



# **The Rising Prominence of China on the World Stage: Canadian Opportunities in a Shifting Global Market**

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## ***Introduction***

In 2014, Chinese Premier Li Keqiang proposed a plan called *Made in China (MIC) 2025*, which has gained worldwide attention. The purpose of *MIC 2025* is to transform the People's Republic of China into a manufacturing leader through multi-phased innovative strategies. *MIC 2025* has been criticized by policy makers in the United States and European Unions because it challenges their current economic power and repositions China as a global economic power. The industrial modernisation process in China creates an enormous demand for economic and technological collaborations with international stakeholders. While not an economic powerhouse, Canada needs to grasp this opportunity to diversify Canadian imports and exports trading partners and enhance joint research initiatives in science and technology between the two countries.

Global uncertainty from the U.S.-China trade war has led to tariffs and strict restrictions on technology transfers. This has particularly hurt businesses in Canada, as China and the U.S. are Canada's largest trading partners. Compared to China and the U.S., Canada faces challenges in pushing forward an innovation-driven economy due to a lack of risk-taking investment culture and limited market size. With regard to the rapid evolving international context, Canada should become a more active player to address economic weaknesses, avoid heavy dependence on its trading partners and explore Canada's innovation potentials. In order to enhance its own economic and political powers, Canada requires a deeper understanding of the new innovation dimensions and directions in China.

This report aims to discuss how Canada should adjust its policy strategies and priorities to establish an innovation-driven economy, while considering China's changing approach to trade and innovation and the tension between U.S. and China. In the first section, it explains how *MIC 2025* emerged and explores the key content of the plan. Section 2 discusses the current relationship between China and Canada. It identifies the key considerations, risks and challenges in Canada of *MIC 2025*. In section 3, the report provides strategic recommendations to the Canadian government on how to leverage Canadian strengths to respond to the rising prominence of China on the world stage and how Canada should manage its position navigating relationships with two superpowers in the context of the U.S.-China Trade War.

## ***Section 1: Background Information***

### ***Strong Signals: China's changing approach to trade and innovation***

Over the last four decades, China has adopted several reform strategies and made progress in integrating with the global market economy. Domestic institutional reform and trade liberalization policy has allowed China to establish economic relationships with the rest of the world, contributing to continuous sustainable economic and social development in China (Zhu, 2012). As China joined the global market economy it showed strong economic growth rates, outpacing western markets like Canada.

In terms of China's level of global integration, evidence illustrates that China has achieved global scale in eight dimensions in the past few decades: (1) Trade; (2) Firms; (3) Capital; (4) People; (5) Technology; (6) Data; (7) Environmental impact; and (8) Culture (Woetzel et al., 2019). For example, China has been the world's largest goods and services trading partner since 2013 because it has comparative labour-cost advantages in terms of specializing in

manufactured products. The banking system in China has also become the largest in terms of assets, and its stock and bond markets are the second and third largest globally, respectively (Woetzel et al., 2019).

Despite this growth in the past 40 years, China's annual economic growth rate has gradually slowed down, and as of 2018 has remained around 6.6% (Congressional Research Service, 2019). There are several factors explaining the stagnation of economic growth in China:

1. Increased production costs, insufficient innovation capacity and a reliance on foreign technology has limited expansion of the manufacturing industrial sector in China (World Bank, 2012):
  - China's manufacturing industry is large due to the surge of foreign direct investment, cheap labour, the rising demand for commodities and necessities, regulations and policies in supporting the industry.
  - Manufacturing costs are continuously rising in China, in comparison with other developing countries. As a result, large enterprises have moved production and business to developing countries such as the Philippines, Malawi, and Bangladesh.
  - Even though manufacturing capacity has been enhanced with the support of foreign techniques, the quality of goods and services is unable to meet the needs of consumers in developed countries because of insufficient domestic innovation capacities.
  - Large and medium-sized industrial enterprises account for less than 1% of Research and Development (R&D) expenditures (Wu & Zhu, 2015). Core technologies and high-end equipment in firms are highly dependent on foreign countries.
2. Brain drains:
  - Increasing numbers of students who study abroad and seek development opportunities overseas. Data from 2008 showed 1.4 million students abroad and only 39,000 returned after their education (Guangzhou Daily, 2009).
  - Increasing the innovation capacity and adjusting the economic structure requires a large number of high-level talents returning from abroad to apply their knowledge domestically.
3. Changes in demographic structure threatens economic and social development in China (World Bank, 2012):
  - Aging population decreases the size of the workforce, reducing labour productivity and slowing economic growth.
  - Costs for China's centralized social services (Medicare, pension plans, and other social security benefits) are increasing, generating a fiscal burden.

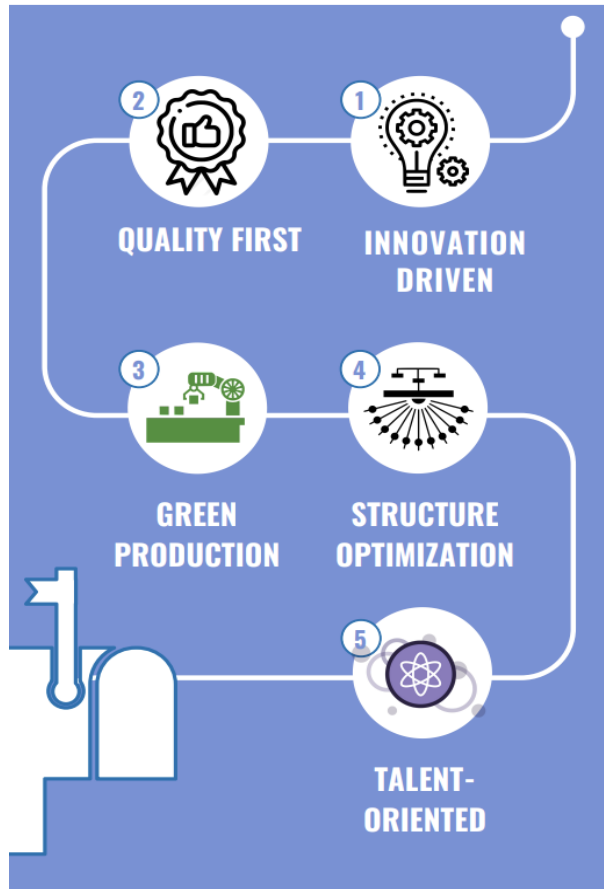
What is “Made in China 2025”?

*MIC 2025* is a new industrial and innovation policy proposed by Chinese Premier Li Keqiang. The plan, officially adopted in 2015, is intended to address China’s current dilemma of a middle income trap, innovation barriers, heavy dependence on foreign technology, lack of skilled workers and an aging population by improving the quality and innovation capacity of its manufacturing industry by December 2025 (US Chamber of Commerce, 2018). The impact of *MIC 2025* has been widely studied in the U.S. and the European Union, but has not yet been fully reviewed and analyzed from a Canadian perspective. *MIC 2025* establishes a framework that identifies multi-faceted objectives, strategic priorities, direction of actions, and policy tools for China. MIC was inspired by Germany’s plan for reindustrialization *Germany Industry 4.0*, which emphasizes industrialization, digitalization, networking and smart green production. Unlike *Germany Industry 4.0*, *MIC 2025* uses a top-down approach, with the central government responsible for executing strategic planning and distributing tasks to China’s provinces and municipalities (EU Chamber of Commerce in China, 2017).

*MIC 2025* clearly indicates five guiding principles, four basic principles and ten key priority sectors to enhance its manufacturing ability in 10 years (State Council of the People’s Republic of China, 2015). The five guiding principles are the targets *MIC 2025* would achieve and the four basic principles represent how the government of China would approach its targets.

MIC 2025's five guiding principles (targets)

## Five Guiding Principles



1. Innovation-driven: realize the transition from “Made in China” to “Created in China.”
2. Quality first: increase the demand for Chinese manufactured goods and services by enhancing quality of domestic products.
3. Green production: apply energy-saving and green technologies to prevent environmental contamination and initiate social and environmental reforms in China.
4. Structure optimization: make structure adjustment and change to service-oriented manufacturing by modifying regulations and legislations.
5. Talent-oriented development: establish a mechanism that manages high-skilled workers and cultivates professional and technical skills in workers domestically.

Figure 1. MIC 2025's five guiding principles

# Four Basic Principles

**MARKET-DRIVEN WITH LESS GOVERNMENT INTERVENTIONS**



**PRAGMATIC AND FLEXIBLE PLANNING PROCESS**

**HOLISTIC ADVANCEMENT AND BREAKTHROUGHS IN KEY AREAS**



**INDEPENDENT DEVELOPMENT AND OPEN COOPERATION**

1. Market-driven with less government interventions: the central government will serve a supporting role in implementation and execution of MIC.
2. Pragmatic and flexible planning process: China will observe new scientific and technological trends before making any decisions.
3. Holistic advancement and breakthroughs in key areas: Prioritize and reallocate the current natural, capital, human and technological resources to priority sectors.
4. Independent development and open cooperation: Chinese industries should avoid reliance on foreign technologies by developing their own technology. Collaborating with foreign firms to transfer technology and reducing trade and investment barriers to do businesses in China.

Figure 2. MIC 2025's four basic principles

*MIC 2025's ten key priority sectors*

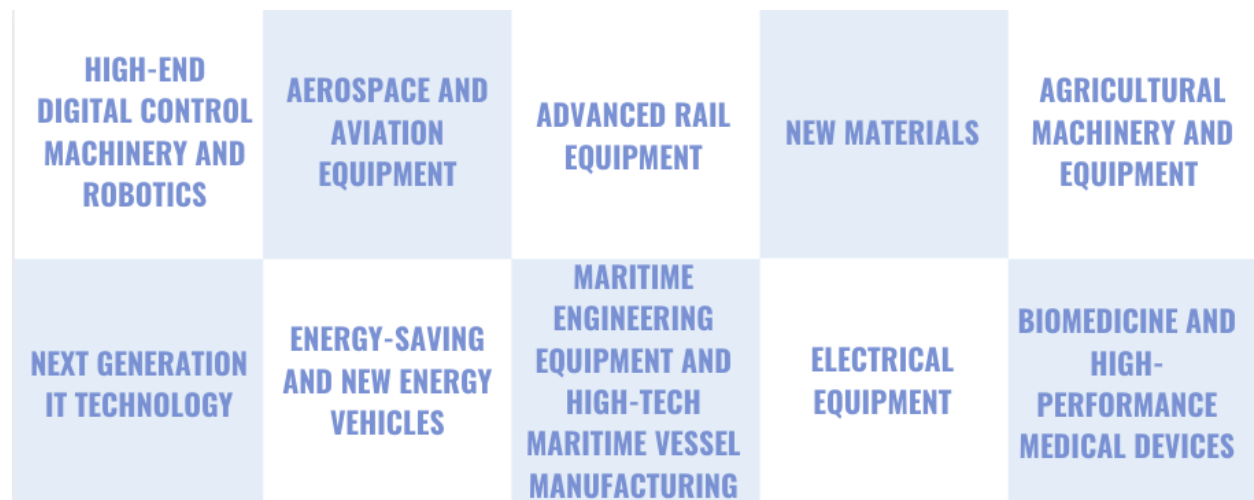


Figure 3. *MIC 2025's ten key priority sectors*

**Next Generation IT Technology:**

- Focus on integrating circuits and special equipment, and improving operating systems and industrial software. This includes the domestic development of fifth generation mobile communication (5G) technology.

**High-end Digital Control Tools and Robotics:**

- Standardize robot production and expand the use of robots in autos, machinery, electronics, heavy manufacturing industry, chemical engineering.

**Aerospace and aviation equipment & Maritime engineering equipment:**

- Accelerate the innovation process and develop heavy-duty helicopters, next generation transport rockets as well as heavyweight transporters.

**Advanced rail equipment, Energy efficient and new energy automobiles, & Electrical equipment:**

- Focus on the concept of green production by applying new materials as well as new energy-saving technologies and establishing digitalized intelligent networks in these three priority sectors.

**Agricultural machinery:**

- Adopt high-end agricultural equipment for major production processes such as cultivation, management and harvesting and digitalize the agricultural process through continuous research and development.

**New materials:**

- Focus on developing and promoting special new materials for military and folks such as high-performance structural materials, functional polymer materials and advanced composite materials.

Biomedicine and high-performance medical devices:

- Accelerate innovation and industrialization level of medical devices through the development of medical robots, high value medical technologies.

*MIC 2025* is an industrial plan that outlines the innovation and manufacturing objectives China would achieve in 10 years. As China is one of the largest trading partner, Canada should seek opportunities to collaborate with China so as to promote free trade and establish new joint research and innovation initiatives in key priority sectors between two countries.

## ***Section 2: Canada and MIC 2025- Key Considerations, Risks and Challenges***

The new world-wide industrial revolution focuses on digitalization and innovative technologies, with countries including Germany, Japan, the U.S. and China already having taken action by making large investments in digital technology. The competitive landscape of global manufacturing has been reshaped. Canada is behind, and needs to take action if it wants to be a part of this industry-wide digital transformation. This will increase the competitiveness of Canadian companies on the world stage and benefit all Canadians through integrating advanced technologies in daily life.

The status and implications of *MIC 2025 are important to Canada*. Researchers and scholars have evidenced that Canada's future will largely be determined by its "geo-political and geo-economic relationship with two powerful rivals," the United States and China (Duckworth, 2018). Canada's diplomatic relationship with China started in the 1970s. Canadian Prime Minister Pierre Trudeau was a global trendsetter who reached out to China and got access to the Chinese market for Canadian businesses in 1973. Since then, bilateral cooperation between Canada and China has included trade, energy and resources, science and technology, education, and culture (Asian Institute and China Open Research Network, 2019). In 2017, Canada and China extended a bilateral free trade agreement, with the intention of continuous mutual economic benefits and enhancing Canadian and Chinese economic growth (Ozelkan, 2018). Additionally, both countries have collaborated on the global stage through the United Nations (UN), World Trade Organization (WTO) and Asia-Pacific Economic Cooperation Organization.

*MIC 2025* signals China's plan for the future of its global industry, investment, innovation and trade. Canada is a multicultural country that has abundant natural resources. With the urgent need for international research collaboration in China, Canada can take advantage of its resources to enhance its economic power through active trade and research partnerships with Chinese stakeholders. Canada needs to take into consideration several key factors and challenges it will need to address its relationship with China, given Canada's domestic priorities, policy landscape and other relationships and how these can align with the commitments China has made through *MIC 2025*.



***Key Consideration 1: Canada currently faces similar challenges in enhancing its manufacturing power and innovation capacity to China.***

- Insufficient research and development (R&D) expenditures in Canada’s business sector.
  - Federal and provincial governments support innovation and R&D through financial incentive programs for small and medium enterprises.
  - Start-ups face challenges when conducting R&D themselves and navigating partnership opportunities with post-secondary institutions within the Canadian context because they lack sufficient initial capital endowments, human and technical resources. As research and innovation involves high risks and uncertainties, universities and colleges prefer to build strong research partnerships with larger sized firms.
- Canada’s intellectual property legislation and regulatory frameworks restrict innovation. There is an inconsistent approach to research and innovation incentivizes for conducting R&D in Canada.
- There is a lack of jobs for high-skilled workers, experts and professionals in science, technology, engineering and math (STEM).
  - One in four STEM graduates from the Universities of Waterloo, British Columbia and Toronto worked outside Canada, mostly in the United States. For companies like Microsoft, Google, Facebook and Amazon.
- Canada’s aging population and changing family structures has led to fewer people entering the workforce, resulting in lower labour productivity and production capacity, and threatening economic growth.

***Key Consideration 2: Canada’s economic strengths and key initiatives align with China’s investment interests.***

- Agricultural machinery equipment: Canada has a comparative advantage in smart agricultural technology, applying modern digital information technologies to enhance agricultural productivity and efficiency. Canada has the opportunity to export smart agriculture equipment and technology to China and establish crop optimization research collaborations between post-secondary institutions and industries in both countries.
  - The co-development of smart agriculture technology mutually benefits economic growth in the short run. With greater production capacity in both countries, there might be an increase in demand for canola and soybeans, key Canadian exports. Canadian exporters should expect to see continued export growth in these products in the next 5 years.
- Green technology: Environmental protection and climate change are one of the Government of Canada’s top priorities. MIC 2025’s emphasis on clean energy and green production processes aligns with Canada’s goal of “achieving a net-zero

emissions economy by 2050” (Government of Canada, 2019). It is possible that Canada could create green production and development mechanisms that integrate green technology into the industrial supply chain, the innovation creation chain, and the resource collection and distribution chain and export these technologies to China.

- Canada and China may jointly accelerate the development of alternative energy and new technologies (e.g. water recycling, wind and solar powers, carbon capture technologies) to reduce contamination and support sustainable development.

### Challenges to Canada in light of MIC 2025

**Challenge 1:** *MIC 2025 is a government-led industrialization plan, which distorts the global market and limits the opportunities for trade and investment in Canada.*

- The overall implementation process of MIC 2025 is government-led rather than market-driven. The central government in China is the dominated investor and provides multiple financial incentive programs to support its innovation and industrial strategies directly. The government subsidizes several industries such as semiconductors, smart manufacturing, agricultural equipment and electric batteries.
- The Chinese government protects and fosters the development of Chinese enterprises by restricting market access for foreign companies and extending the licensing process, particularly to foreign technology suppliers such as telecommunications and ship building.
- The restrictive regulations and direct subsidies will enhance the competitiveness of domestic companies in the global market. In the long run, this protectionist strategy hurts the industrialization process of other countries because innovative Chinese products will be substitutes for those from other developed countries (e.g. Germany, the United States, Canada).

**Challenge 2:** *The Chinese government applies data control, and information and internet monitoring processes policies for foreign businesses collaborating with Chinese enterprises.*

- MIC 2025 emphasizes digital applications in the manufacturing industry and the establishment of a global industrial chain system. In order to achieve this goal, the Chinese government is implementing data and cyber laws such as the *Cyber Security Law (CSL)*, which might put foreign supplier’s proprietary industrial data at risk of being co-opted by the Chinese government. This might limit the incentive for entry of foreign companies into the Chinese market, because of the risk to their intellectual property.
- Chinese e-commerce and information technology businesses including Huawei, Xiaomi, Alibaba and Tencent have become more prominent on the world stage, and their approach to personalized data collection has created tension with Western markets, including Canada.

- The U.S. government formed the process of “national security review” to restrict American companies from doing business and using information and communication technologies from China. Huawei, one of the fast-expanding global telecommunication equipment and services industries, has been dragged into the U.S.-China trade dispute. The U.S. added Huawei and 70 affiliates into its “Entity List”, stating that Huawei is prohibited to purchase parts and components from U.S. businesses without the federal government’s permission. This also restricts Huawei by limiting the service activities and market accessibility in the United States. In December, 2018, Huawei’s CFO Meng Wanzhou was arrested by Canadian authorities and charged with “conspiracy to defraud multiple international institutions.” Canadian, Chinese and U.S. officials were all involved in the extradition process. The arrest of Huawei’s CFO created an ongoing diplomatic and economic rift between Canada and China (Stewart, 2019; Reiff, 2019).
- China’s data and internet control regulations create barriers for Canadian enterprises in collaborating and investing with Chinese e-commerce business sectors by posing risks to Canadian intellectual property.

**Challenge 3:** *Moving towards new innovative industry in Canada requires coordination both domestically and internationally.*

- The issue of information asymmetry arises because Canadian decision makers are unable to get comprehensive and precise information on emerging smart manufacturing policies in China. Implementing further Canadian domestic, bilateral and international policies requires the support of sufficient evidence-based information that is currently difficult to get from China
- Domestically, adjusting Canada’s direction on industrial and innovation policy requires co-operation among all government orders, private enterprises, post-secondary and research institutions, and with foreign investors.
- The difficulty of coordination limits the talent to develop and commercialize new innovations that could generate mutual benefits for both Canada and China.

**Challenge 4:** *US-Canada-China relations*

- On March 22, 2018, the U.S. president Donald Trump announced tariffs and other trade barriers on USD \$50 billion worth of Chinese goods, following Section 301 of the Trade Act of 1974 (Diamond, 2018). Trump claimed that the increased tariffs on Chinese imports would help to reduce the federal government's deficits and increase a fair-trade environment among all its trading partners (The White House, 2018). In addition to tariffs, the US planned to restrict direct investment from China to protect America’s intellectual property.
- On April 2, the Chinese Ministry of Commerce increased tariffs on 128 products imported from the U.S. such as airplanes, cars and steel piping in response to the action enforced by the U.S.. Since then, the trade dispute between China and the U.S. has continued so far (Lynch & Rauhala, 2018).

- Once Huawei CFO was arrested by the Canadian Justice Department on bank fraud charges, China imposed trade bans on Canadian exports primarily canola seed products, soybeans and peas in 2019. In late June 2019, China also added other trade barriers on Canadian meat exports. These product bans had negative impacts on Canadian producers and farmers, particularly those in the agricultural sector. However, China has substituted certain Canadian exports for the now-banned American exports as the result of trade war, which boosts the demand for some goods such as lobster (Business Develop Bank of Canada, 2019).
- Canada, U.S. and Mexico signed the new Canada-United States-Mexico Agreement (CUSMA) in 2018, replacing the North American Free Trade Agreement (NAFTA). Clause 32.10 under CUSMA affects how Canada negotiates free trade deals with non-market economies, which makes Canada to tie with China harder. According to Article 32.10, if Canada wants to negotiate trade deals with non-market economies including China and Vietnam, Canada needs to notify other CUSMA members three months in advance and CUSMA countries are allowed to review any new free trade deals that Canada makes (Gibillini, 2019). Under this condition, Canada requires to balance the trading deals between CUSMA and China cautiously.

### ***Section 3: Canadian Policy Action***

In light of the key considerations and challenges above, Canada is in a difficult position in regard to trade and investment with China and moving towards a new domestic innovative manufacturing industry. However, *MIC 2025* shows a shift in Chinese government priorities and a willingness to operate more openly on the global stage, creating a window of opportunity for Canadian action. Based on the current context, Canada should act on trade, foreign direct investment and domestic innovation.

Below are actions the Canadian federal government should take in order to capitalize on the opportunities presented by *MIC 2025* and mitigate the conflicts between Canada and China.

#### **1) Canada: China Trade**

- Improve information sharing network among industry associations and chambers of commerce from China and Canada.
- Renegotiate the Canada-China bilateral free trade agreements to:
  - Reduce tariffs on certain products for both countries;
  - Eliminate the current trade ban on Canadian agriculture products; and,
  - Enlarge the exports and imports in areas of mutual interests.
- Promote cooperation between two countries through Canada China Trade Conference and China International Import Expo.

## 2) Foreign Direct Investment in China

- Increase transparency by implementing disclosure mechanisms, which will help to obtain extensive and accurate information about the foreign investors and FDI inflows.
- Implement screening mechanisms and form processes of national security review with regard to foreign investment activities.
- Enhance capital investment in the agricultural industry and environmental sector for both Canada and China.

## 3) Domestic Innovation

- Increase Canadian domestic research and development investments in smart agriculture, green technology, and cyber defense capabilities.
- Establish strong research partnerships between Canadian post-secondary institutions, research institutions and industry representatives to enhance innovation capacity.
- Provide government grants and repayable funding to support capital and technology adoption projects as well as workforce hiring and training projects.
- Map out a national Industry 4.0 strategy that integrates technology and innovation into core businesses (Wetmore, 2016).

## Conclusion

China is currently experiencing its fourth industrial revolution and *MIC 2025* provides guidance on how China will integrate digital platforms and innovative technology to increase the competitiveness of Chinese industries on the world stage. The *MIC 2025 plan* creates both threats and opportunities to the Canadian economy. As China is one of the largest trading partners, Canada should take actions to avoid any challenges in trade and investment. At the same time, there are opportunities for Canada to expand trade with China and partner with Chinese corporations as well as institutions to promote research and development. Canada has been dragged into the middle of the U.S.-China trade war, resulting in diplomatic tensions between Canada and China. In light of these circumstances, Canada should approach China openly and cautiously, and act to adjust its domestic and international trading and investment policies in order to be a part of the digital innovative industrial revolution.

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