



MOVING FORWARD:

Issues in Canada-China Relations

Edited by

ASIF B. FAROOQ

Vanier Scholar, PhD Student, University of Toronto

SCOTT MCKNIGHT

SSHRC CGS Fellow, PhD Student, University of Toronto

**MOVING
FORWARD**
45 Years of
Canada-China
Relations

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ABSTRACT: Canada must learn to live with and prosper with global China. A new Canadian approach requires a whole of country effort with determined leadership at the most senior levels of government and bipartisan support. The chapter looks at how this can be accomplished in the face of rising public anxiety about China and outlines a set of objectives and specific actions in the realms of both economy and security.

WENDY DOBSON is a Professor and Co-Director for the Institute of International Business at Rotman and former Canadian Associate Deputy Minister of Finance. She chairs the Pacific Trade and Development (PAFTAD) research network and has published in English and Mandarin on a diverse range of topics, including: Asia's rise, the future of the Indian and Chinese economies in the world economy, the Chinese financial system, and Chinese innovation. *Ya Zhou Xin Shi Li* (亚洲新势力), the Mandarin translation of her book *Gravity Shift* (Rotman / UTP Publishing, 2009), won the Annual Award for the Best Book in Finance and Economics by China's public affairs website Hexun.com. Professor Dobson's most recent book is *Partners and Rivals: The Uneasy Future of China's Relationship with the United States* (Rotman / UTP Publishing, 2013).

PAUL EVANS has been a Professor at the University of British Columbia since 1999, where he teaches Asian and Trans-Pacific international relations. An advocate of cooperative and human security, he has been studying and promoting policy-related activity on track-two security processes and the construction of multilateral institutions since 1988. He is a co-founder of the Council for Security Cooperation in Asia Pacific (CSCAP), the Canadian Consortium on Human Security, and the Canada-Korea Forum. He has directed exchange and partnership projects with more than fifteen institutes in Asia and the Chinese Ministry of Foreign Affairs and funded by governments and foundations in Canada, Japan, the United States, China, Taiwan, South Korea, Thailand and Indonesia. A member of the International Council of the Asia Society in New York and the Asia Pacific Centre for the Responsibility to Protect, he also sits on the editorial boards of *The Pacific Review* and the *Chinese Journal of International Politics*.

Living with Global China: *Agenda 2016*¹

WENDY DOBSON AND PAUL EVANS

INTRODUCTION

The Liberal government has come to power having said almost nothing about China during the election campaign or in its platform. China was not mentioned in the December Speech from the Throne. The only way in which Asia has figured even indirectly is the promise to review the agreed text for the Trans-Pacific Partnership, an agreement which does not include China.

Expectations nevertheless are high that China and Asia will figure prominently in the Liberal government's foreign policy. The inclinations, instincts and worldview of the leadership are significantly different from those of their Conservative predecessors as seen in the style and tone of Justin Trudeau's first two meetings with President Xi Jinping on the margins of recent multilateral forums.

There have been calls for a quick and substantial set of policy adjustments to put Canada back on track after a decade in which the engagement of China was intermittent, conflicted, and narrowly economic. While deeper and broader engagement of China is in Canada's national interest, simply turning back the clock to the strategic partnership of a decade ago is neither wise nor likely. Rather than a restoration we need a reinvention based not merely on past foundations but on a new narrative that is more ambitious and more strategic.

China matters for Canadian prosperity, security, and values in unprecedented ways. It has emerged as a global presence and force in economic, security, diplomatic and institutional terms. Its economy is slowing as it is restructuring but is already the second largest in the world and likely to surpass that of the United States within a decade. It is the largest trading partner of every major country in Asia. It is the largest exporter of goods, holder of the largest foreign exchange reserves, the largest car sales market, the largest carbon emitter and soon to have 20% of the world's middle class with an urban population of more than a billion.

Chinese defence spending is second only to that of the United States. Beijing has become more assertive in matters of sovereignty and maritime disputes even while emerging as a leader in addressing several global issues and building international institutions. Political space for civil society and

dissent has been reduced under President Xi. In an era of geostrategic transition, geopolitics is central to Asia's future and China is both central to what will unfold and difficult to predict.

Like other countries, Canada faces complicated choices in dealing with a China that is big and important, that is coping with an encyclopedia of domestic problems, that is uncertain about its future role in world order, and that embraces a distinctive form of authoritarian capitalism unlikely to change in the foreseeable future.

THE DOMESTIC CONTEXT

No Canadian government can pursue an ambitious China agenda without rebuilding the foundations of public understanding and support. At the moment, public anxiety is palpable. Canadian surveys in the past two years reveal that while more than two-thirds of Canadians believe China will be more powerful than the United States, only about a third see China as highly important to their economy and support a free trade deal. Only 14 % support the prospect of a Chinese state-owned enterprise (SOE) owning a controlling stake in a major Canadian company. A majority believe that the human rights situation in China is deteriorating, that it does not respect the freedoms of its people, and that its growing military power is a threat. More than half believe that China's influence is threatening the Canadian way of life (*see the chapter by Massot*). The words most frequently chosen to describe China are *authoritarian, growing, corrupt, threatening, strong* and *disliked*.

Wariness about China is not unique to Canadians; mixtures of admiration, anxiety, and fear appear in attitudes in other countries. What is distinctive is the speed and direction of the change. By comparison, Australian views of China are more positive and stable despite sharp differences of opinion about China policy. In a multi-country poll taken in 2015, 57 % of Australians held a favourable view of China, close to 20 points *higher* than the Canadian figure and similar to a global median that has been slowly increasing over the past five years. Other polls indicate Australians hold a strongly positive views of the impact of China on their economy and are less worried that their national interests are threatened by a more powerful China.

Public negativity in Canada rests on three foundations. The first is experiential, a product of the fact that interactions are multiplying rapidly and not always positive. Rising house prices in Canada are attributed to Chinese investment; business practices of Chinese firms operating in Canada are under fire; Confucius Institutes are criticized for infringing on academic freedom, and alarm bells are ringing about cyber attacks on Canadian targets. The second element includes attitudes about the nature and domestic policies of China's political system, the role of the state in its economy, and societal values and practices are very different than our own (*see chapters by Malkin and Zhang*). On issues ranging from human rights, democracy and political freedoms to population and labour policies, some Canadians question not just specific policies but the basic legitimacy of the Chinese state (*see also the chapter by Potter*). The third relates to worries

about China's rising international presence, its influence in Africa and Latin America, its rapid military modernization, its assertive stance to maritime border issues, and its potential threat to an international order that Canadians have helped build since the Second World War (*see chapters by Dewitt and Welch, and Paltiel*).

Though business and academic elites tend to view China more positively, public ambivalence has policy implications. Negativity can feed on itself, building an emotional undercurrent that prevents an informed national debate about risks, opportunities and interests. This can become even more limiting when government leaders share and amplify the ambivalence. Leadership, informed dialogue and a new narrative are required.

THE ECONOMIC AGENDA

Long-term collaboration is possible and essential because of significant complementarities between the two economies. Many Canadians are unaware of Asia's growing global economic footprint and the urgency of increasing Canadian participation in these dynamic markets. The Chinese do more than trade: they produce, innovate, lend, invest, and are the major drivers of global growth.

The economic complementarities between the two countries are evident in that Chinese seek security of supply of food, energy and natural resources and Canada seeks security of demand for its rich natural resources. China is increasingly turning to clean energy sources, conservation and renewables — sectors where Canadians are becoming innovators.

Canada has been slow to recognize and build on these opportunities. A joint study by officials in both countries published in 2012 as the *Canada-China Economic Complementarities Study* was subsequently shelved. Proximity to the US market has encouraged complacency among Canadians, who mistakenly assume that our location and natural resource abundance will assure our future living standards. Headlines about China's slowing growth are often misinterpreted as signals of potential crisis and collapse. It would be a major mistake to give up on China at a time when it is restructuring its economy to sustain long-term growth.

Such thinking also neglects the dynamism and potential of Asia as a whole — and fails to grasp the growing competition for these markets. China is a central player in the region's growing production and transportation networks and global value chains. Chinese producers are moving up the value chains in manufacturing industries and services and learning to do what Canadians do well. Chinese firms are becoming international and winning contracts at the expense of Canadian firms. Simultaneously, US demand for Canadian energy is shrinking as production of nonconventional energy liquids and natural gas surges at home, turning American producers into what some in the Calgary-based energy industry call Canada's greatest competitor (*see the chapter by McKnight*).

Other competitors including Australia, New Zealand, South Korea and several countries in ASEAN are lining up to supply China with natural resources and food products assisted by recently-implemented free trade agreements (FTAs).

A cleaner environment is a high priority for the Chinese people and leadership. Canadian clean-tech and uranium suppliers are already active in the Chinese market, supplying wind generators and equipment for smart grids. Managing the environmental impacts of energy production and its use could shape the future bilateral relationship; twinning energy and environment can be a signature item in the next phase of Canada-China relations.

Middle-class demand is increasing pressures for food security and high-protein diets. These factors, along with shortages in animal feed, are changing import and investment patterns. As China modernizes its agriculture, Canadian producers are investing heavily in technology and practices to increase productivity. Middle-class demand is also creating major opportunities for collaboration in service industries such as tourism, education (*see chapters by Ong and Flynn, and Ruan and Yan*), insurance, and health care (*see the chapter by Zakus*).

Infrastructure and transportation industries also have high potential for market development over the long term, especially as China strives to improve linkages along the historic land and sea routes between China and Europe. Canadian firms have globally recognized expertise in land- and marine-based transportation technologies, construction, construction machinery and building materials. The potential for new business is significant in transportation services including aerospace products. Canadian firms have competitive advantages to be tapped in the surge of infrastructure and connectivity projects planned for One Belt One Road (OBOR) (一帶一路) projects. Future collaboration is also possible, linking our own Asia-Pacific Gateway initiatives — but only if we actively participate in these projects and the accompanying value chains.

Collaboration can take many forms. One possibility is equity investments by Canada's large pension funds in Canadian and Chinese agricultural firms aiming to expand food production and promote innovation; another is to organize mechanisms in Canada to enter into long-term supply contracts as part of the traditional cross-border trade in goods and services. Collaboration on energy security depends in large part on Canada addressing transportation bottlenecks. In 2012, the APFC's Canada-Asia Energy Futures Task Force recommended a public energy transportation corridor, created by governments, regulated like a public utility, and operated by the private sector. The proposal is an innovative way to recognize and mediate among the multiple interests concerned with new pipelines in British Columbia. The benefits of collective action in the national interest outweigh individual interests and can be constructed in ways that minimize risks, maximize public gains, and fairly share the benefits.

Cross-border investment is another dimension of complementarity. While Chinese investment inflows to Canada grew rapidly between 2008 and 2014, China's share is still only 6.5% of the total foreign stock. An ongoing policy debate about Chinese FDI has three elements: worries about firm ownership, specifically that SOE decisions will be based on political rather than commercial factors; symmetry of access to each other's market; and national security concerns (*see the chapter by Massot*). While market access and national security concerns are well understood, SOEs are a contentious topic.

Canada's opaque and restrictive FDI screening system is a major issue, creating a chilling effect that has disadvantaged the energy industry at a time of major oil price uncertainty. It has also reduced competitive pressures on Canadian firms, increased the cost of capital, and increased transaction costs in Canada relative to those in countries with more transparent and predictable review regimes.

Meanwhile, in China, private firms are growing in number and size, providing badly needed competition in the home market and abroad. Service industries, traditionally dominated by SOEs, are being opened to competition from non-state firms. SOEs continue to exist in sectors designated as strategic or as natural monopolies (also a common practice in OECD countries). But government ownership of SOEs is gradually being separated from management, with modern corporate governance being introduced, and assets divested to (state) asset management companies more subject to rules of transparency. Accounting and external audit practices are gradually becoming more independent and transparent as well.

While the commercial objectives of many Chinese firms resemble those of other multinationals, their understanding of host countries' regulatory regimes and rules of the road in international business is not (*see the chapter by Malkin and Zhang*). Canadian companies could engage with Chinese partners and assist them in going global. One way to proceed is to use a "zipper" strategy, in which Chinese companies are fully integrated into strategic partnerships in different parts of the global value chain. While negotiations on terms for such partnerships can be protracted, in the end they have the potential for good returns and security of supply.

SECURITY

China's resurgence both regionally and globally pose significant security concerns for Canadian policymakers. Some of these concerns relate to protection of Canadian citizens at home and abroad, including with respect to cyber attacks and espionage that have received considerable media attention. Less discussed concerns exist in the geopolitical domain in which Canada has been a silent spectator for the past decade (*see the chapter by Dewitt and Welch*).

Asia is at a formative geopolitical juncture. American primacy, critical to Asia since the Pacific war, is being actively contested by China. Geostrategic competition between the United States and China is intensifying as the two seek to manage a difficult, important and very complex bilateral relationship. Asians are searching for leadership, institutions and norms to manage a dangerous strategic transition as well as manage a host of dangerous hot spots, bilateral tensions, arms build-ups, and threats to human security ranging from extremism and terrorism to environmental degradation and climate change. All require collective solutions and all are complicated by resurgent nationalisms, unsettled historical memories and the absence of effective multilateral security institutions.

By most indicators Chinese global influence and power do not come close to matching those of the United States. But in its Asian neighborhood, China has emerged as a great power with significant interests, involvement and

influence. The barrage of major initiatives in the past year — the creation of the Asian Infrastructure Investment Bank, the OBOR program, the Silk Road Fund, the New Development Bank — are testament to Chinese efforts to place itself at the centre of a more tightly integrated and networked Asia.

China's regional centrality, its quickly developing military capabilities and its occasionally muscular and assertive approach to advancing its maritime claims, especially in the South China Sea (*see the chapter by Dewitt and Welch*), have deepened anxieties about Beijing's long-term strategy and intentions. China is now a major global presence beginning to shape international norms, rules and institutions. While Chinese leaders benefit from the current American-anchored world order, they do not see it as the global order and are pushing for changes that suit Chinese interests and influence.

Canada's closest partners in the region — the United States, Australia, Japan and South Korea — all pursue some form of strategic hedging policies—both *engaging* and *containing* China's diplomatic and military influence. The Obama administration is systematically strengthening defence relations with its allies, expanding US naval capabilities and insisting that American-underpinned international rules must prevail. Some in Washington argue for a grand strategy to balance and contain China. Others urge the creation of a common strategic framework, requiring a high-level political effort to build the strategic trust necessary for collaborative action to pursue common interests and address common problems. But overall, attitudes are hardening on what to do about China.

Canada's position on the strategic implications of China's rise and the appropriate response to it have not been articulated or seriously debated. Historically, Canada has taken intermittent and sometimes imaginative and constructive roles in addressing Asian security issues, mainly through diplomatic and dialogue channels and in rare instances by military means, such as in Afghanistan. Ottawa maintains limited defence cooperation with Japan, South Korea and Singapore but without formal alliances. It is a member of some of the region's security institutions but not all of them. For example, Canada has been unable to join the ASEAN Defence Ministers Meeting Plus and the East Asia Summit. For more than a decade, Ottawa has not made a major statement or launched a major institutional initiative in the region.

Canada's silence and diminishing visibility undermine our credibility. Academics, journalists and officials in Beijing and across Asia frequently signal that Canada is no longer viewed as an engaged and full partner. Canada is perceived as distant, aloof and reactive, focused narrowly on our own economic advantage.

Going forward the issue is what Canada, working with others, is prepared to do to prevent miscalculations, accidents and escalating rivalry that could spill over into conflict with devastating impact including on regional production networks. Our middle-power role and credentials need to be refurbished, though in a very different strategic setting (*see the chapter by Paltiel*). Canada's traditional middle-power role was to bridge great power differences whenever possible. The bridging role today — to find common ground — requires judicious decisions and a search for ways to adjust rules

and institutions to reflect the views and interests of Asia's rising powers, China chief among them. The challenge is to assist the transition from an order premised on American primacy that can no longer be maintained to an order that has not yet taken shape. Where ending the Cold War in Europe was our earlier objective, today's is preventing a Cold War in Asia.

Unless we are a multidimensional player, Canada will not be accepted as a participant in regional initiatives to dampen geopolitical rivalry or to set the region's rules and framework. Even if we choose a reactive approach, it should be articulated so that partners know what to expect.

NATIONAL LEADERSHIP

Canada should raise its game in Asia and in engaging China. Recognizing the inseparability of economic and security policy, Canada needs a more comprehensive, bold and long-term framework. It should be one that explains Canadian goals with heavy economic focus and a commitment to participate in managing the rapidly evolving security equation.

Our recommendations are as follows:

1. Leadership is required at the highest levels to build long-term relationships with Chinese leaders. In Asia, more so than in the West, fruitful state-to-state relationships are built on the foundations of strong relationships between prime ministers and presidents. High-level interactions should include a stronger and more robust presence in multilateral forums as well as better-orchestrated bilateral visits and institutional connections. Examples of such bilateral mechanisms used by other countries include the US-China Strategic and Economic Dialogue and the Singapore-China management committee that is headed on China's side by one of the seven members of the Politburo Standing Committee. Leaders from Australia, Germany and the United Kingdom not only accompany missions to promote trade, resulting in landmark commercial deals; they directly encourage building trust and understanding through deepening ties among cities, citizens and businesses. They engage with China on broader global and geopolitical issues.
2. Ottawa should play an active role as communicator and connector in setting the tone for the relationship, consistently communicating how and why China is crucial to Canadian interests, and convening and coordinating stakeholder meetings that include provincial and municipal governments, the private sector, and educational institutions in what can be called a whole-of-country approach. A special leadership group should be established, whether in the form of a special Cabinet Committee or the initial focus of the House Committee on Global Affairs. A national commission or panel could be created to define the challenges and opportunities of deeper bilateral relations. Its activities could include moderated forums for individual citizens to interact with experts over what is at stake, how to manage irritants and risks, and find effective solutions. Here universities have a special role to play, especially in frank discussion of concerns and navigating differences in values, institutions and practices.

3. New policy initiatives are desirable, including five-year and ten-year goals for expanding bilateral flows of trade and investment; reforming the FDI screening system; joining the AIIB; encouraging and assisting China's entry into a second round of the TPP while pushing for a Free Trade Area of the Asia Pacific. Negotiating a bilateral FTA should also be a priority.
4. An Asia-Pacific Security and Defence White Paper is needed which assesses regional dynamics and threats, weighs strategic options, and outlines steps for Canada's re-engagement with regional institutions and partners. It would need to consider what kinds of assets — military, diplomatic, non-governmental — Canada needs to play a constructive role in building peace and stability at a time of a shifting balance of power and a resurgent China.
5. The narrative for deeper engagement should be rewritten. It should prepare for a much larger Chinese presence in Canada and on the global stage; it should help address public ambivalence and the expanding list of irritants, frictions and anxieties. It should also recognize the opportunities and shared interests in providing global public goods in areas including climate change and clean technology, stabilization of the international financial system, and disease control.

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The most difficult part is explaining the necessity of living with China rather than expecting or requiring major changes in its basic institutions even as we try to advance concepts like the rule of law and good governance and protect Canadian values and institutions at home. With a new government, we have a constructive moment for formulating a strategic approach that can take shape in early 2016 and be rolled out in the bilateral visits expected to follow.

NOTES

- 1 This chapter draws heavily on our IRPP *Policy Horizons Essay*, "The Future of Canada's Relationship with China" (Montreal: Institute for Research on Public Policy, November 2015).