

Why do Emerging Markets Matter?

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Which emerging markets?

- “emerging” rather than “developing”
- Size, mass, speed, disposition, trajectory
- Ability to change the landscape, rather than just traversing a well-worn path
- Not just the market potential of developing countries, but the fact that the largest emerging countries are changing the economic and political landscape in a way that is, well, awesome. Disruptive powers.
- BRIC, with focus on India and China. In a sense, Japan is an emerging power as well. Even though it is among the richest and most technologically sophisticated economies in the world, it is not an international power in political, diplomatic or security terms. That has started to change with Koizumi and will continue to do so under Abe.
- India and China are re-emerging (along with Russia and Brazil, there is a sense of destiny in these countries)
- It is important to remember that Asia – led by China – was the most economically vibrant region in the world until the early 19th century. Economic historians estimate that as late as 1820, the region accounted for 60 percent of global economic output. The emergence of Asia, in this sense, is as much a re-emergence of the region and a return to its place on the world stage.

Emerging markets are about globalization

- Globalization (meaning the freer flow of goods, services, capital, ideas, technology, and people) has allowed emerging countries to “emerge”
- At the same time, globalization has provided a transmission mechanism for the impact of emerging markets to be felt around the world, including the

negative effects of dislocation and “hollowing out”

- It is precisely China’s extraordinary openness to the world, starting in 1978, that has unleashed its potential as an “emerging giant”. Same with India since 1991.
- The debate over emerging markets is a more sophisticated version of the debate about globalization (not just about developed countries spreading their goods, values, and culture around the world). It will be joined soon by another debate, which will be about changing sources of global influence, international architecture, and the complexities of a multipolar world. Watch this space.

Asia Rising

- Centre of gravity is shifting to Asia, led by Japan, China and India.
- It is customary in speeches on Asia to underscore the growing importance of the region. An audience such as this will be familiar with the standard descriptors of Asian economic prowess. We could pick any number of indicators to make the point: Asia accounts for 40 percent of the world’s economic output. Developing countries in Asia doubled their share of world exports between 1989 and 2004. The middle class in China and India is perhaps 15 times larger than the population of Canada. China alone boasts more than 300,000 US-dollar millionaires. In 2004, China graduated 644,000 engineers; nearly three times the number in the United States. Between 2004-2009, China is building 108 new airports. The largest IPO ever took place last week – over US\$19b was raised by the Industrial and Commercial Bank of China. On the seedier side, Macau has overtaken Las Vegas as the gambling capital of the world. The mind numbs to this seemingly endless litany of accomplishment.
- What is really important about the re-emergence of Asia is how it is affecting global production, sourcing, and investment decisions, and how the three major Asian powers –China, Japan, and India – are reshaping international relations and the architecture of global governance. I have time to only touch on a few examples of how Asia is going global and why it is important for Canada.
- The idea that China has become the workshop of the world is misleading. There is no question that China has a formidable manufacturing capability, one that is extending well beyond basic consumer durables to more sophisticated technology-intensive products. However, the best in Chinese manufacturing is by and large a multinational endeavour, consisting of foreign capital and technology, intermediate inputs from surrounding Asian

neighbours; and, most importantly, demand for final products that is still to a large degree from the industrialized world.

- Canada is of course on the receiving end of many products made in Asia but exported from China. However, Canadian firms by and large have not participated in Asian production networks in any meaningful way. For example, Canada's share in the Southeast Asian electronics trade -- one of the best examples of regional production networks -- is barely one percent.
- India has enjoyed robust economic growth for more than ten years. The rise of India is not only about software, call centres, and cheap pharmaceuticals. It is only a matter of time before India joins the rest of Asia as a manufacturing centre, destination for foreign investment, and participant in regional production networks. I was speaking recently with one of the pioneers of the Indian IT industry, Dr F.C. Kohli of Tata Consultancy Services, who told me that he expects India to be a major manufacturer of computer hardware within three years. The move into manufacturing will start with low-cost computers for the domestic market but will quickly move into higher-end products for export to world markets.
- Likewise, China cannot be typecast as simply a manufacturing economy. : Novartis AG of Switzerland will invest \$100m in pharmaceutical R&D in China, about the same amount as AstraZeneca PLC of Britain. Roche Holding AG has had a research lab in China since 2004, employing about 60 scientists.
- India and China may have historic grievances and they will likely compete for influence in the region for years to come, but Indian and Chinese enterprises fully understand the potential of combining Indian software expertise with Chinese manufacturing talent. Two-way trade and investment are expanding at a record pace. When Chinese and Indian leaders set a target of \$20b for two-way trade by 2008, many analysts scoffed at such an ambitious goal. That goal will be met this year, well in advance of the 2008 target.
- In their own ways and sometimes collectively, China, Japan, and India are seeking to increase their influence on global affairs and on the architecture of global governance. It isn't simply about the quest for a place on the UN Security Council or as a member of the G8. It is about a fundamental shift in the way Chinese, Japanese and Indians see themselves in the world -- a combination of growing confidence that comes with increasing economic clout; a sense of inequity in the current configuration of international institutions and in the global distribution of wealth and influence; and increasingly, an aspiration for Asia-wide economic and political institutions that give the region as a whole greater influence globally.

- Other examples: 6 party talks, China-Africa Summit, Indian nuclear capability, the establishment of Confucius Institutes around the world.
- Canadian thinking on Asia – in both foreign policy and economic policy – is starting to come to grips with the economic power of China, Japan, and India, but it has not yet begun to contemplate the ramifications of Asia’s global influence beyond the immediate commercial considerations.

A Pacific Future?

- According to a recent national opinion poll conducted by the Asia Pacific Foundation of Canada and the Globe and Mail, 58 percent of Canadians agreed with the statement: “Looking 20 years ahead, trade with Asia will be more important to Canada than trade with the US”. The same poll found that Canadians chose China over the United States as the country which offers the most potential for exports and investment by a margin of 13 percentage points. Japan was third, with India and Southeast Asia next, and the EU in sixth position.
- In 2005, our trade with Asia – including exports and imports – was about 12 percent of total trade. In contrast, the United States accounted for around 70 percent of Canada’s total trade. In fact, at historic growth rates and using simple minded straight-line projections, Canada’s trade with Asia could well overtake our trade with the US by 2031 – which is only 25 years away. Nobody should bet the farm on the basis of straight-line projections, but Canadians have clearly observed a trend in our changing trade patterns and they can imagine a future where Asia may well be more important than the United States.
- The point of these observations is not about the accuracy of Canadian public opinion and whether Asia will in fact overtake the US as our most important trading partner. It is rather that Canadians are already attuned to the importance of Asia – China, Japan, and India especially – and that we are embracing the need for closer economic ties with the region. This extends beyond trade into two-way investment. When asked if the government of Canada should promote greater Asian investment in Canada, including in the sensitive energy sector, a strong majority agreed. An even larger percentage of respondents concurred with the statement that the government of Canada should promote investment in Asia, despite obvious concerns over short-term job losses.
- The important statistic, to my mind, is not the relative importance of the United States or China for Canada; it is the importance of China for the United States and vice versa. On current trends, China will displace our prized role as the United States’ number one source of imports next year, and

will overtake us as the most important overall trading partner for the United States in five years. At a time when our government is hesitating about our so-called “strategic partnership” with China, the United States is aggressively pursuing a deeper level of engagement with Beijing. In launching a set of strategic dialogues between top officials of the US and China, Treasury Secretary Hank Paulson has made clear that he is taking a “generational view” of relations with China. I would suggest that this shift in the relative importance of Canada for the United States is much more important than any shift in the relative importance of the United States for Canada.

Are we ready?

- In a survey of over 1000 manufacturers and exporters, the APF and CME found that 63 percent of respondents are not doing business with China. Of the 37 percent that are doing business with China, the most common form of business activity was imports. 65% have been doing business with China for less than 3 years. Thirteen percent of respondents are exporting to China, and one in ten have manufacturing operations in China. Less than 5 percent of businesses are involved in more “exotic” ways of doing business with China, such as the export and import of services, e-commerce, real estate development, and R&D in China. Only 17 percent of respondents have developed “China strategies”.

Mental maps

- Our opinion poll suggests that Canadians are already attuned to the rise of Asia as an economic power, and that we embrace the need for closer economic and political ties with the region. We are still a long way, however, from embedding the Asia Pacific into our mental maps. When we asked the question “Is Canada part of the Asia Pacific region?” only 39 percent agreed with the statement (only 35% in Ontario). It strikes me that there really is only one answer to this question, since Canada clearly borders the Pacific Ocean, and is a member of the only Asia Pacific wide intergovernmental organization (APEC), but the issue of course is not one of geographic awareness, it is about mental maps. The Asia Pacific is not yet part of Canadians’ mental map. We may joke about changing the motto “A mari usque ad Maria” to add one more sea, but the truth of the matter is that we are still getting used to one of the two “maris”. More than one hundred years after the completion of the trans-continental railway, Canada has yet to come to terms with the idea that we border the mighty Pacific Ocean on our west coast and are connected through it to a part of the world that will inevitably shape our future.

The Need for Pacific Gateway Thinking

- The need for a change in Canadians’ mental maps is the reason why I believe the most important priorities in strengthening Canada’s ties with Asia are not

about what we do over in Asia, but about what we do here in Canada. You may have heard about a recent federal government announcement on the Pacific Gateway and Corridors Initiative. This initiative is in the first instance a transportation infrastructure investment project, focused principally on the west coast of Canada. These investments are critical if our west coast ports are to remain competitive and if we want to reduce congestion in the transportation corridors that in many cases have their final destination right here in Ontario and beyond into the United States.

- But the Pacific Gateway has to be more than a set of infrastructure investments. It has to be part of a national strategy on Canada's Pacific Future and how all parts of the country have an interest and an imperative to be part of that future. In the same way that there is a need for investments in physical gateway infrastructure, there is also a need for investment in soft gateway infrastructure that lead to more durable ties with Asia – these include language and cultural skills, market intelligence, and broad Asia-awareness across government, business, and in the education system. The Ivey School and its Asian Management Institute is a leader in this regard, not only in Canada, but among western industrialized countries. But there are not enough Ivey Schools in this country. If Canada wants to have a Pacific future, it must invest in a Pacific future.

- To conclude, let me return to a theme which I began with, which is that the story of the emerging world is a story about globalization. The rise of countries such as India, China, and Brazil are a testament to the power of globalization in lifting countries out of poverty, but this same power of economic leveling across countries is also a source of economic challenge within countries. Competition from emerging countries is exacerbating income inequality in rich countries and creating stresses in the social fabric. Because of our industrial structure, Canada so far has been relatively unscathed. The future may not be so benign. On the flight from HK to Toronto earlier this week, I was sitting next to a man who is in the socks business. He told me that he used to manufacture all his socks in Canada; today he manufactures all of his product in Asia. His business is not doing badly, but there has clearly been a reallocation of benefits away from workers in Canada to workers in the emerging world, and to the owners of capital. We cannot be blind to this phenomenon. At the same time, we must not draw the wrong conclusion by turning our backs on globalization. In many ways, Canada is better positioned than most industrialized countries to adapt to the uncertainties of globalization and to embrace the challenge of emerging markets. We have a highly open economy, excellent quality of life, proximity to what is and will be the richest market in the world for many years to come, and our major cities are as cosmopolitan as they get. In any case, the world will change, and we will be changed by it. One can only hope, and I apologize for saving the management jargon for the very end of speech, that we will be “ahead of the curve”.