

## DANCING WITH THE DRAGON: CANADIAN INVESTMENT IN CHINA AND CHINESE INVESTMENT IN CANADA

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### SUMMARY

While Canadian trade and investment with China is today relatively modest, with China well on track to displace the United States as the world's largest economy, Canada must make it a priority to prepare for a future characterized by dramatically increased trade and investment between our two countries. This paper sheds light on some of the issues and measures Canadian governments will have to consider as they look to establish safe and prosperous relationships with China. To begin with, Canadians choosing to invest in China must be prepared for the risk inherent in that country's peculiar "capitalism with socialist characteristics." The Chinese state continues to play an interventionist role in many significant sectors in the economy, and the strategy behind China's overseas investment in countries such as Canada is specifically aimed at furthering China's own national security goals and geopolitical influence. Canadians wishing to do business in China will also require great cultural competency. The cultural institution known as *guanxi* — in which gifts to sway influence are considered an acceptable, even desirable practice — persists in China, with even native Chinese unclear on where to draw the line between "good" *guanxi* and "bad" corruption.

At home, Canadians may soon be forced to confront questions about how much of our own land security and natural resource security we are willing to compromise by permitting Chinese investment to gather up our farmland and key industries. Canadians should decide sooner, not later, how well our own strategic interests are served by permitting unrestricted Chinese investment in our economy. In anticipation of these issues, Canada's federal and provincial governments should provide increased support for a more comprehensive training and research infrastructure that better prepares Canadians for the growing bilateral trade between our countries. They should also reinvest in the monitoring and regulatory enforcement for food and product safety to ensure that Canadians remain protected from unsafe Chinese imports.

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# DANSER AVEC LE DRAGON: L'INVESTISSEMENT CANADIEN EN CHINE ET L'INVESTISSEMENT CHINOIS AU CANADA

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## RÉSUMÉ

Malgré l'envergure relativement modeste à l'heure actuelle des échanges commerciaux et des investissements entre le Canada et la Chine, et tandis que celle-ci est en bonne voie de remplacer les États-Unis à titre de première économie mondiale, il est de toute première importance que le Canada se prépare à une hausse draconienne des échanges avec la Chine à l'avenir. Cet article illustre quelques questions et mesures que les gouvernements du Canada devront envisager en prévision de relations sûres et prospères avec ce pays. Pour commencer, les Canadiens qui choisissent d'investir en Chine doivent être préparés au risque inhérent à son « capitalisme à facettes socialistes ». Le gouvernement chinois continue de jouer un rôle interventionniste dans de nombreux secteurs importants de l'économie, et la stratégie derrière l'investissement de la Chine à l'étranger dans des pays comme le Canada est expressément destinée à promouvoir les objectifs de sécurité nationale de la Chine et son influence géopolitique. Les Canadiens qui souhaitent faire des affaires en Chine devront aussi connaître suffisamment la culture de ce pays. L'institution culturelle qui porte le nom de guanxi — dans laquelle l'échange de cadeaux pour influencer sur les décisions est considéré comme acceptable et même souhaitable — a toujours cours en Chine, et même les Chinois ne savent pas toujours où tracer la frontière entre les bonnes pratiques guanxi et la corruption.

Au pays, les Canadiens devront bientôt déterminer la limite à ne pas franchir pour préserver la sécurité de nos terres et nos ressources naturelles quand vient le moment d'autoriser les Chinois à investir pour acquérir nos terres agricoles et nos industries clés. Mieux vaut prévenir que guérir et les Canadiens devront décider rapidement s'il est dans leur intérêt de permettre aux Chinois d'investir sans entraves dans notre économie. En prévision des problèmes qui pourraient se présenter, le gouvernement fédéral et les gouvernements provinciaux devraient augmenter leur soutien à une infrastructure complète de formation et de recherche pour permettre aux Canadiens de mieux se préparer à la croissance des échanges commerciaux bilatéraux entre les deux pays. Ces gouvernements devraient également réinvestir dans la surveillance et l'application de la réglementation en matière de sécurité des aliments et des produits pour s'assurer que le Canada demeure protégé contre les importations chinoises insalubres.

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## INTRODUCTION

China displaced Japan to become the second largest economy in the world in 2011, just behind the United States. Given China's uninterrupted economic growth, averaging roughly 10 per cent every year since its significant 1978 economic reform, it will not be too long before it ascends to become the single biggest economy in the world.

The 1978 economic reform opened China to the world as a destination for investment capital, management know-how, and technology-transfer.<sup>1</sup> Between 1979 and 2006, a total of US\$882.7 billion in foreign capital (foreign loans and foreign investments) was utilized in China.<sup>2</sup> Even though the 2008 global economic downturn slowed down the flow of non-financial foreign direct investment (FDI) into China, which slipped 2.6 per cent in 2009 over the previous year, the loss was more than made up for the next year, with 17.4 per cent growth in 2010, and a further 9.7 per cent increase in 2011. The US-China Business Council reported a total value of utilized non-financial FDI in China at US\$116 billion in 2011; US\$105.7 billion in 2010; US\$90 billion in 2009; and US\$92.4 billion in 2008.<sup>3</sup> China itself is also rapidly becoming a source for direct investment around the world, with Chinese investors placing US\$116 billion worth of accumulated value outside their country's borders in 2011.<sup>4</sup> The US\$15 billion bid to acquire Calgary-based oil and gas company Nexen by Chinese state-owned company CNOOC Ltd., in July 2012, is indicative of China's expanding interests in strategic global investments.<sup>5</sup>

This paper aims to inform readers about the changing roles China plays in the global economy, with an emphasis on its relevance to Canadians, both as investors in China and as recipients of Chinese overseas direct investment. Based on the author's two-and-half decades of anthropological research experience in China, the sociological approach in this paper is intended to complement the vast body of publications about China by economists, political scientists, and policy analysts.

The objectives of this paper are as follows: First, to review the challenges and complexities of FDI in China. The Chinese concepts and practices of *guanxi* (pertaining to gift-giving, or, in some cases, bribery, to develop interpersonal networks and influence) are highlighted to make the point that while China offers many investment opportunities, business success in China requires strategic actions based on a sound cultural understanding of the rules of the game specific to the Chinese context. In other words, cross-cultural knowledge and cultural competency are crucial in international business. Emphasis is also given here to the changing nature, yet unchallenged power, of China's state owned enterprises (SOEs) inside China and overseas.

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<sup>1</sup> Loren Brandt and Thomas G. Rawski, *China's Great Economic Transformation* (New York: Cambridge University Press, 2008), pp.1-26.

<sup>2</sup> China Statistical Yearbook (Beijing: China Statistics Press, 2007), 742.

<sup>3</sup> See [https://www.uschina.org/statistics/fdi\\_cumulative.html](https://www.uschina.org/statistics/fdi_cumulative.html), accessed August 8, 2012.

<sup>4</sup> National Bureau of Statistics of China  
[http://www.stats.gov.cn/was40/gjtjj\\_en\\_detail.jsp?searchword=overseas+direct+investment&presearchword=overseas+direct+investment&channelid=9528&record=2](http://www.stats.gov.cn/was40/gjtjj_en_detail.jsp?searchword=overseas+direct+investment&presearchword=overseas+direct+investment&channelid=9528&record=2), accessed April 4, 2012.

<sup>5</sup> CBC News, "China's CNOOC offers \$15 billion for Calgary oil firm Nexen," July 2012.  
<http://www.cbc.ca/news/politics/story/2012/07/23/20120723-nexen.html?cmp=rss>, accessed August 8, 2012.

Second, this paper will provide a brief overview of the fast-growing overseas direct investment by Chinese SOEs and independent Chinese investors worldwide since the early 1990s. This overview is highly relevant to Canada given the Chinese state's interest in securing overseas investment in natural resources, agricultural production and farmland, high-tech and other sectors that China regards as "strategic" or "key" to national security purposes. Canada has already witnessed a sharp increase in Chinese investment in its oil and gas sector in recent years and can expect much more foreign investment from China in the near future.

A key question that we must ask ourselves is whether all foreign direct investments in Canada should be welcomed in the spirit of globalization, or whether there are reasons to safeguard from foreign ownership of selected resources and sectors within the Canadian economy, as a means of optimizing our own future national interests.

Lastly, this paper makes a number of policy suggestions aimed at enhancing Canada's capacity to support our investments in China as well as Chinese investments in our economy.

## **INVESTING IN CHINA — OPPORTUNITIES AND RISKS**

The economic reform of 1978 was a momentous turning point for China's economy and a logical starting point for this paper. After a highly disruptive decade of the Cultural Revolution (1967-77), the economic reform policy, under the leadership of Deng Xiaoping, was intended to contribute to nation building through the Four Modernizations: in agriculture, industry, national defense, and science and technology. By abolishing the self-imposed isolation that commenced at the founding of the People's Republic of China in 1949, China opened itself to foreign capital, technology-transfer and knowledge-transfer. The rest is history, as they say. With uninterrupted yearly growth averaging 10 per cent since then, China has become, within a few decades, an economic power with international political clout.

The Chinese government classifies foreign investment in China in one of two categories: Foreign Direct Investments (FDI) and Other Foreign Investments.<sup>6</sup> Each category comes with specific conditions and terms, and the rules regarding them change from time to time. For instance, in the 1980s, China's central government decentralized the authority of vetting FDI by allowing projects worth less than US\$10 million to be vetted by the relevant local provincial or municipal governments.<sup>7</sup> This decentralization policy boosted the level of small- and medium-sized foreign investments, to the great benefit of the Guangdong province in particular, which received the lion's share of overseas Chinese foreign direct investments (mostly from Hong Kong) accounting for almost 60 per cent of total FDI in China in the early phases of the economic reform.<sup>8</sup> The dominance of overseas Chinese FDI (Hong Kong, Macau and Taiwan) remains strong today, at nearly 50 per cent of all FDI in China.

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<sup>6</sup> China Statistical Yearbook (Beijing: China Statistics Press, 2007), 746. Under the former are six sub-categories: Equity Joint Venture, Contractual Joint Venture, Wholly Foreign-owned Enterprise, FDI Shareholding Inc., Joint Exploration and Others. Under the latter are four sub-categories: Sale Share, International Lease, Compensation Trade, and Processing and Assembly.

<sup>7</sup> G. Wang, *China's New Investment Laws: New Directions* (Singapore: Butterworth, 1988), 173.

<sup>8</sup> Josephine Smart and Alan Smart, "Personal Relations and Divergent Economies: A Case Study of Hong Kong Investment in China," *International Journal of Urban and Regional Research* 15(2):222 (1991).

Both the number and value of foreign investments in China have been consistently rising since the implementation of the economic reform. From 1979 to 1987, the total utilized FDI in China from 1979 to 1987 totaled US\$258 billion, and the average yearly FDI throughout the 1980s ranged from US\$20 to US\$60 billion per year.<sup>9</sup> Recent figures show a total accumulative value of utilized non-financial FDI for the period from 1979 to 2006 of US\$691.9 billion,<sup>10</sup> and US\$478.9 billion from 2007 to 2011.<sup>11</sup>

The distribution of investment dollars by investment category has also changed significantly over the years. The value of enterprises wholly owned by foreign interests rose sharply from 18 projects, worth US\$20 million in 1986, to 46 projects, with a total value US\$471 million, just one year later. But within the broader context of FDI in China, wholly foreign-owned enterprises constituted the least significant type of FDI by both numbers and value in the first decade of the economic reform.<sup>12</sup> Today, the distribution by investment type in FDI is dominated by the wholly foreign-owned enterprises.<sup>13</sup>

**TABLE 1: NON-FINANCIAL FDI IN CHINA BY INVESTMENT TYPE, 2011 AND 2010<sup>14</sup>**

Year	Number of Projects		
	2011	2010	% change
Total FDI	27,712	27,406	1.12
Equity joint ventures	5,005	4,970	0.7
Co-operative joint ventures	284	300	-5.33
Wholly foreign-owned enterprises	22,388	22,085	1.37
Foreign-invested shareholding ventures	35	51	-31.37

The wholly owned foreign enterprise is the form of FDI that investors typically prefer, because it gives them complete autonomy in their decisions about all aspects of the business operation and management. But if the investment is intended for a sector of production and service designated by the Chinese government as one of the “key sectors” or “pillar industries,” for national security purposes, then the only option available to investors is one of several joint-venture categories with a Chinese state-owned enterprise (SOE).

The SOEs were reformed after 1978 to become more efficient and profitable, and given greater autonomy in management, production, and investment decisions.<sup>15</sup> SOEs are now divided into two main types: central-state-owned (those that are managed by the Chinese central government) and local-state-owned (those controlled by provincial, municipal or county governments).

<sup>9</sup> China Statistical Yearbook (Beijing: China Statistics Press, 1988), 733.

<sup>10</sup> See note 2 above.

<sup>10</sup> See note 3 above.

<sup>12</sup> See note 7 above.

<sup>13</sup> See note 3 and note 6 above.

<sup>14</sup> US-China Business Council, [https://www.uschina.org/statistics/fdi\\_cumulative.html](https://www.uschina.org/statistics/fdi_cumulative.html)

<sup>15</sup> Yongnian Zheng and Yanjie Huang, “China’s centrally-managed state-owned enterprises: Dilemma and reform in the post-crisis era.” Conference proceeding, Asia Research Centre, Copenhagen Business School, 2012.

China's centrally managed SOEs, which the state regards as the "best and most important firms," are involved mainly in the key sectors, or pillar industries: natural resources (water, oil, gas, coal and others); mining; public goods and services; high-tech and telecom;<sup>16</sup> weapons and military technology; steel and other heavy industries;<sup>17</sup> and selected food production and processing industries.

While both centrally managed SOEs and locally managed SOEs are now profit-oriented with a degree of autonomy that is qualitatively different from the traditional, pre-reform era SOEs,<sup>18</sup> state influence in SOEs remains, and should be recognized as a significant factor in their business operations and corporate structure in a way that may not match a potential investor's idea of free enterprise. The central or local government appoints the SOE's chairperson and Margaret Cornish notes that at least half of the chairpersons appointed to centrally managed SOEs are also ministers in the central government, thus creating a direct and strong link between public and private sector leadership.<sup>19</sup> She further acknowledges: "During this period of super-growth and globalization the balance of influence has shifted to SOE management. It is conceivable, that the balance of institutional and corporate power could shift back to the bureaucracy and party."<sup>20</sup> Therein lies one of the distinctive features of Chinese-style "capitalism with socialist characteristics": The state can exercise its direct and indirect influence on corporate decisions as it sees fit, and there is an implied understanding in China that the state's mandate must trump business logic in the final analysis. It is precisely this built-in, direct control that party politics may impose on state capitalism, and by extension on joint ventures involving foreign investors, that constitutes a major risk for investors in key sectors in China.

Central and local governments also give preferential treatment to SOEs when it comes to strategic inputs, by providing low-cost loans, while centrally managed SOEs are granted monopolies over "key" sectors.<sup>21</sup> There were 122 centrally owned SOEs in China in 2010, down from 189 in 2003. But the size of these SOEs has expanded significantly over the years under a corporate group structure featuring a number of holding companies (known as second-level companies and third-level companies) tied to the parent SOE through controlling shares and non-controlling shares.<sup>22</sup> While these holding companies may act like independent private enterprises, they are, in fact, subsidiaries of an SOE.

Chinese state capitalism has not diminished since the economic reform. Rather, it has actually grown substantially under a veneer of "private" enterprises employed to support an aggressive overseas direct investment strategy, and to facilitate the absorption of international investment dollars through publicly listed holding companies. Chinese state capitalism is a major player both within China and outside China.

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<sup>16</sup> Jean C. Oi and Xiaowen Zhang, "The unfinished restructuring of China's state owned enterprises." Conference proceeding, Asia Research Centre, Copenhagen Business School, 2012.

<sup>17</sup> Andrew G. Walder, "China's bureaucratic capitalism: Creating the corporate steel sector." Conference proceeding, Asia Research Centre, Copenhagen Business School, 2012.

<sup>18</sup> Margaret Cornish, "Behaviour of Chinese SOEs: Implication for investment and cooperation in Canada." Canadian Council of Chief Executives, February 2012.

<sup>19</sup> Ibid.

<sup>20</sup> Ibid, 15.

<sup>21</sup> See note 15 above.

<sup>22</sup> See note 15 above.

China is a big market with lots of potential. Already it has established a solid track record as the factory for the world, manufacturing all sorts of consumer goods at low cost. Over 60 per cent of FDI in China is in manufacturing. Real estate, leasing and business services, wholesale and retail, construction and transportation are also major destinations of FDI.<sup>23</sup> China is a nation of 1.3 billion people who are gaining fast in their disposable income level. A small but fast growing segment of Chinese citizens is extremely wealthy by global standards. Then there is the rapidly growing and broad middle class, which is already creating consumers for all sorts of goods and services, both domestic and imported. While the estimated per capita annual income in 2011 at US\$7,600 placed China below Angola and Albania,<sup>24</sup> the real gains in income since 1978 have supported qualitative changes in consumption habits, and future income gains are expected to be robust given China's healthy economic growth rate. As of 2011, China surpassed Japan as the second largest economy in the world. It is expected that, short of some major unforeseeable meltdown in China in the near future, it will eventually displace the U.S. to become the biggest economy in the world. China is a shining star that cannot be avoided or ignored within the context of the global economy, and specifically as a destination for investment and as a consumer market for all goods and services.

Currently, Canada plays a modest role when it comes to investment in and trade with China. Canada does not rank among China's major trade partners: In 2011, total imports from China accounted for 10.8 per cent of the value of all Canadian imports, while Canada's exports to China that same year constituted only 4.01 per cent of Canada's total exports.<sup>25</sup> There is clearly more room for Canadian investments in China, but some cautionary notes are in order.

1. For every celebrated success story of FDI in China, there are probably 10 or more failures that seldom attract discussion. Yet these business failures have as much to offer in lessons learned as do the successful cases.<sup>26</sup> Just because China is a strong magnet for global investment does not automatically translate into business success for every investor.
2. The Chinese economy today is a mix of foreign and domestic investments. As Chinese entrepreneurs acquire the skill sets, international market linkages, and the necessary institutional support to forge their own production and distribution channels, both within China and outside China, the initial advantages enjoyed by foreign investors have been drastically diminished by very strong competition. In short, China has become a very crowded and highly competitive place for investment in any sector. During the early years of economic reform, domestic capital was systematically disadvantaged, which created a demand for foreign partners to facilitate export, to obtain foreign currency, or even to do business in other provinces. State policy required banks to extend loans to cash-strapped SOEs rather than to potentially successful private businesses.<sup>27</sup> These inefficiencies were

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<sup>23</sup> China statistical Yearbook (2007), 746.

<sup>24</sup> "Basic Economic Information on China: Rankings, Growth and Dodgy Statistics." <http://factsanddetails.com/china.php?itemid=376&catid=9&subcatid=58>, accessed August 8, 2012.

<sup>25</sup> Asia Pacific Foundation of Canada, <http://www.asiapacific.ca/statistics/trade/bilateral-trade-asia-product/canadas-merchandise-trade-china>, accessed August 8, 2012.

<sup>26</sup> Alan Smart and Josephine Smart, "Failures and strategies of Hong Kong firms in China: An ethnographic perspective," in Yeung, Henry Wai-chung and Olds, Kris (eds.), *The Globalisation of Chinese Business Firms* (London: Macmillan, 2000), 244-271.

<sup>27</sup> Huang Yasheng "Internal and External Reforms: Experiences and Lessons from China" *Cato Journal* 21(1):54 (Spring/Summer 2001)

products of the pre-reform, centrally planned economy, wherein political ideology was paramount, and market-oriented notions of optimization and efficiency were considered counter-revolutionary. The contradictions between Chinese socialist ideology and western capitalist business logic are difficult to reconcile, and the Chinese state has never fully resolved these contradictions since opening its doors to the world in 1978. The “going out” policy introduced in 2000 signified the Chinese state’s ongoing efforts to create “capitalism with socialist [ie: specifically Chinese] characteristics.” By creating new institutional support in the form of preferred loans, state assistance in technology and skills training, and liberalized policies for overseas investment, the Chinese state targets encouraged Chinese investors and private businesses to “go out” and do business abroad. The Five-Year Plan’s guidelines for this “going out” policy clearly articulates that the Chinese state is keen to boost the engagement of Chinese direct investment in the global marketplace.<sup>28</sup>

3. Despite state efforts to counter corruption, the problem remains pervasive across China. How investors deal effectively with demands for bribery — without causing unnecessary and sometimes extreme legal, reputational and financial costs — is a big challenge. The forms these demands for bribery can take cover a wide range: from outright demand for cash payment to overseas accounts, to less direct and blatant extraction, such as insisting on jobs for family members and close friends, or the sponsorship of a son or daughter’s education overseas. How to assess whether such a demand is a form of corruption, or just part of the culturally appropriate reciprocity-based gift exchange, is another major challenge for foreign investors. The line between a bribe and gift is a fine one that requires a high level of cultural competency to handle without setting off negative outcomes and misinterpretations.<sup>29</sup> This issue will be discussed in more depth in the next section titled “The Arts and Politics of *Guanxi*.”

## THE ARTS AND POLITICS OF *GUANXI* — ENGAGE WITH CARE

The Chinese concept *guanxi* (“relationship”, “network” or “connection”) encompasses a complex body of informal practices, based on principles of gift exchange, and is used for both affective and instrumental purposes.<sup>30</sup> It corresponds closely to the western concept of “social capital,” which is generally considered a desirable thing to cultivate and an advantageous asset to have.<sup>31</sup> In Chinese culture, *guanxi* practices have been found to have the positive function of

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<sup>28</sup> *Guomin jinji he shehui fazhan di shi ge wunian jihua gangyao* (国民经济和社会发展第十个五年计划纲要) The 10th Five-Year Plan (2000). <http://ghs.miit.gov.cn/n11293472/n11294974/n11296707/n11640313.files/n11754020.pdf>, accessed January 5, 2011.

<sup>29</sup> Alan Smart, “Gifts, Bribes, and *Guanxi*: A Reconsideration of Bourdieu’s Social Capital” *Cultural Anthropology* 8:388-408 (1993).

<sup>30</sup> Alan Smart and Carolyn L. Hsu, “Corruption or Social Capital? Tact and the Performance of *Guanxi* in Market Socialist China,” in Monique Nuijten and Gerhard Anders (eds.), *Corruption and the Secret of Law*, (Aldershot, UK: Ashgate, 2007), 167-189.

<sup>31</sup> Pierre Bourdieu “The Forms of Capital” in J. Richardson (ed.), *Handbook of Theory and Research for the Sociology of Education* (New York: Greenwood, 1986), 214-258.



building trust in the absence of adequate formal legal and financial institutions.<sup>32</sup> At the same time, it is also noted that there is a strong link between *guanxi* practices and corruption in Chinese societies. In China, both official state discourse and dissident rhetoric tend to condemn *guanxi* practice as a form of corruption.<sup>33</sup> Yet, ordinary Chinese citizens find it difficult to articulate the difference between “good” *guanxi* practice and “bad” corruption. This difficulty is rooted in the very different epistemological roots of the concept and practice in Chinese versus western culture. Smart and Hsu explain it as follows: “...in Western Judeo-Christian tradition, the ideal friend is one who lays down his life for his friends, the antithesis of the false friend who ‘uses’ friends for personal gain. In contrast, in Confucian ideology, ‘using’ friends for personal gain is lauded as the path to true friendships. In this view, genuine relationships are built through transactions that benefit one individual more than the other, since this type of interaction puts the first person in debt to the second and sets up the rationale for further interaction.”<sup>34</sup>

Herein lies a difficult dilemma inherent in China’s anti-corruption campaigns: If all gift-exchange relationships (exchanges in material goods, favours, information, services, etc.) are considered conducive to corruption, then any attempt to eradicate corruption has to begin with a restriction, or even prohibition of *guanxi*-based gift exchanges. Yet, the social significance of *guanxi* as a medium of social integration in Chinese society has deep cultural roots in Confucianism. Given the Chinese state’s current focus on developing a “harmonious society,” there is very little room to entertain the idea of doing away with a fundamental and widely accepted practice of social integration through *guanxi* relations.

Douglas Guthrie, among others, has argued that, as a result of market reform, which improved transparency and accountability in post-1978 China, there has been a corresponding decline in the significance of *guanxi* in both personal and business contexts.<sup>35</sup> This argument is not well supported by evidence, which points to the persistence of *guanxi* for both instrumental and social ends in everyday life in China. This is in spite of changes in the dynamics of *guanxi* engagement, which has happened in response to government-initiated anti-corruption campaigns.

The state’s anti-corruption campaigns highlight the strategic positions of public officials in their capacity to abuse their position for personal gain. As a result, the arena of *guanxi* in the context of Chinese business has moved: From a focus on government officials and toward their designated recipients outside public office, such as their spouse, children, in-laws, other close relatives and trusted friends. The game of playing *guanxi* for instrumental ends has not disappeared, but it has become more complex and increasingly uncertain as the recipients of *guanxi* gift-exchange are no longer the same people directly in positions of authority and

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<sup>32</sup> See note 20 above; Carolyn Hsu “Capitalism Without Contracts versus Capitalist Without Capitalism: Comparing the Influence of Chinese *Guanxi* and Russian *Blat* on Marketization,” *Communist and Post-Communist Studies* 38:309-327 (2005); L. Keister “*Guanxi* in Business Groups: Social Ties and the Formation of Economic Relations,” in T. Gold, D. Guthrie, and D. Wank (eds.), *Social Connections in China* (Cambridge: Cambridge University Press, 2002), 77-96; K. Tsai *Back-Alley Banking* (Ithaca, NY: Cornell University Press, 2002); Mayfair M. Yang *Gifts, Favors and Banquets: The Art of Social Relationships in China* (Ithaca, NY: Cornell University Press, 1994).

<sup>33</sup> See note 23 above.

<sup>34</sup> Alan Smart and Carolyn Hsu “Corruption or Social Capital?,” 170.

<sup>35</sup> Douglas Guthrie, *Dragon in a Three-Piece Suit* (New Jersey: Princeton University Press, 1999); Douglas Guthrie “The Declining Significance of *Guanxi* in China’s Economic Transition,” *The China Quarterly* 154:254-282 (1998).

influence. You leverage *guanxi* in the hope that the people you bestow gifts upon are indeed capable — based on the strength of their links to public officials — of affecting the outcomes of business and contract matters in your favour. But your hope is just that: a hope.

Having connections to powerful contacts in China is no guarantee of business success in China for the simple reason that *guanxi* politics work only in your favour for as long as the person or institution with whom you establish *guanxi* remains in power — or for as long as you are not perceived as acting against their interests. The recent and dramatic downfall of Bo Xilai, ex-Chongqing Party Secretary, may serve as a wakeup call to those who are not sensitive to this complexity in the art of *guanxi*.<sup>36</sup>

## THE GROWTH OF CHINESE OVERSEAS DIRECT INVESTMENT — IMPLICATIONS FOR CANADA

The first inclusion of data on overseas direct investment (ODI) in the Chinese government's official statistical reports appeared in 1998 (see Table 2 below), even though Chinese foreign investment goes back to at least the 1960s in its bilateral relationships with friendly countries in Africa and Southeast Asia, as part of China's "friendship farm" diplomacy.<sup>37</sup> This state-led foreign investment, involving SOEs and government ministries, has continued uninterrupted through to today: In 2011, contracted engineering and construction projects were worth a reported US\$103.4 billion.

After the 1978 economic reform, some SOEs, as well as township and village enterprises (TVEs), began to explore direct investment opportunities in countries with bilateral relationships with China. The introduction of a "going out" policy in the 10th Five-Year Plan, in 2000, marked the first state effort to boost Chinese overseas direct investment involving individual investors. The "going out" policy was repeated in the 11th Five-Year Plan, in 2005, with the identical expressed rationale: That overseas investment by Chinese entrepreneurs will strengthen China's multinational linkages and directly contribute to nation building.<sup>38</sup> The "going out" policy was effective in facilitating the explosive growth of private Chinese ODI worldwide in subsequent years. Liu and Wang<sup>39</sup> estimate that among the 800 Chinese investors in Africa in 2006, 700 were private investors. They further suggest that the total number of Chinese private investments may be much higher than what available data reveal. Many

<sup>36</sup> For details about the Bo Xilai affair, see Tom Lasseter "China Dismisses Congqing Mega-City's Party Head," *Calgary Herald* (March 16, 2012), A22; Malcolm Moore, "China's Future Leaders Told to Embrace Change," *Calgary Herald* (March 16, 2012), A18; Jeremy Page, "U.K. Seeks Probe Into China Death," *Wall Street Journal* (March 26, 2012), A1, A6; "The political battle following Bo Xilai's demise will define China," *The Economist* (March 31, 2012), 56.

<sup>37</sup> Yanjie Wang, "中国的海外农作物种植：规模与争论" (*zhongguo de haiwai nongzuo wu zhongzhi: guimo yu zhenglun*). *International Politics Quarterly* (国际政治研究), 31(2),13-15 (2010).

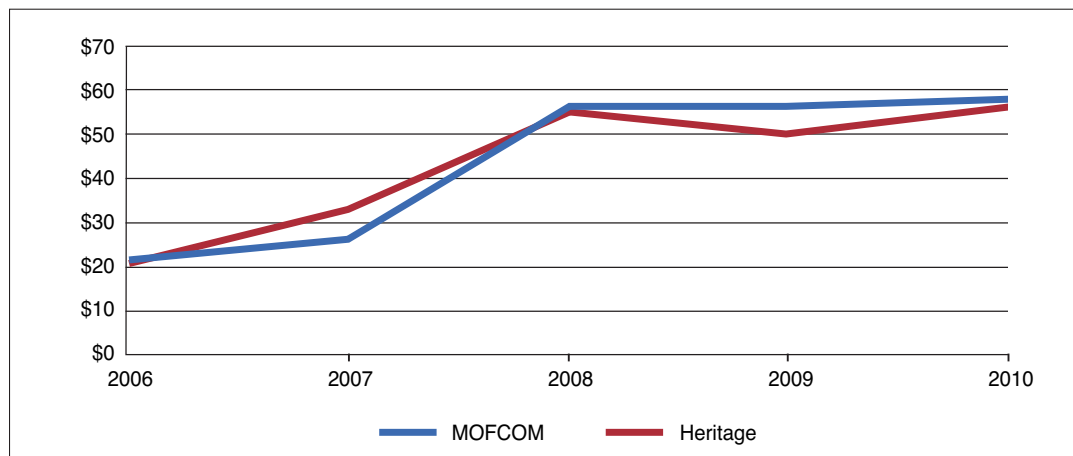
<sup>38</sup> People's Republic of China, "Guomin jinji he shehui fazhan di shi ge wunian jihua gangyao (国民经济和社会发展第十个五年计划纲要)", chapter 9, sections 37.01, 37.02 <http://ghs.miit.gov.cn/n11293472/n11294974/n11296707/n11640313.files/n11754020.pdf>, accessed January 5, 2011.

<sup>39</sup> Hongwu Liu (刘鸿武) and Tao Wang (王涛), "中国私营企业投资非洲现状与趋势分析 (*Zhongguo saying qiye touzi feizhou xianzhuang yu qushi*)."*Journal of Zhejiang Normal University* 浙江师范大学学报(社会科学版), 33(5):37 (2008).

Chinese investors are very small-scale entrepreneurs operating retailers in rural and remote parts of Africa. In 2006 alone, the official record showed that PRC citizens made a total of 160,000 trips to Africa. Just five years earlier, in 2001, Chinese citizens made only 50,000 trips over the course of the entire year.<sup>40</sup>

ODI or Direct Foreign Investment (the two terms are used interchangeably in Chinese government documents) is defined by China’s National Bureau of Statistics as “enterprises set up or bought by domestic investors in foreign countries and in Hong Kong, Macao and Taiwan, and the economic activities centering [sic] on operation and management of these enterprises are under the control of domestic investors.”<sup>41</sup> By the end of 2006, total accumulative Chinese ODI reached US\$75 billion, with a clear sectoral concentration in mining (US\$18 billion); wholesale and retail (US\$13 billion); leasing and business services (US\$19.5 billion); transportation/storage/post (US\$7.6 billion); and manufacturing (US\$7.5 billion).<sup>42</sup> After Hong Kong (the destination of US\$42.2 billion, or 56 per cent, of the total accumulative ODI), the largest recipients of ODI in descending order are Cayman Islands (US\$14.2 billion); British Virgin Islands (US\$4.75 billion); U.S.A. (US\$1.2 billion); Russia (US\$930 million); Republic of Korea (US\$949 million); Australia (US\$794.4 million); Macao (US\$612 million); Sudan (US\$497 million); and Germany (US\$472 million). By comparison, Canada received a very modest US\$140.7 million in Chinese ODI by the end of 2006.<sup>43</sup> Chinese ODI continues to increase in subsequent years (see Figure 1 below).

**FIGURE 1: CHINESE OVERSEAS DIRECT INVESTMENT 2006–2010<sup>44</sup> (Billions of US\$)**



China’s thirst for strategic resource procurement has become legendary in recent years, with the Chinese government’s vigorous overseas investment in oil and gas, mining sectors, fertilizer production, and heavy industries. In oil-rich Alberta, we receive regular news about Chinese SOEs — such as PetroChina, China National Petroleum Corp, Sinopec and others —

<sup>40</sup> Ibid

<sup>41</sup> China Statistical Yearbook (2007), 758.

<sup>42</sup> Ibid, 750.

<sup>43</sup> Ibid, 749.

<sup>44</sup> Heritage Foundation, “Insights into China’s Overseas Investments” (February 24, 2011), <http://chovanec.wordpress.com/2011/02/24/tracking-chinas-overseas-investments/>, accessed August 8, 2012. Note: Estimates by Heritage Foundation are labeled Heritage; Data labeled MOFCOM is based on information provided by China’s official Ministry of Commerce.

and their acquisition of Canadian energy firms. Daylight Energy Ltd, a Calgary-based oil and gas producer, received a CAN\$2.2 billion bid from Sinopec last October.<sup>45</sup> Athabasca Oil Sands Corp. sold a 60 per cent stake in its MacKay and Dover thermal oilsands projects to PetroChina (a holding company of the SOE China National Petroleum Corp) in 2009 for CAN\$1.9 billion.<sup>46</sup> PetroChina, which controls about 80 per cent of China's gas supply, has recently signed a deal to acquire a 20 per cent stake in Shell's wholly owned Groundbirch property, which engages in shale gas development in northeastern British Columbia, with a plan to export liquefied natural gas to China.<sup>47</sup> The Calgary-based company, MEG Energy Corp., which is involved in oilsands production, is 17 per cent owned by China's CNOOC Ltd.<sup>48</sup> In July 2012, CNOOC Ltd. offered to pay US\$15 billion for the Calgary-based oil and gas company Nexen, a bid currently being reviewed by the federal government. China's overseas spending on company acquisitions and new technology purchases were reported at US\$17.1 billion in 2009 and US\$24.3 billion in 2010, a trend that is expected to continue given that projections foresee eight per cent yearly long-term growth in China's demand for diesel, gasoline and gasoil.<sup>49</sup>

The latest Chinese government data on Chinese ODI (non-financial sectors) for 2011 showed a total accumulated value of US\$116 billion (excluding contracted overseas engineering projects), as indicated in Table 2.

**TABLE 2: CHINESE OVERSEAS DIRECT INVESTMENT (NON-FINANCIAL SECTORS), 1998-2011<sup>50</sup>**

Year	Cumulative actually utilized ODI in US\$ billion	ODI by year in US\$ billion (% change* from last yr)	Cumulative ODI in agricultural sector in US\$ billion / no. of enterprises	Cumulative contracted engineering projects in US\$ billion (% change)
2011	116.0	60.1 (+1.8)	2.0 / 865	103.4 (+12.2)
2010	105.7	59.0 (+36.3)	n/a	92.2 (+18.7)
2009	90.0	43.3 (+6.5)	1.43 / 896	77.7 (+37.3)
2008	92.4	40.7 (+63.6)	1.19 / 917	56.6 (+39.4)
2007	74.8	18.7 (+6.2)	0.92 / 1048	40.6 (+35.3)
2006	69.5	16.1 (+31.6)	0.6 / 951	30.0 (+37.9)
2005	60.3	6.9 (+25.8)	0.72 / 1058	21.8 (+24.6)
2004	60.6	n/a	1.1 / 1130	17.5 (+26.0)
2003	53.5	n/a	1.0 / 1116	20.9 (+17.0)
2002	52.7	n/a	n/a	14.4 (+18.2)
2000	40.7	n/a	n/a	14.9 (+15.0)
1999	40.4	n/a	n/a	13.0 (+10.4)
1998	45.6	n/a	n/a	11.8 (+3.7)

\* The author notes that the reported percentage change in ODI, as reported in Chinese government reports, do not appear to reflect the actual change in ODI dollar value from year to year. The author could not find any official explanation of this mismatch. This official percentage change data is included for information purposes.

<sup>45</sup> Stephen Ewart, "Calgary Energy Firm gets \$2.2 Bid – China's Reach into Oilsands Continues," *Calgary Herald* (October 10, 2011), A1, A7.

<sup>46</sup> Dan Healing, "Athabasca Oil Sands Eyes Light Oil Partnerships," *Calgary Herald* (March 16, 2012), E4.

<sup>47</sup> Rebecca Penty, "PetroChina Boosts LNG Export Plans," *Calgary Herald* (February 3, 2012), D1, D5.

<sup>48</sup> Dan Healing, "MEG Reduces Prices of IPO," *Calgary Herald* (July 27, 2010), D1, D6.

<sup>49</sup> Ibid

<sup>50</sup> National Bureau of Statistics of China, various dates.

Other than the evident Chinese appetite for investment in oil and other natural resources, Canada may eventually be affected by Chinese investors' interests in farmland and agricultural production. Food security is a strategic concern of the Chinese government's and many Chinese SOEs and private investors have active investments in farmland and food crop production in Africa,<sup>51</sup> Latin America, Southeast Asia,<sup>52</sup> Australia and New Zealand,<sup>53</sup> and North America.<sup>54</sup> A report in the French newspaper *Le Monde*, at the end of April this year, ranked Chinese investment as the biggest player in farmland acquisition in the world, based on data released by Land Matrix.<sup>55</sup> Regular recurrences of toxic-food scandals in China have spurred growing consumer demand for safe food, organic food, and imported food from countries with strong reputations for food safety. In this context, Canada may serve very nicely as both a source of safe food for Chinese consumers, and as a destination for Chinese investment in farming projects and land acquisition.

## POLICY DISCUSSION

Canada's engagement with China in trade and investment will increase under conditions of improving bilateral relationships between the two nations and the expanding demand for resources in China. China offers Canadian exporters a lucrative consumer market, of tremendous size and rising income level, while Canada offers a wealth of natural resources, human resources, technology and commodities of all kinds that are of interest to Chinese consumers and companies. For a Canadian investor with a solid business plan based on sound market research and proper legal advice, this paper highlights key social-cultural dimensions that can enhance the potential for business success in China.

Cultural competency is necessary for any individual wishing to conduct meaningful and successful interactions in a social setting. Acquiring cultural competency requires learning the language, the cultural code, and obtaining local knowledge that enables a person to interpret correctly what he or she experiences, as well as enabling him or her to act in a way that will allow others to comprehend his or her actions and communications effectively and accurately. A person with a high degree of cultural competency in Canadian society does not automatically perform well in another society. For Canadians working or investing in China, it is a good

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<sup>51</sup> "Hebei's Farmers Eye Fertile Farm in a Distant Land," <http://farmlandgrab.org/post/view/13135>, accessed January 27, 2011; 'Chinese Debate Pros and Cons of Overseas Farming Investments' *The Guardian* (May 11, 2008) <http://farmlandgrab.org/post/view/2348>, accessed January 27, 2011; Zhongxiang Zhang "Sino-Africa Agriculture Cooperation under FOCAC Framework *zhongfei hezuo luntan guangjia xia de nongye hezuo jianlun zhongguo haiwai tuntian shuo.*" *Global Review (Guoji Zhanwang 国际展望)*, 2:95-104 (2009)

<sup>52</sup> Yanjie Wang (2010), 20-29.

<sup>53</sup> Simon Hartley, "Firm Eyes 100 Farms in South," *Otago Daily Times* (April 14, 2010).

<sup>54</sup> Amy Miller, "New Waves of Agricultural Land-grabs Reaches Canada," *The Dominion* (September 27, 2010) <http://farmlandgrab.org/post/view/15808>, accessed January 27, 2011.

<sup>55</sup> Rudy Reitenburg, "Land Rush Continues," *Bloomberg Businessweek* (April 26, 2012). <http://www.businessweek.com/news/2012-04-26/land-rush-continues-deals-target-poor-group-says> accessed 4-May-2012. See International Land Coalition website for details, <http://www.landcoalition.org/publications/transnational-land-deals-agriculture-global-south>.

investment to acquire some cultural competency in the Chinese language (in both verbal and written forms), and cultural knowledge, so that the highly complex and rapidly changing Chinese practices of *guanxi*, gift-exchange relations, corruption/bribery, and state capitalism can be handled with informed awareness, leading to informed decisions. Most investors with extensive global experience are fully aware of the utility of having a good local partner in the society where the investment is being made. This local partner, or a trusted, native senior executive, among many other things, can provide cultural expertise that an investor can rely on when his or her own cultural competency falls short. In particular, the ever-changing consumer demands and class formations that have unfolded in China since the reforms of 1978 require a high degree of local knowledge to identify, and to meet with, the right services and goods.

The inherent contradictions between socialist ideologies and western, capitalist market logic are difficult to resolve. While the Chinese state has diminished its direct intervention in many aspects of China's social and economic organizations since 1978, the central importance of nation building remains a top priority for the state, and is reflected in all its policies regarding FDI in China and Chinese FDI overseas. Canadian investments in key sectors that are of national security concern in China are particularly vulnerable to the political winds and tsunamis that sweep across the Chinese business landscape every time there is a change in state leadership or a disruption in the political power structure. Investors are well advised that doing business in China comes with the added challenge of effectively navigating China's "capitalism with socialist characteristics."

Canada can expect to receive more Chinese investments and more Chinese visitors in the future. In general, tourism businesses are well informed about the relevant differences between western and Chinese cultures, and adjust their service delivery accordingly to enhance the international visitor's experience. In Canada, being a nation with a heavily multicultural population, all major cities and border points provide services in multiple languages, including Chinese. But Canada's service sector remains largely English speaking (except in Quebec, where it is French); very few Canadian businesses in the hospitality sector (with the exception of Chinese-run restaurants and shops) have staff able to speak the major Chinese dialects, and few have developed the cultural sensitivity necessary to tailor services to the needs of Chinese visitors. For example, it is an almost universal Chinese practice to boil water for consumption. There is also a strong preference to drink hot water instead of "raw" water with ice. In China, a thermos of (boiled) hot water and an electric kettle are a fixture in most hotel rooms. In Canada, the coffee maker is the ubiquitous fixture in most hotel rooms, but it is not the ideal appliance to produce good, hot drinking water. A simple adjustment to accommodate Chinese visitors would be to place an electric kettle in a guest's room. Again, this is to highlight the importance of cultural competency as it pertains to good business practices in Canada, as it increasingly hosts visitors and investors from Chinese and other cultural backgrounds.

Moving to a broader perspective from a policy viewpoint, what can be done to enhance this growing two-way engagement between Canada and China? Some have suggested that we should demand from China new or modified rules of engagement in our future trade and investment, such as improved human rights in China in exchange for greater access to Canadian trade, or stronger anti-corruption efforts, so as to level the playing field to accommodate Western sensibilities. Instead, a slightly different approach is suggested here, by asking what Canada can do to enhance capacity building in order to deal more effectively with Canadian investments in China as well as Chinese investments in Canada.

First, it will be desirable for Canada to invest in greater institutional support to expand and enhance its capacity to assist Canadians in acquiring the adequate cultural competency to interact effectively and appropriately with their Chinese counterparts both in China and in Canada. Australia may serve as a model here, given the strength of its state investments in supporting Chinese language courses, centres of research on China and Asia, and various relevant community and institutional activities. In the Canadian context, federal funding via SSHRC (the Social Sciences and Humanities Research Council) can definitely be strengthened to support a greater number of relevant research projects and scholarship developments; CIDA may consider reinstating the funding to Areas Studies that was cut some years ago; and more Centres of Asian Studies should be created to serve as centres of training of future Chinese experts. The enhancement of government-funded China studies, and language training facilities, will be crucial to the development of capacity building in Canada.

Some people may argue that this goal of capacity building is already being met by the Chinese funded Confucius Centres (which are mostly devoted to language training, using China-directed curriculum and textbooks) that were created throughout the world beginning around 2001. The Confucius Centres are part of the soft diplomacy initiative of the Chinese government, which provided the seed money on the expectation that each Centre (usually under the administration of a local university) would subsequently secure operating funds to cover administrative and other expenses. Thus, the Confucius Centres in Canada require financial inputs from both federal and provincial governments, as well as private sources, to support their operation. The suggestion here for greater Canadian institutional support in China Studies and Chinese language training includes the Confucius Centres and other existing language training facilities in Canada, but more importantly, this suggestion points also to the need for our governments to develop critical research and scholarship in China studies, which remain well below sufficient levels. Canada as a nation has a strategic interest in fostering scholarship and Chinese language training capacity to optimize its capacity building, and this mandate can best be met by nationwide institutional support at both the federal and provincial levels.

Second, the existing Canada-China scholarly Exchange Program (CCESP) has served very nicely, for many years, as a form of soft diplomacy. The program links Canada and China through support that enables 20 to 25 Canadian students and researchers to spend four to 10 months in a Chinese university or college each year, and supports roughly the same number of Chinese scholars who spend about five weeks studying in Canada. This program is effective in strengthening Canadian Studies in China, and in providing a valuable opportunity for young Canadians to experience China; to receive further training in Chinese language acquisition in an immersion setting; and to learn to be ambassadors for Canada. This bilateral exchange program warrants consideration for expansion, to the mutual benefit of both countries, and it is heartening to learn that a recently signed Memorandum of Understanding (MOU) between China and Canada addresses this particular item of program expansion.

Third, the government of Canada has adopted a series of troubling funding cuts to the Canadian Food and Inspection Agency (CFIA) in food safety inspection, as well as cuts to government research positions in fisheries and climate change. These cuts do not serve Canada's best interests in the long run, because evidence-based science and effective regulatory enforcement are central to Canada's capacity in safeguarding our ecological, economic and public health as we engage in greater trade with China, and the growing participation of Chinese overseas investments in Canadian industry. Canada is the recipient of a wide range of

Chinese products, ranging from toys to garments, to concentrated apple juice and many processed foods. As trade volumes increase, we will require a greater capacity to test and regulate the quality of these imported products for prohibited chemicals, or excessive levels of restricted chemicals. Lead in toys, heavy metals, and carcinogenic chemicals in food products have already been identified, through random testing by importing countries, as problems in some Chinese products. Given the widespread coverage of toxic food scandals in China since the 1980s, and weak or uneven enforcement efforts in China to ensure compliance with food safety and human/animal health guidelines in food production (for both humans and animals), pharmaceuticals, and consumer products, there are strong reasons for trading partners, such as Canada, to reinforce their product testing protocols to ensure the safety of products imported from China. This proposed enhanced surveillance protocol runs contrary to the Canadian government's recent cuts in key departments such as CFIA, research positions in various fields, and border agencies. An enhanced surveillance protocol serves the general public and the government well, both in short-term benefits and long-term costs. In the short term, Canadians are protected from health and financial risks arising from the consumption of unsafe imported products. In the long run, enhanced monitoring has the potential to spare governments the tremendous health care costs that may arise from chronic problems resulting from the use of unsafe products. Currently the Canadian public has a high degree of trust in the Canadian government as an effective agent of enforcement when it comes to food and product safety. Any erosion of this trust is undesirable. Policy changes are required, including reinvesting in the enhancement and strengthening of regulatory surveillance and enforcement that will be necessary to meet future needs.

Lastly, the issue of foreigners' "land grabbing" in Africa, Latin America and Southeast Asia has been a much-discussed topic in recent years due to the highly charged ethical issues around land sovereignty and food security. While Canada is a country with a wealth of land mass and agricultural productivity, aggressive Chinese overseas direct investment in farmland and agricultural projects, by both SOEs and private investors, may, in the future, lead to bitter public debates among the Canadian public about growing foreign control over Canadian land, when it reaches a certain scale — much as it did in New Zealand and Africa. A central issue of debate in those countries with significant Chinese investment in farmland acquisition, or long-term leasing, is of the question of long-term national strategic interests versus the short-term financial gain available to individuals and/or governments. The failed takeover attempt of Saskatchewan's Potash Corp. by Australian investors in 2011 is an interesting case study of particular relevance to Canada's future policy regarding foreign ownership of farmland and foreign control of primary and secondary production industries in this country. Should farmland and agricultural production capacity, such as potash, be regarded as something of "national strategic interest"? If so, the current absence of policy in most provinces and territories regarding foreign ownership of farmland merits discussion, debate and reformulation, if necessary. In a future world with a population far greater than what it is today, the competition for food supply, and the control over agricultural production capacity and distribution, will become a highly strategic part of geopolitical considerations. Canada has lots of land and great capacity in food production, and it has enjoyed a very privileged position as a food exporter. It is precisely this role as a food exporter that will contribute to Canada's future geopolitical clout, if indeed future human beings eat food in much the way we do today. It is not too early for Canada to consider its position regarding foreign ownership of farmland and agricultural production before foreign investors from the Middle East, China, and the EU arrive in large numbers.



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