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Confidence and Complexity: What the 14th Five-Year Plan Means for Canadian Companies in China

CCBC's Full Report on the FYP – In Partnership with trivium China

TABLE OF CONTENTS

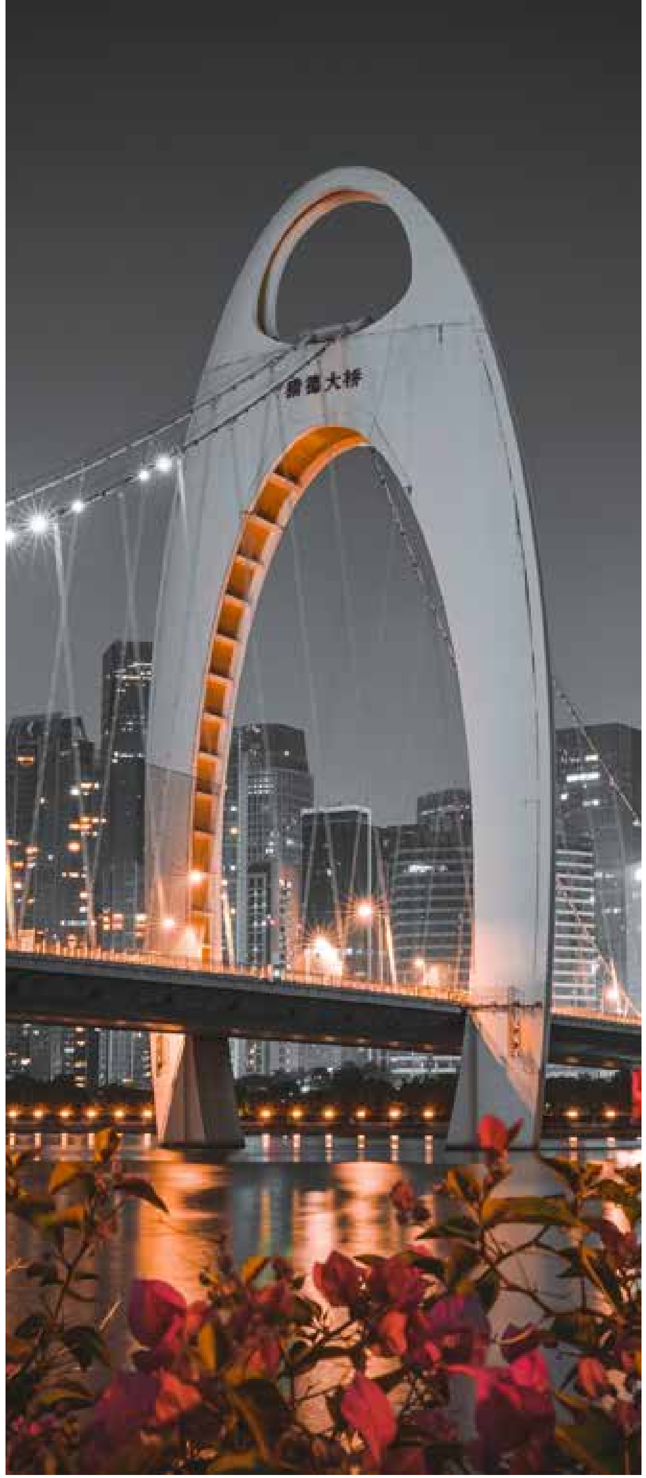
EXECUTIVE SUMMARY

Policymakers view the next five-year period as a key inflection point for China – one that seeks to put the economy on a more sustainable long-term growth path. Broadly speaking, this means moving away from a growth model focused on maximizing economic output to one seeking to ensure that economic development improves quality of life for the average citizen. China's new approach to economic management will serve to restructure large parts of the economy, presenting both opportunities and risks for Canadian businesses operating in or with the Chinese economy.

GDP growth will slow, with China settling into an overall growth trajectory in the neighborhood of 3-3.5%, on average, over the next decade. This is not necessarily bad news, as slower growth will move the economy onto a more sustainable growth trajectory. Lower, but more sustainable, growth will limit the extremes of economic growth cycles and make business planning more predictable.

Ensuring "economic security" is a key theme of the 14th Five-Year Plan (FYP), 2021-2025. To do this, policymakers are seeking to make the economy more resilient, which should lead to more marketizing reforms and a better business environment. Beijing will also seek to enhance technological, energy, and food security by strengthening domestic capabilities in these areas, while simultaneously seeking to ensure reliable sources of key economic inputs from overseas.

The Chinese consumer will become an increasingly powerful economic force. Boosting domestic demand is a key goal of the 14th FYP. The plan aims to boost household consumption by raising household incomes, increasing urbanization, and building out the social safety net. These measures will free up more discretionary income and lead to more consumer spending over the coming five years.



Barriers to trade and investment will be further reduced, which will benefit foreign businesses. However, this will be coupled with increased scrutiny of foreign trade and investment as policymakers seek to ensure that such trade and investment do not make the economy vulnerable to potential supply chain disruptions.

Canadian companies in China face both new possibilities and new challenges. Firm Chinese commitments to business sector opening, including financial services, energy, high-end manufacturing, environmental protection, and others mean more possibilities to engage with the China market than ever before. Likewise, improvements to the business environment will allow Canadian firms to operate with greater ease and more robust legal protections. At the same time, an increased emphasis on economic security and China's brittle relations with Western countries mean that foreign firms must tread carefully. As geopolitical tensions continue to simmer, the risk of reputational damage is set to increase. Canadian businesses should keep China's developmental and political priorities in mind to capitalize on new openings and reduce risks.

China's financial services sector will provide myriad opportunities to Canadian financial institutions (FIs) over the next five years. The sector as a whole will continue to be more open to foreign companies, while China's capital markets are set to see strong growth and open further to international participation. Canadian FIs may benefit in particular from specific efforts to increase funding for small and medium-sized enterprises (SMEs), develop green finance, better integrate Hong Kong's financial markets with those of the mainland via the Greater Bay Area initiative, and expand the commercial insurance sector. At the same time, regulators remain committed to de-risking the financial system, which will lead to more stringent regulation. While this will increase compliance costs, it may benefit foreign FIs vis-à-vis their domestic competitors, as they should be able to more easily adapt to a stricter regulatory environment.

China will remain a growth market for agricultural products, but Canadian agribusinesses don't have a guaranteed slice of the pie. A rising emphasis on food security and concerns about over-reliance on any one country for key commodities may result in a pattern of trade disruptions in certain categories. However, markets for niche and high-end products will continue to grow, driven by the growing middle class and aging population. Canadian suppliers of agriculture technology and inputs may get a boost from efforts to revitalize rural areas and scale up the domestic agricultural sector.

China's increased focus on quality growth – including environmental sustainability – is changing the nature of its demand for natural resources. Demand for resources that comprise the building blocks of heavy industry will plateau – or begin to fall – over the next five years. This trend will be counterbalanced by stricter domestic environmental regulations pushing up prices for domestically sourced resource inputs. Conversely, demand for the resources that underpin the green economy will see strong growth in the coming years, which should benefit Canadian producers. However, if bilateral tensions continue to rise, China's drive to achieve resource security could disadvantage producers in commodity categories where China feels over-reliant on Canada.

China's energy policy over the next five years will seek to decarbonize the economy while also boosting energy security. This will lead to strong growth in renewable-sourced energy, offering expansion opportunities for Canadian renewable energy investors and companies. Oil and gas consumption will continue to grow, as will imports of both; as China seeks to diversify sources of oil and gas imports, Canadian companies may be able to benefit. A drive to increase domestic oil and gas production is creating a more welcoming environment for foreign upstream oil and gas companies.

China's cleantech sector will see strong growth now that environmental protection is seen as an integral component of economic policymaking. Efforts to clean and green China, and ambitions to lead globally on sustainability, will drive new markets for products and services that offer pollution control and resource intensity reduction benefits. Remediating contaminated land and water and improving soil quality are top national priorities; private companies are actively encouraged to participate in these efforts. A host of tax benefits, preferential financing, and other incentives for environmental retrofits and remediation will be rolled out in the coming years. Canadian companies should carefully track this space to identify market opportunities.

The 14th FYP enshrines Beijing's view that data is a critical economic resource, and the smooth and secure circulation of data between individuals, enterprises, government bodies, and nations is vital to the growth of China's digital economy. This new thinking will inform China's approach to data policy over the coming decade and beyond. This development is set to impact not only businesses in the tech sector, but all enterprises collecting, storing, and transferring data in China.

China's economic trajectory: slower, more sustainable

Policymakers view the next five-year period as a key inflection point for China – one that seeks to put the economy on a more sustainable long-term growth path. Broadly speaking, this means moving away from a growth model focused on maximizing economic output to one that seeks to ensure that economic development improves quality of life for the average citizen.

China's new approach to economic management will serve to restructure large parts of the economy, presenting both opportunities and risks for Canadian businesses operating in or with the Chinese economy. Below, we review key macroeconomic themes that will shape the business outlook for Canadian companies over the next five years.

Growth will slow

When it comes to China's medium-term growth outlook over the next 5-15 years, the fundamentals behind the economy's growth are straightforward. Capital investment rates are declining after years of overly-high investment by local governments. The demographic picture has already turned, and the working age population is shrinking, creating a drag on growth over the 5- to 15-year time frame. Productivity growth is increasingly hampered by institutional challenges and the realities of China's fragmented national market. The upshot of all these dynamics is that China will settle into an overall growth trajectory in the neighbourhood of 3-3.5%, on average, over the next decade.

The era of supercharged growth in China is over, and Canadian businesses need to factor in this new reality into their business planning. The good news is that this is not uncommon for an economy at China's stage of development. Even more positive is the reality that China actually needs slower growth to move onto a more sustainable growth path.

China's development model is changing to emphasize quality

What was particularly striking from this year's Two Sessions was that senior Chinese policymakers fully embraced the need to transition to a new model of economic development. The 14th FYP emphasizes that the quality of economic growth will increasingly be prioritized over the quantity of growth. This means that increasing productivity and moving up the global value chain are top concerns.

While Chinese policymakers have long signalled this shift, they are undertaking it now with a new sense of urgency. That is underscored by the fact that the 14th FYP does not have a quantitative economic growth target – instead it emphasizes targets around income growth, environmental protection, and quality of life issues.

Ensuring economic security is a top concern

The 14th FYP includes a dedicated section on ensuring "economic security" for the first time, a clear sign that the concept is now top of mind for policymakers. Policymakers are seeking to make the economy more resilient and create sustainable growth, which will reinforce the shift towards a growth model focused on quality over quantity. This should lead to more marketizing reforms and a more rules-based business environment.

Another critical piece of the economic security push is a desire to address vulnerabilities related to China's interactions with the global economy. In recent years, heightened tensions with the United States, as well as the global COVID-19 pandemic, have caused supply disruptions for many Chinese companies. Going forward, policymakers want to minimize the risk of such disruptions, which is leading to an increased focus on securing supplies of key economic inputs, particularly technology, energy, and food. To enhance technological, energy, and food security, Beijing is seeking to increase domestic capabilities in these areas; where domestic capabilities are lacking, policymakers are seeking to ensure they have diverse and reliable sources of supply from overseas.

Here come the Chinese consumers

Boosting domestic demand is another key goal of the 14th FYP and is likewise seen as an integral component of creating a higher-quality and more resilient economy. China's drive to boost domestic demand is embodied by the Dual Circulation Strategy (DCS) – an economic policy framework that is featured prominently in the 14th FYP. The DCS looks to make "internal circulation" (i.e. the domestic economy) the main driver of the economy, in part by increasing household consumption. To do this, the 14th FYP promises to raise household incomes, increase urbanization, and build out the social safety net. These measures will free up more discretionary income and lead to more consumer spending over the coming five years.

China will deepen ties with the global economy, but on its own terms
In addition to promoting "internal circulation," the DCS also seeks to optimize "external circulation" (i.e. China's interactions with the global economy). Over the next five years, China will continue to deepen trade and investment ties with the rest of the world, but it will seek to do so in a way that contributes to the overarching goals of promoting high-quality growth and ensuring economic security. On the whole, this will lead to more market openings and fewer barriers to trade, but it will simultaneously lead to more scrutiny of foreign investment and trade as policymakers seek to ensure that such trade and investment does not make the economy vulnerable to potential supply chain disruptions.

Opportunities will expand for Canadian companies
China's economic trajectory is very good news for foreign companies operating in China. Lower, but more sustainable, growth will limit the extremes of economic growth cycles and make business planning more predictable. In addition, over a five-year time horizon, the government's efforts to move up the value chain and boost productivity in order to achieve better quality growth will necessarily require the involvement of foreign companies. While geopolitical pressures will continue to create uncertainties for the China market – and the domestic regulatory environment is still far from consistent or reliable – our view is that the fundamentals of China's ongoing economic transition will continue to create opportunities for Canadian companies looking to expand in China.

Implications of the 14th Five-Year Plan for Canadian businesses

The 14th FYP presents Canadian companies in China with new possibilities and new challenges. On the whole, the business environment for foreign companies is improving. At the same time, an increased emphasis on economic security and China's brittle relations with Western countries mean that foreign firms must tread carefully.

It will become easier for foreign companies to invest in China
In recent years, Chinese leaders have repeatedly committed to greater economic opening to foreign businesses and investors. A slow but steady drumbeat of liberalizing reforms and business environment improvements have gradually increased the space for overseas entities to operate in China. The 14th FYP recommitted China to this course, pledging reductions to the negative list for the cross-border trade in services, improved laws protecting foreign companies and investment, efforts to improve the business environment, further development of free trade zones, and continued pursuit of greater financial opening (see Section 3).

Some sectors will see a particularly warm welcome
The 14th FYP views overseas capital as a crucial tool for achieving longer-term development goals of increasing productivity and moving the economy up the global value chain. The plan specifically calls for increased foreign investment in the following areas:

- Medium- and high-end manufacturing
- Technological and industrial upgrading
- Modern service industries
- China's central and western regions
- Research and development centres
- National science and technology programs
- Energy conservation and environmental protection industries

The combination of greater all-around opening and the 14th FYP's specific calls for foreign investment in key areas presents a golden opportunity for Canadian business. Companies that can directly contribute to national objectives can expect generous treatment and ample incentives. As such, Canadian firms should identify areas where business goals align with China's development priorities and seek to demonstrate how their presence contributes to these goals to reap the benefits.

Beijing's economic security push is increasing scrutiny of foreign companies…
Amid promises of greater opening, foreign companies are likely to face increased governmental scrutiny in the 14th FYP period. Beijing has made ensuring economic security a central feature of the next phase of its economic development and, for the first time, the FYP features a dedicated section on coordinating economic development with national security. This is leading to increased scrutiny of foreign investment as officials seek to ensure that foreign money contributes to economic security. In its annual report, the country's macroeconomic regulator – the National Development and Reform Commission – said it will begin conducting national security reviews of foreign investments in 2021. Likewise, China's legislature pledged to "enrich its toolbox" for safeguarding the country's development interests, signalling that multinationals can expect a greater degree of government oversight in the coming years.

…but also provides opportunities

Beijing's economic security push mainly centres on securing supply chains in key strategic areas, with a view to enhance self-sufficiency. Canadian companies that can fill gaps in supply chains or contribute to building domestic capabilities will be welcomed with open arms. Canadian firms should evaluate how their industry could be affected by the economic security push and come up with strategies to mitigate attendant risks, seize potential opportunities, and ensure their operations are fully compliant with Chinese law.

Geopolitical tensions create risks for Canadian companies

The 14th FYP signals that many of the policies that have contributed to elevated tensions with the West in recent years will continue, including a more assertive foreign policy, strict controls over political expression, and hardline policies towards religious and ethnic minorities. These will likely serve to further exacerbate rising tensions between China and the West, which will increase political risks for Canadian companies. For example, in the past two years, tensions between Ottawa and Beijing led the Chinese side to impede shipments of Canadian goods such as canola.

Amidst heightened geopolitical tensions, foreign companies are facing increased reputational risks, both in China and at home. Recent national boycotts in China of foreign apparel makers who made statements on Xinjiang serve as a cautionary tale about the dangers of taking a political stance in the China market. Conversely, as popular opinion of China sours in Canada, Canadian companies operating in or selling to China may also face opprobrium at home.

To complicate matters further, Western (particularly U.S.) sanctions against a growing number of Chinese companies may create difficulties for Canadian firms with extensive supply chains in China. This more complicated geopolitical environment means that Canadian companies need to carefully identify potential risks and prepare contingency plans, ensure that messaging on hot-button issues is clear and consistent, and evaluate supply chains to identify at-risk local suppliers and partners.

Financial opening to continue, coupled with tighter oversight

The 14th FYP largely locks in policymakers' current approach to the reform of China's financial services sector – pledging to continue the process of financial liberalization while strengthening oversight of the financial system. Over the next five years, several trends arising from this approach will be important for Canadian FIs; we review these below.

The financial sector will further open to foreign investment. The language and tone in this year's plan was relatively conservative compared to the 13th FYP. While the 13th FYP called for "expanding the scope" of financial opening, the 14th FYP calls for "steadily and prudently promoting the opening of banking, securities, insurance, funds, futures, and other financial sectors." This reflects the fact that most areas of financial services have already been fully liberalized in recent years, so there is little room to further "expand" openings. Instead, over the next five years, regulators will focus on implementing the openings already announced in recent years.

China's financial markets will increasingly be open to foreign investors. In particular, the plan aims to:

- Deepen connections between domestic and overseas capital markets
- Improve the system of qualified foreign investors
- Promote the internationalization of the renminbi (RMB)
- Improve administrative services for entry and exit, customs, foreign exchange, and taxation
- Push forward cross-border securities investment pilots in some free trade zones

More broadly, China will continue to expand and improve its capital markets. To this end, the document called for:

- Improving and expanding the scale of China's capital markets
- Increasing the proportion of direct financing in overall financing, especially equity financing
- Improving equity markets through fully implementing a registration-based IPO system, establishing a delisting mechanism, and improving the quality of listed companies
- Deepening reform of China's main OTC equity market, the New Third Board (also known as the National Equities Exchange and Quotations, NEEQ)
- Making bond issuance more market-oriented
- Improving and expanding the scale of the bond market and issuing long-term treasury and infrastructure bonds

Another key theme for financial services in the next five years will be to improve financing for SMEs. Related measures include:

- Creating new and innovative policy tools to further financial support of private enterprises
- Improving the financing credit enhancement support system
- Ensuring equal treatment of public and private business in credit applications
- Reducing overall financing costs for private business

Continued liberalization will be coupled with a focus on financial de-risking and enhanced regulatory oversight. To this end, the plan called for:

- Improving corporate governance of financial institutions and strengthening supervision of shareholders' equity and related party transactions
- Developing early warning systems for financial risks
- Enhancing oversight over shadow banking

Policymakers see both challenges and opportunities related to the development of fintech. Policymakers are keen to develop the fintech sector; however, the emergence of internet giants, like Alibaba Group Holding Ltd. and Tencent Holdings Ltd., has led to concerns about their ability to distort markets, challenge state power, and foster financial system risk. In the coming five years, policymakers will attempt to strike a balance between developing the sector while also ensuring there is sufficient oversight. To this end, the plan calls for:

- Strengthening supervision of fintech in general and improving risk assessments for new innovative fintech products
- Accelerating the digitalization of financial institutions
- Promoting the development of a digital currency

In addition to the themes laid out above, the following items from the 14th FYP will also be of interest to Canadian FIs.

- **The government looks to make progress on the Greater Bay Area initiative,** which aims to create connections between mainland financial markets and those of Hong Kong and Macau.
- **The plan promises to "vigorously develop" green finance.** This should lead to a large increase in green lending and green bond issuance, as well as the development of green financial assets such as carbon futures.
- **The plan promises to deepen reforms in the insurance sector,** and specifically aims to improve commercial insurance.

Implications for Canadian financial institutions

Over the next five years, China's financial services industry will continue to grow quickly, presenting numerous opportunities for Canadian FIs. China's financial services sector will continue to become more market-oriented, which will benefit Canadian FIs that are likely to thrive vis-à-vis their Chinese competitors in an increasingly competitive financial services marketplace.

In recent years, foreign FIs have been heartily encouraged to invest in China, as the international expertise and best practices they bring are seen as key to developing China's financial services industry. This trend will only continue in the years ahead and is relevant to the foreign FIs across the financial spectrum, including banks, insurance companies, securities firms, and asset managers. In particular, the recent regulatory relaxations for the fast-moving commercial insurance and wealth management sectors should offer especially exciting opportunities for Canadian FIs with expertise in these areas. To succeed against incumbent Chinese players, Canadian FIs looking to enter or expand in the Chinese market should attempt to distinguish themselves by focusing on their strengths – advanced expertise and specialty high-level services – and/or by carving out a niche for themselves within the market by focusing on a specific region or customer group.

At the same time, the increased focus on financial de-risking will likely raise compliance costs for all FIs. However, a better, more tightly regulated sector is likely to be relatively advantageous for Canadian FIs, who will likely more easily adapt to the stricter regulatory regime than domestic FIs.

For Canadian asset managers, it will become increasingly easier to invest in China's capital markets – and repatriate earnings. Greater access to China's stock and bond markets will allow Canadian investors to more directly benefit from China's economic growth and invest in dynamic Chinese companies. It also offers an important opportunity to enhance portfolio diversification given Chinese capital markets' relatively low correlations with other global markets.

China's agri-food market will continue to grow

Policymakers have flagged food security as a top priority under the 14th FYP as part of a broader focus on ensuring economic security (see Section 1). To this end, the 14th FYP introduced an annual grain production goal of 650 million tons. This target is lower than 2020 production levels and is not likely to meaningfully impact Chinese demand for imported grain.

Reading between the lines of this target, policymakers have come to terms with the fact that imports of many agricultural products – from feed grains and oilseeds, to dairy and infant formula, to red meat – will continue to grow for the foreseeable future. The plan indicates that China will seek food security via diversifying sources of agricultural imports and improving the efficiency of agricultural production.

Diversifying sources of agricultural imports
Efforts to reduce reliance on traditional major exporters like Canada, along with the U.S. and Australia, have been ongoing since shortly after the launch of the Belt and Road Initiative (BRI) in 2013. Diversifying agricultural product import sources is (again) listed as a key priority in the 14th FYP.

- The FYP features an expanded section on the BRI, pushing more major investment projects and infrastructure links, which will reduce costs and shipping times for agricultural products to reach China's market from alternative suppliers of agricultural commodities.
- Also on the priority list is building a world-class agricultural trading company, capable of competing with global leaders in this space, namely the ABCDs – Archer Daniels Midland (ADM), Bunge, Cargill, and Louis Dreyfus. While not explicitly named, it is likely this trader is a subsidiary of COFCO, the state-owned food company.

Building larger, more efficient, and more productive farms
At home, the 14th FYP calls to accelerate a reform agenda aimed at building larger, more efficient, and more profit-oriented farms. This entails modernizing and professionalizing the farming sector in a number of respects, and redoubling efforts on rural development.

- Seed research is flagged as a top innovation priority – commercial approvals for domestic cultivation of genetically modified crops, which have been stalled for nearly 20 years, look set to finally move forward. Trade partners may see less scrutiny of imported genetically modified varieties as a result.
- Familiar goals like protecting farmland, improving mechanization, and greening agriculture are still in place.
- Critically, building a profitable farming and food processing industry at home is linked with higher priorities on rural development, like growing incomes and increasing non-farm employment in rural areas.

Rural development has become one of the top national policy priorities. Rural areas are the target of a flagship "rural revitalization strategy" that aims to pick up where the recently concluded poverty alleviation campaign left off. The strategy aims at expanding rural industries and boosting employment, incomes, and consumption at the village and township levels.

- Efforts to deliver on this agenda may impact trade relationships if imports in certain product categories are seen to trade off with employment-generating local industries.
- Rural development will certainly demand time and attention from policymakers previously concerned primarily with agribusiness and food production.

Macroeconomic goals in the 14th FYP are also likely to impact agri-food demand. Efforts to raise incomes, expand the middle class, and boost domestic consumption – undertaken as part of the Dual Circulation Strategy (see Section 1) – will not only increase China's appetite for high-quality agricultural products, but also move demand up the value chain, toward a more diverse diet including more processed, packaged, and prepared foods.

Implications for Canadian agribusinesses

China will remain a large and growing market for agricultural commodities and food products for the foreseeable future.

However, the nature of that demand is evolving.

Canadian agri-food businesses that can supply a diverse and high-end product range will be advantaged by demographic changes, including rising incomes, a growing middle class, and the aging population.

- **Processed food companies,** particularly those whose products appeal to consumers seeking healthier or more convenient food options, should feel confident in seeking market access and building partnerships and sales channels in China.
- **Niche and high-end Canadian agricultural products,** like fruit and seafood – particularly those seen as having health benefits – will continue to see large and growing markets.

Broadly, demand for commodities, including staple grains and oilseeds as well as livestock products, will remain high.

- **However, China's focus on food security will continue to create sensitivity** around any commodity where Canada – or any Western country – holds a dominant import market share. China's efforts to diversify trade partners in these categories may result in trade disruptions.
- **That is not necessarily a reason to shy away from market development efforts** in China, which will remain a major buyer of these products from global markets for the foreseeable future. In categories where Canada does not hold a massive market share, it is less likely that trade will be disrupted.
- **Companies should approach China as one of many important markets**, manage risk, and ensure diversity in their own sales strategies as well.

Canadian suppliers of agricultural technology and inputs that are suitable for China's context will also see a robust market as a result of efforts to protect and improve farmland, and ensure operating farms are as efficient and profitable as possible. While the 14th FYP provides broad outlines of an ambitious agenda for modernizing the farming sector, the Central No. 1 Document – released every January – will provide detailed policy signals on which farming techniques, technologies, and products will be prioritized for promotion.

Natural resources demand will shift along with China's industrial structure

Demand for metals and other resources will continue to increase over the 14th FYP period. This will be driven by growing energy demand, increased urbanization, and a buildout of infrastructure in rural areas.

Policymakers are looking to continue a transition away from "growth at all costs" under the 14th FYP, and shift toward a focus on growth quality, rather than quantity or pace. As a result, the FYP targets a move away from an economic structure dominated by environmentally impactful and energy-intensive heavy industries, and toward a move up the value chain.

- Nowhere is this reflected more clearly than in the industrial and manufacturing sectors, where the FYP mandates strict environmental targets and a push to boost innovation in a bid to build higher-value, more productive industries.
- Risks associated with the financial system are also a top priority and have been explicitly linked with national security. Reducing risk in the financial system from state-owned enterprise (SOE) and local government debts is a top priority, and will likely result in restructuring among major state-owned industrial companies.
- Canadian companies with customers and partners in the resources and heavy industry sector should be aware that many of their largest customers are likely to be SOEs. These customers are facing mounting regulatory and financial scrutiny, which may result in sudden changes in their ability to pay bills or fulfill obligations. Companies should take care to learn as much as possible about their key SOE customers and partners – including monitoring Chinese-language industry coverage about these companies in order to manage risks.

The FYP calls to build a leaner, greener industrial sector in a number of respects. These include:

- An ongoing push to reduce industrial overcapacity – particularly in energy-intensive and highly polluting sectors – and improve efficiency through consolidation
- Efforts to implement pollution control retrofits and strict capacity controls in some sectors, and to build a carbon emissions market that makes it more expensive for heavy-emitting companies to operate
- Support for industrial enterprises that are capable of innovating and upgrading product offerings to refocus on high-quality, specialty, and new materials

Support for innovation and technical breakthroughs is a key priority in the FYP, spanning all sectors, but with a particular focus in industries that are heavily reliant on foreign technologies, and in other sectors plagued by technical bottlenecks.

- The plan targets 7% growth in R&D spending across all sectors. In heavy industry, petrochemical, and other resource-intensive sectors, this spend will likely be focused on energy intensity and pollution emissions reduction.
- The plan promises tax breaks for innovation – some of which have already materialized as of writing. If customers for resources are in highly innovative sectors – particularly new materials, which is highly prioritized by the 14th FYP – this may increase their buying power in the short term and result in breakthroughs that shift markets in the medium term.
- Expanding new infrastructure – which spans smart transportation infrastructure like electric vehicle charging stations, to big data management centres and processors capable of powering artificial intelligence research – is also a key goal of the FYP.

Climate policy commitments under the 14th FYP will drive growth in renewable energy, nuclear energy, energy storage, and new energy vehicles. We elaborate on these drivers in our sections on energy (Section 6) and cleantech (Section 7), below. China's increasing commitment to new energy generation and use, nuclear energy, and to peak carbon emissions before 2030, will drive significant demand for the resources that underpin these sectors, including copper, nickel, lithium, cobalt, uranium, gold, and silver.

The 14th FYP also recommits to an environmental protection agenda that has led regulators to crack down on domestic mining and smelting in recent years. This may result in

- More demand for higher-quality, higher-grade natural resources that generate less pollution during processing
- Reduced domestic production (and potentially more imports) of some minerals and metals, including rare earths
- Interest in offshoring more processing than in years past, and importing more refined products

The 14th FYP's focus on ensuring economic security will mean that China will be evaluating the reliability of its sources for imported natural resources, with an eye on making sure that import sources are diversified and reliable. This will also likely lead to more investment by Chinese companies in overseas mining resources.

Implications for Canadian resource businesses

China's evolving economy is changing the shape of its natural resources demand.

- Aggregate demand for resources that comprise the building blocks of heavy industries (like iron ore and coal) and inputs to other highly polluting sectors (like petrochemicals) will continue to rise in the short term.
- By the end of the five-year period, they are likely to plateau or begin to fall.
- **Canadian suppliers of these materials should look to take advantage of rising demand over the next five years, while also planning for reduced demand in the future.**

Meanwhile, Canadian producers of resources that offer environmental benefits or fuel green development are likely to see their markets boom.

- Environmental benefits may include ores or other raw materials that offer reduced pollutant emissions or have less energy-intensive processing requirements.
- The building blocks of the green economy, such as lithium, cobalt, and nickel, will see strong demand in the coming years, which should benefit Canadian producers.
- Uranium demand will also increase on the back of China's efforts to promote nuclear energy.

The push for economic security also has implications for Canadian resources producers.

- On one hand, if bilateral tensions rise, China will consider risks associated with reliance on Canada for key commodities. Canadian companies should seek to demonstrate that they are reliable suppliers while monitoring the political situation closely and building in contingency plans.
- On the other, China's push to bolster key industries at home may generate more opportunities for the resources sector, including suppliers of metals and minerals to the strategic tech and cleantech sectors, and suppliers of potash to Chinese producers of fertilizers.

China's energy mix to decarbonize in order to achieve climate goals

China's energy policy over the next five years will be driven by efforts to achieve two overarching goals. The first is to gradually decarbonize China's energy mix to achieve China's climate commitments. The second is to strengthen China's energy security. More detailed five-year plans for the energy sector are planned for release by the end of 2021; these will bear careful watching by Canadian energy companies. In the meantime, we review the main themes for the energy sector coming out of the 14th FYP.

The use of renewable energy will greatly expand. In September 2020, Chinese President XI Jinping pledged in a speech to the United Nations that China will reach peak carbon emissions before 2030 and achieve carbon neutrality before 2060. The 14th FYP builds upon these pledges and aims to build a clean, low-carbon, safe, and highly-efficient energy system. To do this, the 14th FYP aims to reduce carbon emissions intensity, measured by CO_2 emissions per unit of GDP, by 18% over the next five years.

Efforts to reduce carbon intensity will lead to a substantial increase in both the development and consumption of renewable-sourced power. The 14th FYP calls for non-fossil energy consumption to account for roughly 20% of China's total energy consumption by 2025, up from 15.9% at the end of 2020. To do this, the plan urges efforts to:

- Vigorously increase the scale of centralized and distributed wind and solar power development
- Accelerate the growth of distributed energy in eastern and central regions
- Accelerate the construction of hydropower bases in western and southern regions
- Develop offshore wind power in an orderly fashion
- Safely push for the construction of coastal nuclear power plants
- Establish a batch of hybrid clean energy bases
- Improve energy storage technology and grid absorption capacity for renewable energy

Coal consumption will grow, albeit slowly. Coal is the big loser of China's drive to decarbonize its economy, and the 14th FYP pointedly projects a smaller role for coal in China's future energy mix. The 14th FYP pushes coal production to cluster in resource-rich regions, meaning coal mines will be shut down across the country. However, while the plan indicates that coal will consist of a smaller proportion in China's energy mix, actual coal consumption will continue to increase throughout the five-year plan period. Notably, the 14th FYP did not issue a coal consumption cap, although a cap may still be included in the sectoral 14th FYP for Energy expected later this year. In fact, the plan indicates that installed coal-fired power capacity will continue to grow, although the scale and pace of new capacity will be "rationally controlled." Since the issuance of the plan, President Xi has declared that China will peak coal consumption and begin phasing it down during the next five-year plan period (2026-2030). The upshot is that policymakers will strictly control the growth in coal consumption over the coming five years.

Oil and gas demand will continue to increase

For oil and gas, policy direction described in the 14th FYP largely stays the course. Demand for both will increase as China's decarbonization efforts focus on reducing coal in the overall energy mix. China's renewables buildout will also benefit natural gas, whose flexibility as a power source makes it well-suited to supplement renewable energy that may not be able to meet electricity demand at times when the wind is not blowing and the sun is not shining.

Nuclear energy capacity will expand. The 14th Five-Year Plan aims to expand China's nuclear power generation capacity from 48 gigawatts (GW) at the end of 2020 to 70 GW by the end of 2025.

Energy security concerns push for more domestic production and diversified import supply. Enhancing energy security is a key component of the broader directive to ensure national security (see Section 1). Notably, for the first time the 14th FYP set a floor for minimum domestic energy production (4.6 tons of standard coal equivalent). The plan also calls for:

- Maintaining stable and increased domestic production of crude oil and natural gas
- Increasing domestic reserves of oil, gas, and coal
- Ensuring self-sufficiency to supply "core oil and gas demand"

Despite these efforts, demand for oil and gas is likely to outpace increases in domestic production, meaning that oil and gas imports will rise in the coming years. The 14th FYP acknowledges this reality, but it seeks to diversify the sources of oil and gas imports so China does not become overly reliant on any one supplier.

Upstream oil and gas sector is open to foreign players. The 14th FYP reiterated policymakers' announcements made in the beginning of 2020 to gradually relax market access for oil and gas exploration and extraction, in order to accelerate the utilization of deep sea and deep layer unconventional oil and gas resources.

Implications for Canadian energy companies

Foreign investment is welcome in China's wind and solar energy sectors. These sectors will grow rapidly in the coming years and should offer opportunities for Canadian energy companies and investors.

Increased oil and gas imports over the coming five years is good news for Canadian oil and gas producers. Given that China currently imports relatively little of its oil and gas from Canada, Canadian companies may be able to benefit from China's efforts to diversify sources of supply. However, increased tensions in the Canada-China relationship could serve to discourage Chinese imports of Canadian oil and gas. Canadian companies should monitor developments closely and seek to position themselves as dependable suppliers. More broadly, even if Canadian oil and gas companies do not directly sell to China, increased demand from China will be positive for global oil and gas prices.

The desire to increase domestic oil and gas production, combined with the reiteration of the promise to open upstream exploration and production to foreign companies, could create opportunities for Canadian oil and gas companies. However, China's remaining untapped oil and gas reserves are all difficult to access and are likely of limited commercial value.

Cleantech will prosper on the back of increased emphasis on environmental sustainability

Environmental protection used to be "nice to have" – now it is viewed as an essential component of broader economic policymaking.

- Efforts to integrate environmental impacts into development planning have been prioritized by President Xi to address pressing domestic pollution issues since he came to power in 2012.
- These efforts are bearing fruit at home, with the general public enjoying bluer skies and cleaner waters, and the Party enjoying a boost in reputation as a result.
- They are also central to a vision of "high-quality development" that requires a shift away from an energy and resource-intensive model of economic growth.
- Now, President Xi is aiming even higher – seeking to establish China as a global leader in sustainability.

As a result, environmental issues are front and centre in the 14th FYP. The 14th FYP seeks to support China's path toward peaking carbon emissions before 2030, its most ambitious medium-term climate target to date. They include:

- A pledge to reduce the carbon emissions intensity of the national economy by 18%
- A call to improve energy storage technology and grid absorption capacity for renewable energy
- Strong language and aggressive, if qualitative, targets on ecosystem protection and environmental remediation
- Plans to upgrade industrial facilities, and more broadly, move industries up the value chain

Taken together, these will drive robust development in the cleantech sector in the coming years.

Environmental protection and ecological restoration projects feature prominently in the FYP. There is a particular emphasis on preventing and remediating soil pollution – an effort that has gained momentum following passage of the Soil Pollution Prevention and Control Law, which went into effect in November 2020. The 14th FYP calls to:

- Speed up efforts to remediate contaminated farmland and construction land
- Implement technical solutions to mitigate further ecological risks to water and soil

Pollution control and remediation efforts are also getting a boost from the rising priority of food security – which has been recognized as a key aspect of national security.

- The 14th FYP includes the first-ever quantitative target for food security.
- Protecting and expanding China's limited supply of arable land and fresh water from contamination is a critical aspect of food security policy.

The FYP also pushes industrial facilities to get cleaner and move up the value chain – requiring significant investment in cleantech to reduce emissions of a variety of pollutants and decrease resource intensity. Critically, production upgrading is increasingly framed through a lens of economic benefits, including making China's industries more globally competitive and reducing input costs.

- The steel, petrochemical, and building materials sectors in particular are slated for additional environmental regulatory scrutiny under the FYP.
- Efforts to control emissions of volatile organic compounds – particularly in the chemical and petrochemical, coatings, pharmaceuticals, packaging, and printing industries – are also prioritized.
- Industries that comply and implement green upgrades will benefit from tax incentives and green financing policies.

Implications for Canadian businesses

The prospects for cleantech companies serving China's market are only growing brighter. Cleantech upgrades will be in high demand as regulators translate the FYP into new regulations and standards. Canadian businesses with the ability to support industrial upgrading, including pollutant emissions reduction and resource utilization efficiency improvements, will be well-positioned to capture a portion of an explosion in green investment over the next five years.

The FYP directly solicits more involvement from private companies in ecological protection and restoration, further opening the door to Canadian businesses. Canadian businesses are likely to see significant opportunities in soil remediation solutions and should take note of the list of soil remediation and soil pollution source control projects planned for the 14th FYP period. Successful participation of leading Canadian companies in these demonstration projects would bring both reputational and economic benefits to the Canadian cleantech sector. Canadian companies may also consider supplying technologies and know-how to prominent Chinese companies in the space to take advantage of their network.

Financial support policies – including tax incentives and green financing – are likely to be major factors determining the demand for and profitability of certain technologies. Canadian companies in the cleantech sector should examine the specific types of environmental protection and water and energy conservation equipment that qualify for corporate income tax credits in order to better understand market opportunities and plan business strategies.

China is pioneering a novel approach to data policy

The 14th FYP signals a fascinating evolutionary shift in China's macro thinking on data policy. The FYP enshrines Beijing's view that data is a critical economic resource, and the smooth and secure circulation of data between individuals, enterprises, government bodies, and nations is vital to the growth of China's digital economy. Under this new high-level rationale, all data policy — including policies related to data privacy, cross-border data transfer, data infrastructure, and cybersecurity — will ultimately be enacted from an economic perspective. This is an important development that will have consequences for businesses operating in China. We briefly outline this development below.

Data is now seen as a key economic input. In April 2020, China's State Council released Opinions on Improving the Mechanisms for Market-based Allocation of Production Factors. The document was notable in that it officially designated 'data' as a 'factor of production' — one of the key inputs to the creation of value in the economy — alongside the traditional four factors of production: land, labour, capital, and technology. The purpose of the policy was to hammer home the rising importance of data in the digital economy and the economy overall, and to highlight the sharp contrast between the maturity of the land, labour, capital, and technology markets, which are well-regulated, relatively stable, and reasonably mature, and the state of the data market, which is poorly regulated, unpredictable, and immature. In essence, the Opinions signalled that China's top leadership considers data critical to China's future economic growth, and thus China must move quickly to solve outstanding problems with the data market so that the potential of this critical resource can be unlocked. A year after this policy was released, establishing a "data factors market" was included as a key strategic goal in the 14th FYP.

The Chinese leadership has identified several problems hindering the development of a data market. These are:

- **Data is poorly understood and categorized:** There are few clear legal and technical categories for data, making it difficult to target certain data for special regulation, and to standardize the structure of critical data for better interoperability.
- **China has not legally defined an asset class for data, or clarified data ownership.**
- **It's hard to put a dollar value on data:** There is no standard or commonly-accepted method for data valuation, causing price to vary wildly in data transactions.
- **Bookkeeping and accounting procedures for tracking data as an asset have not been solidified.**
- **Data quality is difficult to ensure:** Data quality standards are underdeveloped.
- **Data origin is difficult to verify:** Technologies, such as blockchain, which would allow data buyers to verify the origin and legality of the data they purchase and process, are still in their infancy.
- **Businesses don't know what to do with their data:** There aren't enough clear business models and use cases for capitalizing on data assets.
- **Critical data resources are hoarded or monopolized by both government bodies and big tech.**

Over the next five years and beyond, China will pursue a three-pronged strategy to address the problems and build its data market. This strategy consists of:

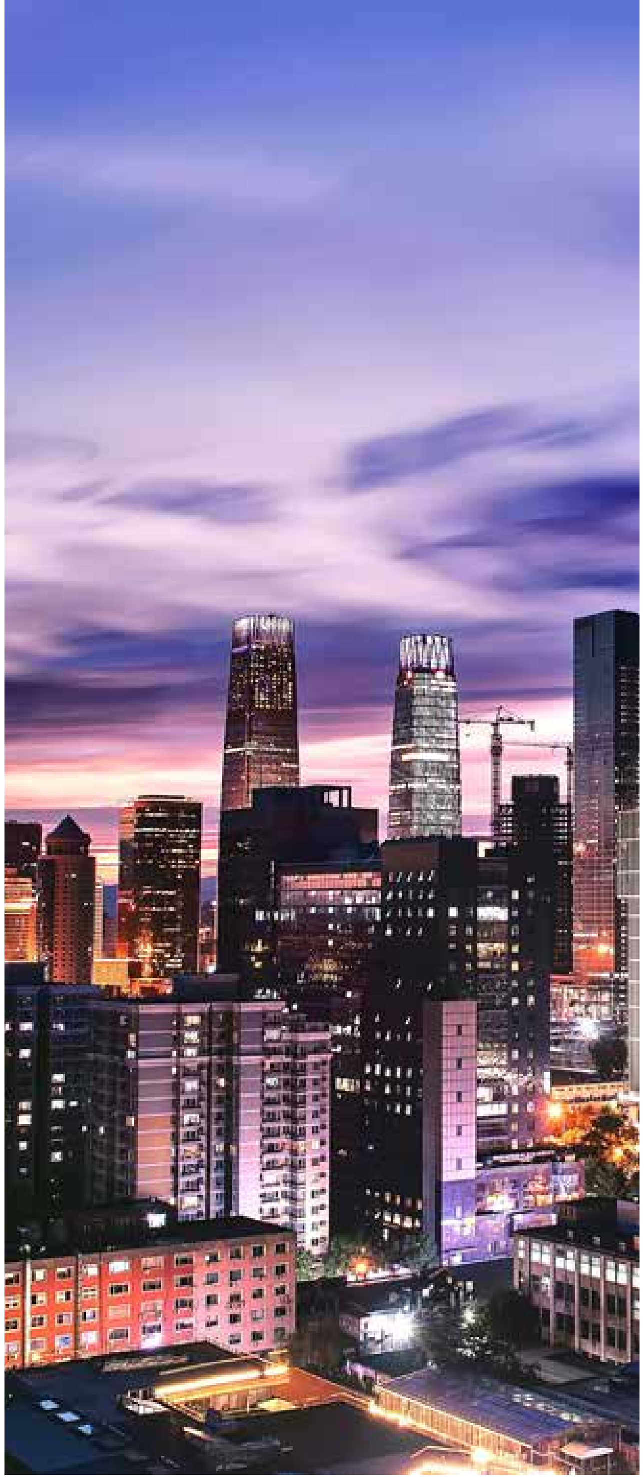
- **Government open data initiatives:** China's government bodies are the country's largest data processors, processing an estimated 80% of total domestic data. National-level policy increasingly requires government agencies to make non-sensitive administrative data publicly available, to act as a form of "seed inventory" in the data market.
- **Developing business use cases:** China will move to cultivate new data-driven industries, and it will support the construction of standardized data development and utilization scenarios in agriculture, industry, transportation, education, security, and urban management. There will be a particular focus on how such industries can leverage data in artificial intelligence, wearable devices, internet-connected vehicles, and the Internet of Things (IoT).
- **Policy support:** China will move to establish a robust legal regime for data governance. The most urgent and foundational issues revolve around data classification and legal data ownership. Personal data, financial data, health data, industrial data, machine-to-machine data, government data, and many other data types must be legally and technically classified into clear buckets before regulations can be developed to target those data types, and asset classes must be established so the value of data can be accurately determined. Additional policies, such as those covering privacy, security, and quality, will be simultaneously developed.

Implications for Canadian businesses

Data regulation will expand. China will work quickly to roll out a suite of policies, laws, and standards geared towards propelling the data market to greater maturity and predictability. This means doubling down on the enforcement of national-level data policies and laws such as the Cybersecurity Law, and speeding up the release of the Data Security Law and the Personal Information Protection Law, which are currently in draft. Beyond this, many sectors — particularly finance, healthcare, and advanced manufacturing — can expect industry regulators to develop a suite of data-related standards and regulations relevant to data common to specific industries.

China is set to become a global leader in the development of data-driven business models. China will be expending considerable resources to support the development of unique business cases for data capitalization. Businesses specifically engaged in buying, selling, collecting, and processing data should be alert to new markets and innovative business models emerging in China.

China will seek to facilitate data trading. The interplay between regulations, technology, and the market is complicated. China will renew its efforts to establish pilot projects — such as experimental data trading platforms — where regulators can test the efficacy of various approaches to data categorization, data privacy regulations, new business models. Canadian companies with considerable non-sensitive data resources suitable for capitalization should explore the possibility of participating in such pilots. Participants will have a rare opportunity to build government connections, get an insider's view of the state of China's data market, and contribute to the formation of China's data policy regime.



CONCLUSION

Getting with the program(s)

In China, government policy determines market outcomes. As such, foreign companies perform best in China when they understand policy trajectories and craft their business strategies accordingly. Over the next five years, the Chinese economy is set to undergo a series of profound transformations for which the 14th FYP serves as a roadmap. Analysis of the plan reveals four key trends that foreign companies will need to navigate as they attempt to optimize operations for China's policy environment. Canadian companies that can adapt to these trends will come out winners in the next stage of China's development.

- **Quality over quantity:** China is making a decisive pivot from the high-speed, relatively lower quality growth of previous decades in favour of a more sustainable and measured growth model focused on moving the economy up the value chain. Specifically, we are seeing moves toward more professional financial services, strong emphasis on environmental protection, as well as efforts to enhance the global competitiveness of Chinese companies and bring domestic industry up to international standards. Canadian companies, with their knowledge of global best practices and deep experience in developed markets are well placed to adapt to and benefit from these changes. Likewise, Canadian companies that can satisfy demand for higher-quality products, contribute to industrial upgrading and environmental protection drives, and help to develop key technologies will find abundant opportunities in the years to come. At the same time, Canadian companies should be prepared to confront the emergence of innovative new Chinese competitors, both in China and abroad.
- **Building resiliency:** Chinese leaders view economic security as a key aspect of national security. As such, Beijing is looking to secure its supply chains and reduce reliance on foreign countries for critical economic inputs. The 14th FYP aims to enhance China's technological capacity by improving manufacturing capabilities for core technologies, strengthening R&D, and boosting its performance in cutting-edge science. Over the course of the 14th FYP, policymakers will also seek to improve domestic supplies of food and energy. However, for many technologies, crops, and energy sources, China will remain reliant on imports. Where this is the case, economic planners will seek to diversify sources of crucial materials from a wider array of trade partners. Canadian companies that can help China to boost its domestic production and research capabilities, as well as those who can supply key economic inputs will be warmly welcomed. It is worth remembering, however, that China's ultimate goal is to become more self-sufficient, so while there may be ample space for foreign companies to contribute key inputs and expertise in the short term, these opportunities may diminish over time.

- **Greater openness:** Beijing views foreign firms and capital as key ingredients in its efforts to upgrade the economy. Overseas companies will be given more freedom as policymakers gradually make it easier for foreign companies to invest in China, particularly in the finance, service, and high-tech sectors. Improvements to the business environment will offer foreign firms more certainty that their basic rights will be protected in the China market. In general, Canadian companies can expect a more even playing field vis-à-vis their Chinese competitors due to more impartial and efficient application of laws and regulations. At the same time, as enforcement of legal and regulatory regimes improves, Canadian companies should be prepared to accept higher compliance costs compared with previous years.
- **Growing geopolitical challenges:** The 14th FYP indicates that China will continue to play a more assertive role in global affairs. The country will also continue to pursue policies at home that contravene Western notions of human rights. This means that tensions between China and much of the Western world will rise in the coming years. As they do, Beijing is actively looking to ensure its economic security, double-down on sovereignty-related issues, and hit back against foreign sanctions. As such, Canadian companies and investors will be subject to increased scrutiny as Beijing hones tools for ensuring that foreign business activity is fully in line with national security imperatives. Canadian firms operating and selling to China will need to be vigilant to avoid being caught in the crossfire stemming from potential diplomatic or economic spats between China and the West. Similarly, as popular passions over politically sensitive topics run high, Canadian firms should simultaneously beware of running afoul of an increasingly nationalistic Chinese public and facing censure at home for operating in or selling to a China that is increasingly looked at unfavourably.

A beginning, not an ending

Policy in China is constantly evolving. The national 14th FYP is only the first and most general of the economic plans that the Beijing will produce over the coming year. Over the course of 2021 and into early 2022, the government will release dozens more industry- and issue-specific five-year plans, including for energy, environmental protection, science and technology, resources, agriculture, and many others. The details of these plans are still being hammered out by the relevant government ministries; when complete, they will break policy down to the granular level and provide a much more complete picture of how the government plans to develop certain segments of the economy. By studying these subsidiary FYPs, Canadian companies can gain a much clearer picture of how they can align themselves with and benefit from important policy goals.

Let's get actionable

Canadian firms operating in China can position themselves to capitalize on Beijing's policy trajectory by taking the following steps:

- Carefully examine the 14th FYP to determine what its policy trends mean for their respective sectors and markets. Canadian companies should then revisit their China strategies to decide how to position themselves to take full advantage of emerging policy currents while minimizing potential risks.
- Adjust messaging, branding, and government relations strategies to reflect the 14th FYP's priorities. Chinese officials may be eager to start dialogues with companies that can contribute knowledge and expertise in line with the 14th FYP's mandates. This in turn, may allow Canadian companies to positively influence the policy debate and operating environment. Where relevant, Canadian companies

should understand key stakeholders in their respective industries and develop outreach and messaging plans aimed at officials and other key figures.

- Be aware of risks stemming from increasing geopolitical tensions and Beijing's renewed focus on national security. Canadian companies should conduct internal audits to identify vulnerabilities and develop effective contingency plans for mitigating risk and reputational damage.
- Track announcements and policy developments from relevant government ministries, departments, and industry organizations (including sectoral FYPs) to stay ahead of regulatory and market changes. Canadian companies should ensure that they have robust systems for monitoring important announcements, policy rollouts, and comments by key officials.

Summing up

China's economy is changing fundamentally. In some respects, the outlook for Canadian companies has never been brighter. Wide-ranging liberalizations are set to allow Canadian firms to compete on a more even playing field with their Chinese counterparts across an ever-broader range of sectors. Likewise, Beijing's focus on improving financial services, greening the economy, and industrial upgrading offer exciting new opportunities to foreign companies. At the same time, however, mounting national security concerns and a volatile geopolitical landscape mean that risks are also rising. Canadian firms will need to take extra care to avoid running afoul of tightening national security regimes and become comfortable with a higher degree of government scrutiny. The 14th FYP is the definitive document for understanding the key trends that will shape Chinese economy in the short to medium-term future. In order to succeed in China, Canadian companies will need to firmly grasp both the opportunities and challenges presented by the new policy directions outlined in the 14th FYP and craft their China strategies accordingly.

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