of them announced today. They will provide better intelligence for Canadian companies. They will provide contacts and support. We really do need that in China, unless Canadian businessmen become a lot more fluent in Mandarin.

While we have made gains in China, as we have just heard about the Australians and the French, we are always playing catch-up with other countries that are more aggressive and more coordinated and more focused on their objectives.

In the context of what we are discussing, it is important to remember that as strange as China is to us, so are we to the Chinese. They really do not understand some of the things we do, how we do business, but they are prepared to learn.

I have attached a number of charts on issues that are in the presentation that, unfortunately, I did not have enough time to prepare and have translated. However, I can take you through what the charts will tell you.

The first chart will tell you that late last year, China did go past Canada as the largest supplier to the United States. The second chart, which is a shorter term chart, demonstrates how much our export trend into the United States has flattened since the dollar appreciated. The dollar’s value has been a factor, but you must wonder whether we would have been overtaken before that if energy prices were not as high as they have been over the past few years. The next chart shows Canada's total imports from and exports to China. There is an ever-widening gap. We are in deficit. There is then a chart that shows our trade imbalance, which has gone from $5 billion to nearly $30 billion.

We went to a study by the United States International Trade Commission, a three-part study requested by Congress. The first part was issued a few days ago, entitled “Description of Selected Government Practices and Policies affecting Decision-making in the Economy of China.” It is USITC Publication 3978. I recommend it to you. It has a lot of useful information.

The first chart that I attached for you to examine will show you the increase in investment from the private and the foreign invested private sectors and how they are becoming more important in China. The next chart shows you the percentage of GDP produced by ownership type. This will show that foreign invested companies have moved from less than 5 per cent in 1978 to over one-third in 2000, and there is no information for 2005 yet. Another chart indicates gross value of industrial output by ownership type, and 60 per cent of it in 2005 was represented by foreign invested companies. That is a very sharp increase. In 1985, it was 2 per cent; and in 1990 it was about 10 per cent.

Exports to the United States by foreign invested companies are significant, with over 60 per cent of the exports from China to the United States by foreign-invested companies. That is what Mr. Jiang was talking about. The next chart shows the monetary value of these exports from foreign-invested companies in 2006 at over $140 billion. The imports into China by foreign-invested companies represent nearly 60 per cent of the total. When you get the charts, and with the transcript you will be able to put them in context, you will see that the foreign invested component of the Chinese economy is growing rapidly and is becoming important and is the principle factor in international trade.

Why are we so far behind? Canada has had bilateral most-favoured nation trade with China since the 1960s. We entered into those agreements in part to have a vehicle to sell wheat to China and in part to restrict imports from China of textiles, clothing, toys and inexpensive foot wear. As we have heard, two-way trade between Canada and China in 1998 was about $10 billion. Last year, it was $47.5 billion. That is increasingly not in our favour, and we really do have to do something about it.

Our key agricultural exports to China have increased by 81 per cent from 2006 to 2007. China does need to feed itself. That 81 per cent represented about $700 million worth of barley and canola and canola oil. It is one of the few markets where we seem to sell as much canola oil as we do canola. There is little tariff escalation.

China is by far the world's largest consumer of pork. There are great potential markets in China for Canadian pork, but we cannot sell it there because

Canadian producers use a feed additive called Paylean, which is not approved in China. We should be focusing on demonstrating to the Chinese authorities that this additive is risk-free in the applications used in Canada.

I raise this because we see stories in the *Winnipeg Free Press* about having to gas piglets. We have just introduced a program for culling sows out of the Canadian herd because, for a variety of reasons, we cannot market the product. The United States has introduced country of origin labelling on meat. Retailers in the United States are not keen on the recordkeeping that they would have to do and as a result, they are cancelling contracts for Canadian livestock. We have a very depressed situation there. This is the type of opportunity that we might be able to deal with if we had a good working relationship, which we do not have.

I was asked a number of questions, and I think that you will see from some of the charts that the rapid growth really accelerated after China's accession to the WTO in 2001. Canada has always had most favoured nation treatment, almost forever, with China, but that has not brought us the benefits that it has brought other countries that have taken advantage of it. We did not have to do anything to adjust to China entering the WTO, absolutely nothing, because we were already there. We provided them with all of the most favoured nation treatments that we would anyone else who was a member of the WTO without it.

I was asked whether China's impacts on the world are generally positive or negative. The Chinese would tell you it is too early to say. They deal with history in a much longer time frame than those few years. It is quite clear that China is now driving the world economy, and it is picking up slack due to reduced activity in the United States.

We have heard about China's seemingly insatiable demand for energy and its natural resources. We sold $103 million worth of iron ore to China last year. I am not such how much steel we imported. It was not very much.

The Chinese market is being affected as well by their demand for coking coal and ocean transportation. We have seen the impact in the steel market where, 10 years ago, we were having safeguard inquiries all over the world because hot rolled steel sheet was going for $250 a tonne. About two weeks ago, it broke through $1,000 a tonne. That is a big change. This morning, Canpotex signed new contracts with China for potash which will triple the price the Chinese paid last year. The Chinese must feed themselves. They are concerned about world prices. They have been putting restrictions on exports of feed grains because they are consumers, as Mr. Jiang explained to you.

The Chinese are activists and they are demanding. You see articles in the Chinese press complaining about increased prices for food and about shortages. The Chinese have to deal with this. They have to cope with it. It is a rapidly growing market. Wages are increasing, and so is inflation. Consumers want value for money. Their export prices are going up. They are discouraging energy intensive exports by removing rebates on that and by imposing export taxes. In fact, the Chinese trade surplus actually fell in the most recent quarter by 10.8 per cent. The Minister of Commerce said, “Do not get excited; it is not an inflation situation.” However, exports did increase by about 7 per cent. If the surplus went down by 10.8 per cent, that means imports were growing a lot more quickly. That will accelerate as Chinese consumers earn more and more and are able to satisfy pent-up demand. Chinese consumers are not interested in cheap products that will fall apart. They are interested in the best products that they can get and good value for money. They are tough negotiators, but there is a market there.

I also attached to this presentation that we gave to the clerk the text of a speech that Peter Mandelson, the EU trade commissioner, gave in London yesterday. I think it might be useful in your work. Commissioner Mandelson has indicated that China is not simply an unstoppable juggernaut. It is also grappling with a governance challenge so large that it has no precedent in political history.

Investment is not easy. These are early days. The central government has introduced policies designed to transform the economy into something that is much more market-based, and to reduce state ownership. We have shown you what has been happening.

Commissioner Mandelson said that the EU investors have experienced a number of concerns on foreign ownership caps, local partner requirements and other restrictions. The EU is trying to get more into the telecommunications business and the financial services business in China, and they will because they work at it.

There are entrenched attitudes. People that grew up with state ownership in some cases are still very much attached to it. You will find that while the younger people in these companies and government departments in China, many of whom have been educated outside China, have a much more open attitude, their bosses are still based on seniority and it is a slow process.

The policy initiatives are developed by the central government but they are implemented at the local level — the provincial and even the municipal level. It takes a long time to filter down. You will find pockets within the country where the directives are not followed, either because of concerns about impact on jobs or investment in the area or because the decision makers locally do not agree with the central people. It is not too much different than Canada in some respects.

The human rights issue is next. My business is promoting trade and investment. What strikes me about some of these issues is that a lot of them are related to communications. I recall that Canada, the same day that Iraq invaded Kuwait, was being criticized in the United Nations for its treatment of indigenous peoples. There was a lot of attention gained by those seeking publicly to embarrass Canada at that time before the rest of the world by arriving in New York at the UN in canoes. It had great impact and made great media, but I am sure they did not paddle all the way from James Bay.

Commissioner Mandelson has said that the Olympics should not become a trade issue. He cautioned that you will not get very far with China if you try to inject issues like Tibet without coming off the tracks. He says this because some appear to assume that a course of direct confrontation in connection with the Olympics and Tibet serves our interests, and indeed Tibet's. However, modern China presents us with a dilemma. Our concerns and protests must go hand in hand with a strategy for ensuring that China continues to look outward to pursue internationalism.

You should not underestimate the pride of the Chinese people in having the Olympics, and their pride in their growing economy and their prosperity. The question most often asked by Chinese people, students and people in the government is this: “When do you think we will catch up with the United States?” It is a burning issue for them. They want to catch up to the United States; they want to get past it.

They are anxious to learn; as I said, they are much more adept at learning English than we are at learning Mandarin. However, there are lingering suspicions about discrimination and anti-Chinese attitudes that magnify negative impressions. You have to look at it from the other side.

What China means for Canada is whether we look at the glass as being half empty or half full. The opportunities are there; we have to develop them. It has been pretty easy in the past to export and invest in the United States until we have had the situation with the dollar and the housing crisis and a recession in our biggest market. That shows that we really do have to diversify.

In his closing remarks, Commissioner Mandelson said there is one thing more frightening than China's exponential growth. It is that growth suddenly stalling or crashing. China's economic failure or a decision by China to work against or isolate itself outside the international security or trading systems would be catastrophic for China and for us.

Your task is important; it is complex. You are trying to assess a rapidly moving target. I hope these comments help you and I am happy to answer any questions you might have.

Glen Hodgson, Senior Vice-President and Chief Economist, Conference Board of Canada: I have been on the Hill several times in the last year so I am not feeling neglected at all.

The Chair: You have actually been in front of our committee before.

Mr. Hodgson: That is right. I have one comment and then I will refer to three pieces of research we have done in the last year that are pertinent to Brazil, Russia, India and China — the emerging world.

If I have had one contribution to economic thinking, it was to create a phrase, “integrative trade,” which was designed to capture the new international business paradigm that is led by foreign investment. It is firms taking apart their value chains to position them anywhere around the world. The opening two speakers referred to that by talking about the shift of American production to China.

American firms are taking advantage of lower-cost labour in China; Canadian firms are trying to do that as well. We have discovered a few ways where Canadian firms are building their linkage and integration into the Chinese economy through their changing behaviour. That is an important concept because it overlays all the research we do at the Conference Board of Canada. It is something we fit into our research program.

The three pieces of research I want to refer to are, first, a paper we published this past January called *The Rise of the BRICs: What does it mean for Canada?* — meaning Brazil, Russia, India and China. It is about 60 pages long, so it is hard to summarize in a sentence; but I thought I would read the three bullets that provide a summary in the executive summary.

First:

Canada should deepen trade and investment ties with the BRICs and concentrate on moving up the value chain by specializing in knowledge-intensive, high value-added goods and services.

We cannot compete based upon the cost of labour anymore. We have to compete using our brain power is the core message.

Second:

The BRIC countries do present the threat of lost jobs in developed countries,; however, this threat is most immediate for industries dependent on low-skilled labour.

The threat of lost jobs applies to Canada. Again, the investment we have to make in human capital, allowing our workforce to move up the value chain again, is very much the theme coming from the reports.

Third:

China and India will remain the dominant pair of the foursome thanks to their large and increasingly better-educated populations, their low-cost labour and their growing openness.

So Brazil and Russia are there, but it is really a China-India story. That is in line with the opening remarks you heard from the other two presenters.

The second piece of research is a study we did in March of last year. We will release an update of this within the next two or three weeks. It is called *Canada's Changing Role in Global Supply Chains*.

We set out to try and develop a new methodology for measuring the degree of integration between Canada and other countries around the world, and their integration into our value chains. We found a spectacular rise in the level of trade and integration from 1992 to about 2000 — the Tech Wreck, 9/11 — driven by the free trade agreement with the United States. That is no particular surprise. That is what economists would have expected coming out of a free trade agreement, moving up the value chain with more integration in production.

However, from 2000 until 2005 in this study, and 2006 in our most recent study, there has actually been no integration at all. We are stuck in neutral when it comes to Canada integrating with the United States and Europe, but also with the emerging markets, with China and India.

The one striking exception is the degree of integration of Chinese things into Canadian value chains. You see more and more Canadian companies relying upon lower cost inputs, things that fit into value chains coming from Asia — from China, Vietnam, Korea and a lot of other countries.

We are not seizing the opportunities in terms of our exports going into other markets, but Canadian firms have figured out that with the rising dollar and with increasing global competition, they have to find a way to get more efficient. They are relying increasingly upon Chinese and other Asian inputs fitting into their own value chains. That will be reinforced when the study comes out.

The third report I want to touch upon caused a stir in the media. It is called *Canada's Missing Trade with Asia*. It caused a stir because we point out the fact that maybe we are not measuring the right things when it comes to our trade with Asia.

We focus on things such as service exports and imports where we are probably 50 years behind the evolution of our domestic economy when it comes to measuring international trade and services. The fact is, many goods and services go through third party countries. They go through the United States on the way to Asia. They come into Canada from the U.S., having off-loaded at U.S. ports.

It is the same thing at the other end. A lot of trade through Hong Kong ends up in China and other markets in Asia. That does not get captured accurately by the trade data we have from Statistics Canada and from other sources.

The third and probably the biggest component is called “sales from foreign affiliates.” Back to my integrative trade idea, foreign affiliates are created through foreign investment. We are increasingly seeing this as the way to penetrate foreign markets. You create a partnership in the foreign market; you create a sales distribution centre and then make sales from there. Those are not part of our exports but they are a major and growing part of the overall balance sheet of Canadian companies.

The model is that you have to invest in China or India to do business in those markets. You cannot sit in Mississauga or Chicoutimi any longer and make sales in offshore markets. You can do some of that, but it is matter of integrating into the value chains and reaching consumers through these foreign affiliates.

The outcome of this study was that we effectively doubled the level of Canadian trade and overall business with Asia by adding in services, looking at third markets, and adding in sales from foreign affiliates. The trouble is that even though you double the number today, you see a declining trend from 2000 to 2005. Even though the aggregate number is bigger, our share of global trade with those markets is falling. This is consistent with the stories told by the other two presenters.

I will stop there and we are all open for questions.

The Chairman: Thank you. We appreciate that. We have something short of an hour. I would appreciate it if the questions were brisk and to the point. I will also ask our witnesses to respect that; otherwise, we will not be able to have as good an exchange as I know we will have.

Senator Smith: I do understand the word “patience.” I have been fascinated with China for years and have been lucky to go there probably 10 times starting in 1975 when every day the Red Guard on your floor at the hotel would come in like a Jehovah's Witness missionary with the little red book and sit down and discuss with you Chairman Mao's thoughts of the day. It was so surreal you had to soak it all in to understand.

I do not want to focus overly on the economic opportunities because I know they are there, with the huge population, the incredibly strong work ethic of the Chinese people, their relatively good education system, and the ties between China and Canada that are growing because of the growing population of Chinese people here.

I cannot resist asking about what I call flashpoints— and this might appeal to the professor. That is, subjects that you cannot talk about without poisoning everything; not that I am suggesting that. I am not talking about Olympic boycotts. The word “patience” comes back. There are some things about which you cannot have rational discussions, such as Tibet, Taiwan and Falun Gong. I live near the Chinese Consul General in Toronto. There are always about 30 people there. There is Darfur and reigning in North Korea.

In recent years I go more to India. I cannot think of any flashpoint that I cannot talk about in India that is in this category. It is not that I want to go over and talk about these thing. I am wondering at what point will their growing integration into the global community help them to understand that if they can have rational discussions on one of two of these subjects it would cause people to take a great big breathe of air and say, “Well!” Do you have any thoughts on this?

Mr. Jiang: Thank you for the observation and question. I want to briefly respond to you. It is a serious problem. Let us take the recent Tibet issue. The Chinese, not only inside China but outside China, and not only the government but the Chinese community, are fully mobilized. It is becoming very emotional. This is a good example of the dilemma where China is. It is growing so fast. It is coming to the global scene so fast that there are many of the things they could not cope with or know how to cope with. They thought they would learn but are not learning enough. They have internal debates all time. I know they have them. I talk to them all the time. I go to China six or seven times every year. I am engaged with those policymakers and the academics and the people who write the internal reports.

Just over a week ago, *The Globe and Mail* opinion editor, Patrick Martin, called me and asked, “Can you help? We have so much complaint about our media coverage on Tibet. Can you write an op-ed to explain why they are up their nose about Tibet?”

I wrote a piece, which I will forward to you gladly. There are historical reasons with regard to Tibet alone; afterwards, we can take Taiwan and other issues. Tibet is where all the modern development contradictions seem to come together. There is a dilemma, a deadlock. There is an issue of sovereignty on both sides. There is the issue of geopolitics. There is the issue of religion, and the issue of economic progress versus traditional culture, and that of overall economic welfare versus environment protection in Tibet.

If we now focus on China versus Tibet, it is a flashpoint of many of these things coming together. There are no perfect solutions. There may be better solutions. As China is moving forward, China is not doing in Tibet anything that it is not doing in the rest of China, in Han China. There is degrading of the environment and extracting of resources. There is lower labour cost. They damage the rivers. They are not preserving like the Tibetans.

I see that dialogue is the way to go. Currently, what would be our impact on China? Our leaders are not on talking terms with the Chinese leaders. That will definitely not help. Let us not talk about the economic side. In order to integrate China — and this is back to your point — into the global society, we must work with them, saying that we need to do this or that, and we are waiting to help you.

We can make high moral ground statements about Tibetan people's rights, but we do not implement any programs. Do we see programs implemented by the current government on improving human rights issues, in dialogue and concrete measures? I hope that is the case.

Senator Smith: I often thought that in North Korea they are in a position to do something much more positive. I know they have done some but they can do more. That does not compromise their pride in the way that perhaps Falun Gong or Taiwan do. Do you have any thoughts on that?

Mr. Jiang: North Korea is now billed as a “China as a responsible power” story. What happened starting yesterday is that China is in Shanghai for the first time hosting the “Five Plus One” nuclear talks on Iran. Everyone is now asking whether China is now shifting initiatives of to do in Iran what they did in North Korea. They have leverages. They have $80 to $100 billion of contracts in Iraq. When the U.S. congress declined CNOOC’s bid for Unocal, after the Noranda fiasco here, all they say is that you do not welcome us in North America. They say that they have all this money, $18.5 billion, ready to invest in the United States, following market rules, that was denied. They asked where does the money go? They go to these troubled spots as seen by many western countries. That is what is happening. To work with and integrate them and let them take some of the leading roles as in North Korea and now in Iran. That is a better way to go rather than saying, “You are totally terrible on this and that.” It is not a black and white picture.

The Chair: Would either Mr. Clark or Mr. Hodgson like to add something on that issue? Very well. We will move on to more questions.

Senator Johnson: How do you foresee the agenda of international institutions, such as the World Bank, the International Monetary Fund and the WTO, evolving in light of the shifting of global economics and the rising prominence of China, India and Russia?

Mr. Hodgson: Perhaps I can start on that because I represented Canada on the IMF for three and a half years back in the 1980s.

There is a separation happening between the IMF and the World Bank. Arguably, if the world were to start again today to create those organizations, it would not create the IMF. It was created at a time of fixed exchange rates and no international capital markets. Now we are in a world of floating exchange rates and open and bloody-minded international capital markets that discipline countries without good policies.

The World Bank is different. There is an ongoing chronic need for development finance. We have an IMF and a World Bank. The world does not know how to shut organizations down.

It is a matter of picking up the pace of evolution and allowing the shareholding organizations to reflect the shifting power relations in the world. That is a starting point. From that, it is a matter of figuring out how to play an ongoing role in terms of rubber-stamping or advising on good policies.

The IMF is aware of this. I think the Government of Canada is. The fact is that Finance Minister Flaherty was there. The fact that there has been ongoing dialogue about changing the ownership structure and influence structure in both organizations is a good thing.

It is difficult for countries that have been shareholders since the beginning — the Western Europeans and the North Americans — to give up power. Yet that is what we are asking them to do. Clearly, if China, India and Brazil are to be taken more seriously, they will have to take a bigger ownership stake in the organizations, have more influence in management and play a larger role going forward.

We are at the beginning of a beginning of a debate about the shift of power and control within places like the World Bank and the IMF. Canada has been prepared to allow the evolution to proceed and try and guide it. Not every industrial country is as willing to give up their influence and power. The U.S. has a central role over this because Congress has a veto in any major decision in both the World Bank and IMF. Ultimately, it returns to Congress to decide whether to make fundamental shifts.

Mr. Clark: With respect to the WTO, India and Brazil have been there from the outset. India was instrumental in designing the current round of trade negotiations and both Brazil and India are on the steering group. Russia will get in there eventually. Likely it will not sooner but later because Russia is not prepared to pay as much to accede as China and Vietnam did, for example.

China is taking it rather slowly with the WTO. They are learning their way. They are acting in a responsible and cautious manner, but they are starting to take positions in the negotiations. They are staying to say, “That is not acceptable to us. We think you should do it this way.” In dispute settlements so far, they have been targets. Pretty soon, they will be challengers and they will be well prepared, well represented and they will not be bringing frivolous cases.

They do not like the way the system is used against them any more than they like criticism on Tibet. However, it is at a different level. That said, they are learning to live with the situation. They make agreements and live up to the agreements. It is a time-consuming process but it is business. There are in the business of business.

As far as the WTO is concerned, I do not see a problem with them being there. I see a much bigger problem without them being there.

Senator Johnson: Right.

Mr. Jiang: I want to add one point. Chinese overseas investment has become challenging to the international financial institutions such as World Bank and IMF simply because a large amount of China's loans are untied.

They go to Africa, for example. Large scale investments often overtake the amount of the World Bank or IMF functions in that continent. They have been welcomed because China does not tell them what to do or make pre-conditions on human rights, good governance, et cetera.

They take a philosophical position saying those issues are for those people to sort out themselves. Many countries in Africa welcome this. Others say, “We experimented with IMF policies for 20 or 30 years and it did not get us anywhere. Now we have these funds coming in to help.”

That challenge will grow. China will challenge the rest and say, “This is the way we want to do things” because they have the money.

Senator Johnson: What about in our own country in terms of our domestic policies to stimulate foreign investment and better engage China as a commercial power? Should we change taxation and immigration systems to serve some of these purposes with regard to China?

Mr. Jiang: Regarding immigration?

Senator Johnson: What kind of domestic reforms of policies should we look at in Canada in terms of stimulating investment in China and better engaging China, whether it is business or otherwise?

Mr. Jiang: This is an absolutely critical year. This year, China is opening up the financial sector. Five years after joining the WTO, all the barriers are gone and are gradually opening up. I did not touch on this dimension because I have forwarded to be translated now a three-part series I wrote for the China brief of the Jamestown Foundation based out of Washington, D.C., called *China Flexes Muscles on Wall Street*. It is three parts covering growing sovereign wealth fund, foreign takeovers and so-called currency wars.

They are now arranging themselves, prepared to do the currency adjustment, preparing their own financial institutions for the foreign investment firms — banks and insurance companies, including Canadian ones — who are coming into China. They are geared up to reform themselves to be competitive in order to face what they call the coming onslaught of big international investment firms into the Chinese mainland. That is what we are looking at in the coming years. That is an important dimension you mentioned.

Senator Downe: In your presentation, you talked about political irritants between China and Canada. You also indicated how the Australians go to China, raise their points of concern and then, on the other hand, do business as well.

What prescription do you have for Canada to get out of the current problem we seem to have with China?

Mr. Jiang: The China Institute at the University of Alberta organized a closed door ”Chatham House rules” expert conference back in January. We had more than 40 experts from the academic world, from government bureaucracy in Ottawa, the private sector and provincial government officials as well. We discussed and debated the whole day. We reached some recommendations. The report will be out soon and we will be happy to provide that.

To summarize: It is important at this moment to think about how to engage the Chinese while at the same time preserving Canadian principles.

I have talked to some of the senior Chinese diplomats here in Canada, and they are waiting. As they say, everything is on the table. If the Prime Minister is waiting to visit China, they would be willing to move. Of course they would like to see a “lower temperature” on the issue of the Dalai Lama which they see as a slap in the face given all the publicity. It is becoming an even more emotional issue. Nevertheless, we see other leaders have gone to China, have raised the human rights and Tibet issue and the Chinese are making it clear they do not object.

Look at the recent criticism they faced regarding the provincial minister of Ontario and the mayor of Toronto's visit saying you cannot raise these issues and whether we should or not. It does not matter to the Chinese. They say, “If you want to raise these issues, do you have a mechanism? We are willing to talk to you.”

I am going to Beijing next month to talk about human rights. It is a project between the University of Ottawa and Peking University. We have been doing that since the mid-1990s. It started with the CIDA-funded first human rights project.

The Chinese are not saying they will not talk about it. The Chinese wanted to talk. We see now that these formulas are not effective. Therefore, the Conservative government has shut down and discontinued the annual human rights dialogue that started with the Liberals. As a non-partisan academic, I said, “Fine. Replace it with something effective.” We all want to participate in some way. Get the NGOs in. Do not do it government-to-government if it is not effective. Get the NGOs, the private sector and the other sectors in. The Chinese are saying that we are welcome, but we have not taken initiatives. The highest initiative has to be from the Prime Minister going there and talking about our problems. The Chinese, through the ambassador, are willing to talk.

We need to take that initiative. Unpleasant as some of the issues are, we need to raise them. It is of great concern to us as Canadians. We have values, and we have talked about that, but we are not implementing them other than making these statements occasionally at the higher levels.

Another problem is the creation of this confrontation between trade and human rights. They are not confrontational. One is not at the expense of the other. We need to implement them both. That is why I said we need a China strategy. We need to work on this with comprehensive study groups, and then move the agenda forward. However, leadership at the highest level is absolutely required.

Senator Downe: I agree. There is obviously a major problem in the relationship. We have not resolved the situation with tourism after years of negotiations.

The Chinese government is obviously very polite. They will engage in discussion, but they will not move on a number of files. Your advice is that it has to be from the Prime Minister directly, at the most senior levels, and has to be done in China as opposed to comments from here to China.

Mr. Jiang: I think China was ready long ago, but there were perceptions that financial criminals have come to Canada. The first line of defence is that China is a human rights abuser and the government cannot be trusted. The lawyer has not even taken up the case and we are already putting up this line. After that, nothing moves.

That is quite a barrier in various cases. It is definitely a block, but it can be removed. However, you need to have engagement at the highest level. They are looking for that; they are looking for give and take.

The Chinese government is a very pragmatic group of people now. They look at Canada and the overall foundation. I personally believe it is very good.

I grew up in mainland China and left there in 1984. In the 1960s, when we were going through starvation, everyone knew, and still remembers, the story about Canadian wheat. It is a great story. Everyone also knew about Norman Bethune. The base is still good.

There are debates among academics and others. Some say that we lost influence over China's impact because we screwed up in the past 40 year. They say it started with Prime Minister Pierre Trudeau who should have never recognized that rogue state in 1974. I say that we lost influence because we stopped engaging the Chinese. We can never make decisive changes inside China, but we can have dialogue with China and make sure that those influences translate into supporting progressive forces inside China to pursue a more open and reform-oriented direction. That is why I am very worried that we are not providing our input for that purpose.

Mr. Hodgson: Our research on foreign policy shows very much what Mr. Jiang has just set out. We talk a lot about getting the balance right. We all understand that our focus on America is Job 1, but China is Job 1(a). Finding ways to engage China at many levels is critical. We, too, have delivered CIDA-funded aid projects in China to try to educate bureaucrats about how to form good policy and how to do economic planning and economic forecasting. We have to return to the day when we were looking for every possible mechanism to engage the Chinese.

You can say things to your friends that you cannot say to your enemies, and you can be more frank with countries with whom you have an ongoing dialogue about human right, democratization and the current challenge to China from rising inflation. For me, as an economist, the biggest short-term threat is inflation rising to 7 or 8 per cent and the peasants rebelling and getting left behind. That is the kind of thing you can say to someone with whom you have a deep relationship that you cannot say to someone with whom you have an antagonistic relationship.

The Chairman: I want to ask about competing with China, particularly in the area of manufacturing. We have heard that it is not only low labour costs, but that it is also the lack of environmental standards, the lack of regulatory safeguards, the lack of the rule of law and the lack of labour unions. Some of our people are asking how we can compete with a state that, in effect, gives you a huge disadvantage to start with, making your product that much more expensive.

Mr. Clark: The situation with the environment is changing rapidly. The environmental protection agency has been upgraded to a full ministry. There are new laws and new regulations.

China is the biggest user of energy, and they need to conserve it. They need to conserve natural resources. They need to keep the economy clean. They have introduced a number of policies that are designed to eliminate high-polluting industries, to ensure that production is more energy efficient and cleaner.

For example, in the last year they took out 50 million tonnes of smelting capacity that was outmoded and outdated. That is about 10 per cent of their total. They have rules about new investments that preclude using antiquated technologies. In a number of sectors, including chemicals, they have policies designed to reduce pollution and emissions and to conserve resources. Wage rates are going up. We have clients who import from China, and they find the since wages have gone up the price of the product has gone up and is no longer competitive.

Industries are moving from the south of China to the north of China because the competitive situation is changing in China.

We imported about $500 million worth of auto parts from China and exported about $300 million worth to China, so there is two-way trade.

Value chains are important, structuring them is important, and building relationships is important.

Things are changing in China. The people in China are not happy with pollution. They want the environment cleaned up. They protest against chemical companies polluting waterways and lakes. They are looking for cleanups too. It is not an overnight process, but it is beginning, and the Chinese are taking it seriously.

The Chinese have introduced measures to deal with global warming. They set up global warming targets that are much more serious than what President Bush announced today. He said that by 2025 he wants to get to the point where the United States is no longer increasing emissions.

Mr. Hodgson: I think Mr. Clark is correct that there is an evolution going on. First, any firm investing in China that tries to have lower standards there is running a huge risk to their business model and their reputation. We have seen many firms that tried to have lower standards for labour that were slaughtered in the media in the West. I think of Nike and many others. That, frankly, is dumb business. I believe that good practice is exporting the North American practice.

You see that in the miners and manufacturers. They have figured out that is an important risk to their business going forward.

Second, there is a lot of noise right now about how we can build a level playing field on climate change and green taxes. Green taxes have been introduced in B.C., and I can see it coming with the next U.S. administration. There are rumbles around green tariffs where we may end up imposing an import tax on things coming from China and other countries that do not adhere to some future agreement. We are already looking at ways to create a level playing field going forward, but I put most weight on the reputation risk. If I were advising any company, I would advise them to develop the same kind of standards we are putting in place here in Canada.

Senator Peterson: You pointed out that the Chinese government purchased most of the American debt. I read recently that they are bailing out and buying Euros. Is there any potential impact on North America related to that?

Mr. Hodgson: First, they have not purchased most of the debt, but they have a large share, as do the Japanese, and increasingly sovereign wealth funds are now sources of investment in American treasury bills. The impact is obvious. If foreign governments and their agents do not buy U.S. paper, it will put upward pressure on long-term interest rates in the United States. It is actually ceding control of U.S. economic destiny to those investors. Part of the reason I have talked about global imbalances and the fact that the U.S. has had such huge structural deficits up to this point is because, one day or the other, the bond holders will be in charge, and that is the risk the United States runs.

The U.S. is in a much more serious short-term situation around subprime, but those structural imbalances are still there. Japan, China and other bond holders will have a lot of leverage on the U.S. economic policy going forward.

Senator Peterson: Do you think the Chinese currency is fairly priced vis-à-vis other world currencies?

Mr. Hodgson: Given the fact that it is pegged to a basket, it is hard to come up with the right price. It is interesting that it finally broke through 7 Yuan to the dollar and is up to 6.90 or 6.95 and heading in the right direction. Over the long-term, I would think an exchange rate of something like four to one and not the historic eight to one would be more reflective, and maybe beyond that.

I like that Professor Jiang talked about purchasing power parity as the comparator. If you use PPP, China's share of the world goes from 5 per cent to something like 15 per cent. That would suggest three or four to one is probably the more accurate long-term reflection of the exchange rate.

Mr. Jiang: I wish to add one point on the currency side. The Chinese are having an internal debate. I had a conference there over two weeks ago with some new findings presented by Chinese Academy of Social Sciences researchers on this front. They do not know what to do with this $1.37 trillion. The more they buy into U.S. treasury bounds and see the U.S. dollar declining, they are losing these assets. They cannot stop buying them either because where do they go?

You have the sovereign wealth funds of the established state-run China Investment Corporation, CIC, putting $3 billion into Blackstone and in only a matter of months they lost over 50 per cent of the value. They do not know what to do when facing internal pressure. The problem is they have too much. They have followed a traditional mercantilist paradigm in accumulating all the currency surplus. They really have no way out. It is not good to buy; it is good to buy. It is a catch 22 situation, and we are continuing to see this. However, if they want to reduce inflation pressure internally, the only way to go is to increase the value of their currency vis-à-vis the U.S. dollar.

The Chair: Thank you for that.

Senator Corbin: I appreciate everything our witnesses have told us today, and I look forward to reading the documentation provided to the committee.

I have two questions. I will claim some ignorance, but I would like to be enlightened about the facts. Was it one or two years ago that we blocked the attempt by a Chinese company to take over a Canadian oil company? That is a fact, is it? Could you tell us about it? Can you conclude by saying whether that was a good or bad move on the part of Canada?

Mr. Jiang: I do not recall that we actually blocked an oil company from being purchased. It was Noranda, which is Canada's large mining operation, a global sized company, being purchased by China Minmetals, China's largest metal company. That was in the fall of 2004, early 2005. It fell through not because of any political measures taken in Canada to block it; it eventually did not go through. At that time in Canada we had a negative national discourse against this deal proceeding because it became a debate about whether Canada's sovereignty was at stake or not. That did not go through, primarily due to business reasons. That was a small, miniature debate in comparison with China's national offshore company CNOOC trying to bid and purchase Unocal, which is the ninth-largest U.S. energy company, in fall 2005. Since then, we have only had problems regarding investment and not takeovers.

The largest is the over $4-billion purchase of PetroKazakhstan's assets, which is a Canadian firm based in Calgary, but the assets were all in Kazakhstan.

Senator Corbin: That came from the dark ages of my memory. Thank you for clearing it.

What proportion of the national economy does Chinese defence budget represent?

Mr. Jiang: The Chinese have about 2 to 3 per cent of its annual GDP figures devoted to that, if my memory serves me right. It has increased about 15 to 17 per cent in the past close to 20 years. It sits at just over $35 billion annually, but that would not include some other costs. The estimates by international observers, by the United States, is probably anywhere from two to three times, or even higher, as much as the claimed budget. Therefore, the Chinese tend to argue saying that China is somewhere between $30 billion to $50 billion, but where is the United States? It is over $500 billion, right? It is approximately the total volume of the rest of the world combined. That is the argument, and some people say China's defence budget may be as high as $120 billion if you include all the R&D and the space program and the nuclear program that are not included in the military budget. I could be wrong; others can correct me on that.

Senator Corbin: Do the Chinese use defence products to leverage trade negotiations with developing countries, for example in Africa? Are you aware of that?

Mr. Jiang: Let us take the Africa case. The African case is not primarily through arms deals because most of China's investment, 71 per cent to be precise, is in the energy sector. Others are in other resources. China does provide what international observers call basket solutions, which give you not just oilfield and resource site development but building infrastructure, providing schools, doctors and other development assistance. They believe a better comprehensive relationship forged will facilitate resource extraction locally.

If you look at the figures of arms exports, for example, China is being criticized for exporting arms to Sudan. China is the largest trading partner with Sudan. However, Russia and many other countries export far more arms to Sudan. Overall, on the international scene, China is a smaller player in arms dealing when compared with the United States, France, Israel and Russia.

Therefore, to answer your question, yes, China provides incentives, but not from the angle of arms deals. I have not heard preconditions because China's so-called loans and investments are officially “anti-.” Of course, they say that, but there are always implicit terms in there such as developing oil fields and other things.

The Chair: I was saying to our researcher that we seem to have focused totally on China tonight, but that is fair enough. We will have other sessions where we will focus on Russia and India.

Senator Corbin: You have a lot of reading.

The Chair: Yes, there is and we apologize. We did not get the material in time to have it translated and we have a rule whereby we cannot distribute it unless it is in both official languages. However, we will distribute it as soon as that is done.

Senator Stollery: I will bring Russia into the conversation but, first, I would like to thank the witnesses because the testimony has been extremely interesting.

My first question is a follow-up to the conversation on the Chinese reserves, the famous $1.6 trillion or whatever it is. At the OECD, I have heard a figure that adds — and no one knows what it is — how much is held privately. We are talking about the state reserves, but what was brought to my attention is that because the banking system is not well-organized and the figures are not readily obtainable, what happens to private money that Chinese manufacturers have “under the mattress”? That was the term described to me by people who follow this closely. It was suggested that there could easily be the same amount of money held privately in the western banking system in Hong Kong and under the mattress. No one really knows.

However, my question brings Russia into the conversation. I am sure I am not the only person who saw the lead article in the *Financial Times* yesterday about Russian oil production having reached its maximum. I think it was about two or three years ago that Russian oil production reached its maximum. It is said by the largest private Russian oil company that Russian production will now start to decline as is happening in other oil fields. I thought that was extremely important because fields deplete.

Would this not cause some concern? Russia has all those arguments over pipelines and where they will go. It is difficult to follow unless you specialize in it. What happens to this massive economy and this massive development — development on steroids as Mr. Jiang said — that depends so much on energy? What happens when the energy starts to deplete?

I could be wrong, but I would have thought that the largest source of petroleum products for the Chinese would probably be Russia. I do not know if they have a pipeline from Kazakhstan. Is there a pipeline from Kazakhstan to China or does it go through the Russian pipeline system?

Mr. Jiang: Kazakhstan's first pipeline for exporting oil beyond former Soviet republics went to China two years ago.

Senator Stollery: I see. However, Russia is either the eighth largest producer of oil in the world or the second largest producer depending on which source I use and is the largest producer of natural gas. What happens and what must the concerns be of the Chinese leadership with the prospect of these fields being depleted?

Mr. Hodgson: I seem to the token economist on the panel.

I think you just explained with the example of Russia and China juxtaposed why oil is at U.S. $115 per barrel now. We entered a phase globally where there is no easy politically safe oil to tap into except for the oil sands in northern Alberta. You have seen the story over and over again.

You are hearing stories out of Venezuela where Petróleos de Venezuela is a state monopoly and is not doing a good job of secondary and tertiary extraction. Oil is getting hard to find. It is always in politically riskier places.

We have tapped out new exploration in the North Sea and Alaska. Canadian conventional oil production is also dropping on an annual basis and we are starting to fill in behind with the oil stands. This is a global story. China happens to be the reason why on the demand side prices are at $115 per barrel because they have added between 6 per cent and 8 per cent annual growth to global demand on an ongoing basis.

Senator Stollery: Where does this all take us?

Mr. Hodgson: It has not been reflected in real prices being charged to Chinese consumers. If anything it has added to the subsidy bill for the Chinese government.

Mr. Jiang: The Chinese have an overall energy strategy termed “pipelines from the north; oil tankers from the south.” In order to reduce the dependence on sea lanes which they believe are vulnerable, they developed a broad relationship with Kazakhstan in the past five years. They have extensive ownership and operation there and are going into all the former Soviet Central Asian republics.

Developments are very slow with Russia though. In the North Sea part of China, they have been negotiating a pipeline with Russia for many years. Russia plays off between China and Japan as to whether the pipeline will go to Japan through Hokkaido or into China. They have still not come to a conclusion.

However, the Chinese are very pragmatic. They said we negotiated a pipeline which is the best way to ship more oil. They have offered to help Russia upgrade their rail systems from the Russian far east into China and then Russia will not have to pay for it, just ship China the oil as a payment. The Chinese have been doing that in the past four or five years. I have talked to the people engaging in this.

Back to the overall picture of the global oil supply, the peak oil theory has been predicting the peak of oil for a long time. Russia is, overall, the third largest comprehensive energy producer and the largest in gas. In regard to oil, however, there are two arguments. One argument says that production has peaked. Others say there is more technology and potential for other fields to be developed.

The key issue here is not at which point production has peaked. It is that the global energy exploration costs in oil and gas has skyrocketed now. For upstream development today, in comparison with three years ago, you are paying about 70 per cent or 80 per cent more, and downstream is even more expensive. We can say maybe not peak oil, and depletion may not start, but surely the cheap oil era is over and we are into the expensive oil era. That is the situation now.

Senator De Bané: As our time is very short, I would like to put three questions to our three witnesses, and each of them could take just a minute to answer.

Mr. Hodgson, I would like very much to have the 60-page study that you prepared. How do you see that international financial institutions, either the IMF or others, must be modified to accommodate those new emerging powers?

Mr. Jiang, I thank you for your article about Tibet. You opened my eyes as to why the Diaspora around the world is absolutely behind the government on that issue. I have learned a lot reading your article. I would like you to tell me, in a few words, what the federal government's position should be on the issue of state-controlled corporations from China buying Canadian companies. In your opinion, what should the position of the Government of Canada be on that?

Mr. Clark, I have read your CV. Your experience is awesome. I thank you for what you are doing with charitable organizations, in particular for terminally ill children. This is very commendable. As one of our top experts on trade, to what extent should Canada think about changing some of its trade remedies like countervail, antidumping safeguards, et cetera, in view of those emerging countries? When I was a kid, Asia was not a competitor. It was a laughing stock, Japan included. Today, however, it is a different matter. Can we do something about it? When we went to Mexico on the tenth anniversary of NAFTA, they told us they were so happy to have all those big American manufacturing companies locate here after NAFTA, but all those companies have now left for China.

Mr. Hodgson: Perhaps I will separate the issue of ownership and control and the powers of the international institutions. We are on an evolutionary course now where the emerging market countries, be it China, India or Russia, are expecting more of an influence on the governance of the organizations, either as shareholders or through the decision-making councils. I do think that the forum that is most important for the emerging markets going forward will be the WTO, because it will be a matter of creating a level playing field around trade rules. For me, the IMF is an organization created for another time that is looking for a raison d’être. The World Bank still has a relevant role, but it is really the rich countries that provide the capital that allows the soft loans to be extended from the World Bank.

Mr. Jiang: I would say we should look at what other countries, even our provinces, have been doing with China. The Australians and the European companies, with some European reserves on the continental side, but Britain and Japan are saying that they want China's investment going there. It does not matter if it is state or private owned. The sovereign wealth funds are welcomed. They need them to stimulate their own market for their own jobs. These countries studied China more extensively, especially Japan. They figured it out. There is no way the Chinese can take over their economy, not even close. That is their conclusion. However, they can help and save and create jobs, value-added, and all that stuff. Our provincial governments, especially in the western part of Canada, and all these U.S. state level officials and legislators have been telling Chinese to their face, clearly saying, “We are not taking the federal government's position. We welcome Chinese investment, private owned or state owned.” They have done extensive studies, consulted people on the ground in China, and concluded that with our current regulatory framework, we are adequately dealing with any kind of Chinese coming to invest in our economy. This is our side and that of other like-minded countries.

On the Chinese side, they have definitely learned the lessons of Noranda and Unocal. In the past several years, in one of the three articles, I have identified that. Their lesson is not to be aggressive, to be low key, to go outside and take only minority shares and go slow. When they take over a company or bait with shares, they team up with a local company, as with the United States. That is the approach they are taking. They want to have profits. They want to be on the equity and production side. Therefore, for anything produced in the market, with energy resources and prices rising, they can make profits. If you look at the margins and the percentage of oil produced by Chinese companies around the world, very little of them ship back to China. They just sell it on the market in the world. We do not have any fear that the federal government's position should say clearly to them, “Come,” because we should be confident with our regulatory framework saying this is fine.

Mr. Clark: Thank you very much, senator, for your kind words. Our trade remedy laws are as effective as those of anyone else in the world. The Chinese government would like Canada, like 70 other countries have, to recognize for dumping purposes that they are a market economy. There has been resistance to that within the government. They have not done that. However, the Canadian laws are as effective as the American's.

With respect to countervailing duties that you mentioned, China reached an agreement with the United States last November to eliminate a number of subsidies, which they are now implementing, so that reduces it. In most cases, if you investigate the Chinese for subsidies, you get very small amounts because there is not enough to go around with all of the companies there to make a big impact. The trade laws have been pretty effective in dealing with steel, and they are as effective as anyone's in the world. When you get into other areas like footwear, bicycles and furniture, they will not be as effective because there is no real state involvement in those industries.

The Chair: I was struck by a comment made by Mr. Clark when he said in Beijing or maybe in other places in China that we are just wishing to soon catch up to the U.S. Is that correct?

Mr. Clark: It was not so much the U.S. as France and Germany and New Zealand in some areas and Australia. They are really developing those markets, and they are developing ASEAN. We are far too slow to get off the mark and negotiate trade agreements in ASEAN, in Asia and with China in order to get into the value chain. It is going over as well as coming back, sir.

The Chair: I was curious as to whether these young Chinese were referring to just the economic success, or are they also looking at things like labour laws, religious freedoms, civil society, the rule of law and so on? Are they aware? Are they looking at what else comes from France, Germany, the United States and the rest of the world?

Mr. Clark: They are looking very much at it from a consumer perspective. I have not discussed religion with them. I learned early on that we are not supposed to discuss it at the dinner table either, so I do not discuss religion with them.

With respect to laws and freedoms, I personally have not felt terribly oppressed when I am in China, and I have been there quite a bit. There may be situations where the Chinese feel that they are not as free as they might be, but I certainly get the impression that they feel freer than they used to be. I worked with Chinese lawyers. They have well developed practices. They are continuously looking to other jurisdictions to build their own laws and regulations. We do a lot of work with Hong Kong, the administrative region of China. We provide them with all kinds of information on everything Canadian in terms of regulatory systems and building codes. They are insatiable for information.

The Chairman: I was not trying to be controversial. I was sincerely interested in the development of the Chinese society. The jailing of a dissident is not acceptable in our society. Is this something that the Chinese masses, particularly the young educated people, are looking at and seeing as one of the areas where they would like to be like other parts of the world?

Mr. Clark: When I cannot agree on an issue with younger people in the government, when I talk to their colleagues, they say, “It is not that they do not agree with you; it is not politically astute to agree with you.”

The Chairman: Thank you for that. Gentlemen, you have all been very informative. Your presentations have been exceptional, as you heard from our colleagues. I can assure you that your comments will be appropriately reflected in our reports, and I expect that they will be positive. Thank you for coming. We certainly appreciate it.

The committee adjourned.
