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The Future of Canada's Relationship with China

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Foreword

This year, 2015, is the 45th anniversary of the establishment of diplomatic relations between Canada and China. In 1970, it was clearly a historic moment. Today, its importance is all the more evident. The world has been transformed by the ascendance of China to the top tier of global powers — or, to be more precise, its return there — along with the rapid expansion of the vast network of interconnections we call globalization. China and Canada are no longer worlds apart. We are deeply intertwined. And yet Canadians still struggle to understand and appreciate this relationship. The engagement it demands of governments and business leaders has too often been sporadic and disjointed.

Indeed, China remains an enigma to most Canadians, and we have yet to fully grasp the potentially profound implications of the re-emergence of this global power for our country, our economy and our security. This "public White Paper" is a call to action to all those who believe constructive engagement with China is critical to Canada's future prosperity. Wendy Dobson and Paul Evans make a compelling case for why it is critically important that Canada engage China more effectively, and they provide a comprehensive, forward-looking framework for that engagement.

The Institute for Research on Public Policy and the Munk School of Global Affairs share a desire for better public policy and a commitment to ensuring that public decisions are informed by the best of what policy research has to offer. Collaborating on the publication of this essay was our way to ensure the national conversation called for by Dobson and Evans begins immediately, as the work of the 42nd Parliament gets under way.

The IRPP's Policy Horizons Essay series was created in 2011 to provide a forum for thinkers to look beyond the day-to-day questions facing government and consider the major social, economic and cultural shifts that will have a lasting impact on Canadian public policy. Thus, it seemed an ideal publication vehicle for this important essay, which we hope will become required reading for our national leaders. We look forward to the debate that ensues.

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The Future of Canada's Relationship with China

Wendy Dobson and Paul Evans

By virtue of its size and increasing global presence, China is a major force in today's world and likely to remain so for the foreseeable future. Superlatives are commonplace in describing China's global position: the largest population and second-largest economy, the largest exporter of goods, holder of the largest foreign exchange reserves, the largest car sales market, the largest carbon emitter…the list goes on. The Asian Development Bank (2011) estimates that by 2030 China will have 20 percent of the world's middle class, an urban population of more than a billion people and a related explosion in demand for housing, education, health care, and financial and environmental services. Chinese homebuyers in the United States were reported recently to outnumber all other foreign buyers, overtaking Canadians, who had previously topped the list (Gopal and Gittleson 2015). Chinese defence spending is second only to that of the United States, at about a third the US level.[1]

Countries around the world face significant challenges of living with a major power with such different values and institutions. For their part, Chinese leaders and people actively study Western history and experience to learn from foreign successes, with a view to adapting foreign ideas and institutions to the Chinese context, which is shaped by its long history and unique institutions.

Canadians have been slow to learn about China. There is a tendency to picture China in ways that can be misinformed, biased and incomplete, coloured by the hope that as Chinese become wealthier, they will also become more like us and adopt our values and institutions. When this does not happen we feel disappointment, even alarm, and we miss the myriad small administrative changes under way in China.

[1] See, for example, estimates from the International Institute for Strategic Studies (2014).

A central message of this essay is that we should learn about China and live with it as it evolves. That does not in any way mean sacrificing our values and institutions. Rather it means we will face choices, some of which will be difficult; we will also have to manage the risks in deepening our relationships with China and its distinctive form of authoritarian capitalism.

Today's China has both domestic and international dimensions. Understanding its domestic development begins with a recognition that much change is administered rather than springing from the grassroots, driven by the central political imperative of raising living standards and providing jobs in sufficient numbers to maintain the Communist Party's legitimacy and central control. Rapid industrialization in the past 30 years has been spectacularly successful in achieving those goals but at the cost of a severely degraded environment, rising inequality of incomes and opportunity, and corruption. As Chinese leaders point out, in many respects what is happening now in China is a modern version of what happened at early stages of industrialization in Western countries.

A key question for the future is whether the party's search for administrative efficiency will substitute for political reform. Current indications are that party leaders are determined to avoid simultaneous political and economic liberalization of the kind they believe led to the collapse of the Soviet Union. It is too soon to draw conclusions from the two-year record of President Xi Jinping. Interpretations of his goals and strategy are divided; some argue he has a plan that will succeed in retaining party legitimacy and control, while at the same time, programs to redistribute opportunity and incomes throughout the country beyond the dynamic coastal provinces will lift the entire population out of poverty. Others argue that the political pressures created by the energetic anticorruption campaign are generating rising risks of push-back that could cause social and political disarray. What is evident is that many Chinese are anxious and uncertain about what a modern and wealthy China will look like.

China's growing international presence is raising hope and alarm simultaneously among its neighbours and beyond. In the postwar period, China has been a major beneficiary of economic progress in Asia stretching from India to Japan, as cross-border businesses have created regional production networks connecting economies with one another and with major markets in the United States, in Europe and around the world. The growth slowdown in 2015 and stock market gyrations, while understandable repercussions of the challenging economic reforms the Chinese leadership is pursuing, have caused significant cross-border concerns. At the same time China is now becoming more assertive in the region, pursuing aggressively what it defines as its core interests in defending its maritime boundaries. Why now? This assertive turn reflects several factors: the desire to build domestic support for Xi's anticorruption drive and economic reforms agenda; rising confidence stemming from China's own economic success and its ability to avoid the worst effects of the 2008-09 global financial crisis; and a calculation that American power is declining and mired in Middle East conflicts even as the United States "pivots" back to Asia.

In an era of geostrategic transition, geopolitics is central to Asia's future. China is now playing a central role and seems to have adopted a complex set of objectives that may be difficult to achieve. Regardless of whether the Chinese leadership succeeds or fails, there will be large-scale implications across borders that will affect us all.

This is why it is in Canadians' interest to learn more about China and develop a long-term framework for the bilateral relationship. Indeed, today Canada is lagging behind most of its G20 peers in relating to China. Strategic issues of this nature require attention by top political leaders within a strategic context. Yet Canada has been absent; in the past 10 years there have been only three prime ministerial visits to China and no major policy statements.

This paper proposes a fresh start to our engagement with Asia, starting with China, with five recommendations:

- Lead from the very top in adopting a whole-of-country approach to economics, security and public education.
- Build on the strong economic complementarities between Canada and China.
- Modernize our economic ties.
- Strengthen and shape the relationship at multiple levels.
- Establish a credible middle-power engagement in Asia.

These recommendations are based on the analysis that follows, beginning with an examination of the Canadian public's negativity toward China. Next we will focus first on the remarkable economic complementarities of the two countries and on opportunities for greater collaboration and second on the changing security dynamics between the United States and China in the Asia-Pacific region, which will affect those economic prospects. Canada cannot afford to stay on the sidelines. The five recommendations are elaborated in a further section, which is followed by our conclusion.[2]

Public Anxiety about China

A sustainable policy framework depends upon public understanding and support. Two features of contemporary Canadian public opinion about China stand out: its increasing negativity and a wide gap between experts and the broader public in understanding, predictions and prescriptions. Both the negativity and the gap have significant implications for Canadian policy.

Recent polling by the Asia Pacific Foundation of Canada (APFC) paints a picture of growing public anxiety.[3] In 2014 more than 70 percent of Canadians thought that within a decade China would be more powerful than the United States, but only 36 percent supported

[2] The recommendations also build on a number of previous expert studies including Dobson (2011); Canada-Asia Energy Futures Task Force (2012); Evans, Campbell and Lortie (2012); Mulroney and De Silva (2013); McKinsey & Company (2014); Grinius (2015); and Lerhe (2015).

[3] A link to all the APFC polls can be found at https://www.asiapacific.ca/surveys/national-opinion-polls.

a possible free trade deal with China; 35 percent saw China as highly important to their economic prosperity, down 10 percentage points from the year before; 14 percent supported the prospect of a Chinese state-owned enterprise (SOE) owning a controlling stake in a major Canadian company; only 10 percent had "warm feelings" about China; 60 percent saw China's growing military power as a threat to the Asia-Pacific region; and more than half felt that China's influence was threatening the Canadian way of life. Two years earlier, in 2012, the poll (asking similar questions) probed the words most frequently chosen to describe China. They were, in descending order, *authoritarian*, *growing*, *corrupt*, *threatening*, *strong* and *disliked*. Only 5 percent chose the word *admired*.

In 2014, the share of respondents who felt China's economic power was more an opportunity than a threat declined by 10 percentage points to 40 percent, from 50 percent in 2012. In that two-year period, support for the proposition that the human rights situation in China is better now than a decade ago declined from 47 percent to 39 percent.

This downward trend mirrors the cooling of views about China in several, but not all, Western countries. Multicountry surveys conducted by the US-based Pew Research Center revealed that in 2009, 53 percent of Canadians had a favourable view of China. Six years later this share had declined to 39 percent. During the same period American views became more negative by about the same degree, even as views in France and the UK were generally stable. Only 6 percent of Canadians polled in 2014 felt that China was respectful of the freedoms of its people, a figure similar to the numbers in other Western countries but well below the global median of 34 percent in the group of 39 countries surveyed (Wike, Stokes and Poushter 2015; Pew Research Center 2013, 2014). Wariness about China is not unique to Canadians — indeed, mixtures of admiration and anxiety or fear can be found in surveys in other countries. What is distinctive is the speed and direction of the change in Canadian opinions.

Australian views of China are more positive and stable. In the Pew Center's 2015 poll, 57 percent of Australians held a favourable view of China, close to 20 points higher than the Canadian figure and similar to the global median that has been slowly increasing over the past five years (Pew Research Center 2015). Polling by the Lowy Institute for International Policy, based in Sydney, indicates strong support for the view that China is positive for the Australian economy and little support for the idea that a more powerful China would threaten national interests (Oliver 2015).

In Canada, China receives a significant and increasing amount of media attention and public comment, much of it critical. The negativity has three elements. The first is experiential, a product of the fact that interactions with China are multiplying rapidly and are not always positive. For instance, rising house prices in Canada are attributed to Chinese investment, and concerns about the business practices of Chinese firms operating in Canada come under fire. Confucius Institutes have also come in for criticism. Intended to spread Chinese language and culture, their operations within Canada's educational institutions have raised questions about their impacts on academic freedom. The second element includes attitudes about the nature, legitimacy and domestic policies of China's political system, the role of the state in its economy, and societal values and practices very different than our own. On issues ranging from human rights, democracy and political freedoms to population and labour policies, Canadians question not just specific policies but the role of the Chinese state. The third form of negativity is seen in fears of China's rising international presence, its influence in Africa and Latin America, its rapid military modernization, its assertive defence of its maritime borders and the potential threat that it poses to an international order that Canadians have helped build since the Second World War.

These concerns translate into more negative views of China in Canada than in Australia. A recent study of APFC data on attitudes toward trade-liberalizing agreements with various countries provides some insights. Canadians prefer to trade with traditional allies, with countries with similar values and institutions, like European Union members and Americans. Attitudes toward engagement with potential Asian partners like South Korea, India and China — and less so Japan — are found to be shaped by misinformation and lack of information. For example, respondents expressed concerns about political rights in South Korea even though it has a strong and lengthy record of political rights. In contrast, Australians are far better informed and, for example, see China's growth as an economic boon, particularly for Australia's resource-rich areas (Allen 2015).

Canadian experts and organizations most directly engaged with China share some reservations about Chinese values and institutions but emphasize the importance of dealing with China and the opportunities that exist for working together despite differences. Business and professional groups such as the Canada China Business Council, the Canadian Council of Chief Executives and Canadian Manufacturers & Exporters study closely the potential for business with Chinese enterprises and governments, organize collaborative events with their counterparts and develop ventures such as incubators that provide services to Canada's small and medium-sized enterprises seeking to expand into the Chinese market. Academic groups support the deepening and broadening of interactions with Chinese counterparts through student exchanges, recruitment, joint research and collaborative teaching.

Public ambivalence has policy implications. Negativity can feed on itself; framing China as more than the sum of our fears colours transactions; inhibits balanced discussion, long-term planning and decision-making; and encourages caution by political leaders. Lacking public support and an informed, open and vigorous debate about China and how to react to it, we risk reducing Canada's options to a simplistic trade-off between promoting trade and supporting human rights. The chill becomes even more limiting if government leaders share and amplify the ambivalence.

What is missing in Canada is public leadership and education, which Australia has provided particularly effectively. For a generation, top political leaders there have actively engaged in public discussion and explained the importance of Asia and China, leading with two White Papers, in 1989 and 2012. There is continuous debate, sometimes rancorous but on balance healthy, among academics, policy-makers, civil society, the media and businesses. Sharply conflicting views of China and alternative policy prescriptions play out in the media daily without producing the anxiety and skepticism evident in Canada.

Canada is struggling to find a narrative for deepening engagement with China while recognizing and navigating significant differences in values, institutions and outlooks and managing the risks and frictions that deeper interaction entails. Canadians can both serve core economic and security interests *and* promote human rights, democracy and rule of law, some of the values hard-wired into the Canadian mindset. The challenge is to advance the prospects for political and social evolution in China while respecting the facts that most of its citizens view the Chinese governance system as legitimate, that the Communist Party is unlikely to collapse in the near future and that China's long-term future will differ from our own. The evolution depends fundamentally on the Chinese people themselves.

While differing ideologies, personal experiences and judgments prevent unanimity of opinion, a stable consensus is possible based on realistic expectations; expert knowledge that is widely disseminated and discussed; and a realistic discussion of risks, possibilities and interests. Canadian values include not only freedom, democracy and the rule of law but also tolerance of differences, openness and the peace, order and good government identified by the framers of our constitution — values arrived at by dialogue, compromise and the search for common ground.

Developing a shared narrative will take a major investment and intellectual and political leadership at several levels.

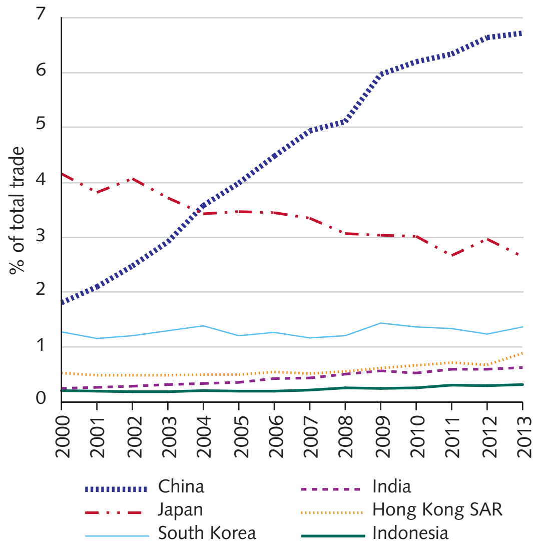
Building on Economic Complementarities

A promising part of a shared narrative is the opportunity for long-term collaboration to realize the benefits of the remarkable complementarities between the two economies. Many Canadians seem to be unaware of Asia's growing global economic footprint and the urgency of increasing Canadian participation in these dynamic markets. These markets are beginning to match the US economy as *the* market where globally competitive companies must be present if they wish to remain global.

The economic complementarities between the two countries are evident in China's reliance on imports of energy and natural resources and Canada's comparative advantage in supplying those imports from its rich endowments. China is increasingly turning to clean energy sources, conservation and renewables — a sector where Canadians are becoming innovators. Secure supplies of food and water are Chinese priorities, and Canadians are major food producers and exporters. As well, Canada supplies needed services such as education,

FIGURE 1

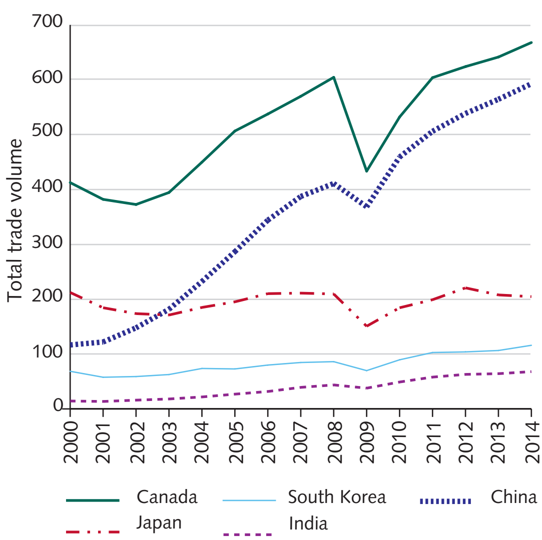
Canada's trade with selected Asian economies as a proportion of total trade, 2000-13



Sources: Industry Canada, "Trade Data Online" (https://www.ic.gc.ca/app/scr/tdst/tdo/crtr.html?productType=NAICS&lang=eng); Statistics Canada, CANSIM, table 376-0036.

FIGURE 2

United States' total trade with selected economies, 2000-14 (US$ billions)



Source: US Department of Commerce, Bureau of Economic Analysis," International Trade in Goods by Area and Country, Seasonally Adjusted Detail," table 2.2, "U.S. International Trade in Services by Area and Country, Seasonally Adjusted Detail," table 3.2. (http://www.bea.gov/index.htm).

in which it ranks as the world's sixth-largest player; Chinese students alone account for a third of the foreign student population in Canada (DFATD and Roslyn Kunin & Associates 2012).

Yet Canada has been slow to recognize and build on these opportunities. The two governments have recognized the potential benefits of building on complementarities, but a joint study by officials published in 2012 as the *Canada-China Economic Complementarities Study* was subsequently shelved.[4] Deep integration with and proximity to the world's largest and wealthiest market encourage 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 may be misinterpreted as signals of potential crisis and collapse. But Canadians shouldn't give up on China at a time when it is undergoing difficult reforms that will ensure it is around for a very long time.

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.

China alone accounts for 40 percent of Asian GDP, yet as Canada's second-largest national trading partner it accounts for less than 7 percent of our total trade (figure 1); the relationship represents less than 4 percent of our exports but nearly 12 percent of imports.[5] In comparison, Canada-US trade is the world's

[4] Foreign Affairs, Trade and Development Canada, "Canada-China Economic Complementarities Study" (accessed october 9, 2015). http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/china-chine/study-comp-etude.aspx?lang=eng
[5] Industry Canada's Trade Data Online database, www.ic.gc.ca/app/scr/tdst/tdo/crtr.html (accessed June 29, 2015).

largest relationship, although China-US trade is closing the gap (figure 2), with the American market accounting for 65 percent of Canada's total trade, nearly 75 percent of our total exports and just over half of total imports. Canada remains relatively invisible in the Chinese market, ranked as the 18th-largest supplier, whereas Australia ranks 6th, supplying nearly 5 percent of China's total imports. Canada's share languishes at less than 2 percent.[6]

Making the Chinese market a Canadian priority is urgent as new competitors and disruptive technologies appear. Of particular concern among the competitors lining up to supply China and other leading Asian economies with natural resources and food products are the recently implemented free trade agreements (FTAs) that China has signed with Australia, New Zealand and South Korea. Exporters from those countries will have preferential access to Chinese markets at Canadians' and others' expense.

In the China-Australia FTA (known as ChAFTA), Chinese concessions to Australia in meat, wine and seafoods will allow Australian competitors to make inroads into markets where Canadians have been successful. By Australian estimates, ChAFTA could increase total trade between the two countries by more than 10 percent, from A$150 billion in 2013 to A$170 billion over time (Sun 2015). If Canada were to achieve similarly improved access, annual total trade with China would increase from C$77 billion in 2014 to nearly $90 billion over time, with exports of pulp and paper, oilseeds, base metals, energy products and aircraft.

At the same time Chinese producers are moving up the value chains in manufacturing industries and services and learning to do what Canadians do well. For example, Chinese firms are becoming international and winning contracts at the expense of Canadian firms, as happened when Bombardier bid to supply the Boston subway but lost to a Chinese enterprise (Bloomberg Business 2014). Radical changes are also affecting energy market conditions as fracking, the disruptive technology unknown less than a decade ago, transforms US demand. The US market has been Canada's largest for energy, but the surge in nonconventional energy liquids and natural gas production is turning our American neighbours into what some in the Calgary-based energy industry now call Canada's greatest competitor.

The energy sector is a potential game changer for the entire relationship. China seeks security of supply while Canada seeks security of demand. Comparative rankings of energy suppliers to Chinese and Asian markets highlight the gap between Canada's market performance and its comparative advantage. Canada's energy exports are mainly coal and some petroleum products, which totalled C$1.7 billion in 2013 (Asia Pacific Foundation of Canada 2014).

China is now ranked by the US Energy Information Administration as the world's largest net importer of petroleum and other liquids (United States 2015). As the expert Canada-Asia Energy Futures Task Force organized by the APFC emphasized in its 2012 report, the potential for oil and gas exports across the Pacific is evident in the large price differentials

[6] For the comparison, see "China," Observatory of Media Complexity, at https://atlas.media.mit.edu/en/profile/country/chn/ (accessed October 9. 2015).

between North American and Asian markets. Greater market access for Canadians would bring substantial income gains. The task force pointed out the market development opportunities in China for Canadian firms from across the country, including those in eastern Canada offering hydroelectric and nuclear expertise, producers of uranium in Saskatchewan and oil and natural gas in the western and Atlantic provinces, and suppliers involved in energy conservation, renewables and clean tech across the country. More Canadian exports to Asian energy markets could also be a catalyst for expanded trade in goods and services through linkages to Asian supply chains and ultimately for reduced trade imbalances, particularly with China. Such growth would also provide welcome royalties and tax revenues for Canadian governments and First Nations communities.

A cleaner environment is a high priority for both the Chinese public and the leadership. Canadian clean-tech and uranium suppliers are already active in the Chinese market, supplying wind generators and equipment for smart grids (McKinsey & Company 2014); these sales help to position the sector to contribute to meeting targets to clean up the urban environment and promote conservation. China has turned to nuclear power to help replace its heavy reliance on coal. Cameco Corp., based in Saskatchewan, has won 5- and 10-year uranium supply contracts. But the numbers are small relative to potential.

Managing the environmental impacts of energy production and its use could also shape the future bilateral relationship. Industry groups like Canada's Oil Sands Innovation Alliance (COSIA) are advancing innovative methods of reducing the environmental impacts of oil-sands oil on water, land use and carbon emissions. COSIA has set a target to reduce water use in the oil sands by 50 percent by 2022 (Cattaneo 2015). Such innovations could be attractive to countries like China where, in parts of the country, extraction and other industries face severe water shortages. The opportunities for exporting such services will expand in the years ahead. But as China and other large Asian economies speed up the search for ways to reduce environmental damage and promote greater energy efficiency, the window of opportunity is closing for two reasons: more aggressive competitors are meeting existing demand for fossil fuels, and demand is expected to shrink as China's growth slows and as climate change concerns deepen.

Food security is another high priority in China. Rising middle-class demand is shifting toward high-protein diets, and shortages in animal feed are changing import and investment patterns. McCain Foods, Canada's top food products company, has experienced first-hand the speed of change. Its investment in a potato processing plant in Harbin began in 2005, and by 2013 the plant's capacity had to be doubled to respond to exceptional growth in demand (Potato Pro, n.d.). The two countries' agricultural sectors are highly complementary in terms of China's security of food supply objectives and Canada's relative abundance. Yet in 2014 China accounted for 6.4 percent of Canada's total agricultural trade (Agriculture and Agri-Food Canada 2015).

As China makes the transition from traditional to modern agriculture, Canada's sector is innovating, investing heavily in technology and practices to increase productivity. Demand for meat, fish, seafood and vegetables is strong but lags behind the growth of markets for grain and oilseeds. Pork exports to China increased fivefold between 2008 and 2012, and collaboration on pig genetics is ongoing between a Canadian company and one of China's largest pig breeding companies (McKinsey & Company 2014). Dairy is a sector of unrealized potential. Canada is the world's 14th-largest dairy producer but it exports less than 5 percent of total production. In New Zealand, by comparison, dairy exports account for one-third of merchandise exports and China is its largest market (Wheeler 2014). Canadians are missing out on dairy exports because of protectionist supply management arrangements that came under fire from trading partners in the final days of the Trans-Pacific Partnership (TPP) negotiations.

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. The political significance of this infrastructure drive is discussed in the next section. Initially labelled by the Chinese government as the Maritime Silk Road and Silk Road Economic Belt initiatives, they have become known as One Belt, One Road (OBOR), encompassing both the overland (belt) and maritime (road) routes.[7] President Xi Jinping's announcement of OBOR at the Beijing Asia-Pacific Economic Cooperation (APEC) summit in November 2014 (along with Chinese funding of $40 billion) was followed by the formation of the Asian Infrastructure Investment Bank (AIIB) in late March 2015, with 57 members from Asia and Europe and a Chinese capital commitment of $100 billion. These programs draw on Chinese capital to promote development in central Asia and facilitate closer economic cooperation over a very long term. If the infrastructure development even partially succeeds, it will have a significant impact of linking poor Asian countries into the global economy. Canadian firms have globally recognized expertise in land- and marine-based transportation technologies, and in construction, construction machinery and building materials. The potential for new business is significant. But to realize these opportunities, Canadian firms will have to expand their links with Asian supply chains and Canada will need to join the AIIB.

Prospects for collaboration in transportation services are also significant. China's air services industry is already the world's second-largest market. Canada is the world's fifth-largest exporter of aerospace products and has developed competitive advantage in technical and management skills. Winning even a small slice of the business China has planned for the next 10 years would be significant. In that time, it is expected that China will build 97 new airports, many of them smaller regional airports that handle planes of sizes similar to those produced by Bombardier, in addition to 35,000 kilometres of new expressways and 30,000 kilometres of new rail tracks (McKinsey & Company 2014).

7 For details of OBOR, see, for example, Economist Intelligence Unit (2015).

Potential for collaboration exists in other service industries as well, including tourism, education, health care and environmental services. Chinese tourism will grow from its level of 500,000 Chinese travellers to Canada in 2013. Euromonitor, a business research firm, ranked Canada as the number 22 destination for Chinese tourists in 2012, a position that seems far below potential when compared with the United States, Japan, France and other European countries, not to mention nearby Asian destinations of Hong Kong and Macau (Grant 2013).

Canada is already an education destination. Many Chinese parents think their own system prepares children to succeed in national tests while a foreign education ensures the English-language proficiency and cultural skills necessary to be leaders in China and beyond. Canadian educational institutions have aggressively recruited Chinese students, and a federal international education strategy has set a target of 450,000 foreign students studying in Canada by 2022, up from 239,000 in 2011 (DFATD 2014).

But change is coming as the Chinese government shifts its objectives toward reversing the outflow of students by 2020, improving the quality of educational services in China and making China itself an education destination. Canadians should anticipate this shift by delivering more educational services abroad. We should also change our current heavy emphasis on recruitment to a broader concept of delivery of quality education and to encouraging young Canadians to study in China and other Asian countries. Indeed, the APFC is planning competitive grants to Canadian educational institutions to encourage students, young professionals and other groups to acquire competencies such as Asian-language skills.

The potential for exporting other services to China or investing in China stems from the growth of demand in China's middle class for health care, environmental services, transportation and financial services, all of which Canadians do well. There is potential for collaboration as Canadian innovations are introduced and diffused in the Chinese market. In financial services, Canada has a strong reputation because of its successful navigation of the global financial crisis and because of its large pension funds, which are diversifying investments of their pools of capital around the globe, including in China. Canada was also a first-mover in establishing a renminbi hub, the first in the Western hemisphere, to provide facilities for financial transactions in Canadian dollars and renminbi. This responded to China's push to increase use of the renminbi (also called the yuan) in low-risk trade and investment transactions, as a step toward its long-term goal of making the renminbi a world currency and reducing the risks of its dependence on the US dollar.

Investment and Capital Flows

Another significant dimension of the two countries' economic complementarities is cross-border investments in productive assets for conducting business in each other's economies and in neighbouring countries. As outward investors, large Canadian companies such as Manulife, Sun Life, BMO, Bombardier, SNC Lavalin and others have built up networks of Chinese and Asian affiliates over many years. Manulife, for example, established its China operations in 1897 and entered into a joint venture with Sinochem in 1996, creating Manulife-Sinochem Life Insurance Company (MSL). MSL now has the largest geographic footprint of any foreign joint venture in China. Recently Canada's pension funds have also been acquiring assets in Asian public and private equities and real estate. Yet the size of Canadian foreign direct investment (FDI) stock in Asia pales in comparison with Canadian investment in the United States, which accounts for almost half of the total (table 1).

Inflows of Chinese investment to Canada grew rapidly between 2008 and 2014 (figure 3), but China's share, at around 6.5 percent, is far below the Americans' nearly half of the total FDI stock in this country. There is an ongoing policy debate about Chinese FDI, which has three dimensions: worries about firm ownership, specifically that the decisions of SOEs will be based on political rather than commercial factors; the principle that Canadians should have the same access to the Chinese market as Chinese investors have to the Canadian market; and national security concerns. While market access and national security concerns are reasonably well understood, SOEs are a contentious topic. SOEs have been prominent among Chinese investors in the past (for example, they have carried out all of the largest Chinese investments and acquisitions in Canada to date, concentrated in energy and mining; SOEs also dominate those sectors in China). But since 2007, privately owned Chinese firms have invested in Canadian companies in the minerals and coal sectors and in chemicals, solar power and telecom equipment.[8]

Private firms are growing in number and size and are a source of badly needed competition in the home market and abroad. Services industries in China, which have been dominated by SOEs, are being opened to competition from nonstate firms. While there is little doubt that SOEs will continue to exist in sectors designated as strategic or as natural monopolies (also a common practice in OECD countries), government ownership of SOEs is gradually being separated from management; modern corporate governance is being introduced; and the divestiture of assets to (state) asset management companies subject to strict rules of transparency is going ahead. Government's

TABLE 1

Inward and outward stock of Canada's FDI, selected countries, 2014 (C$ billions)

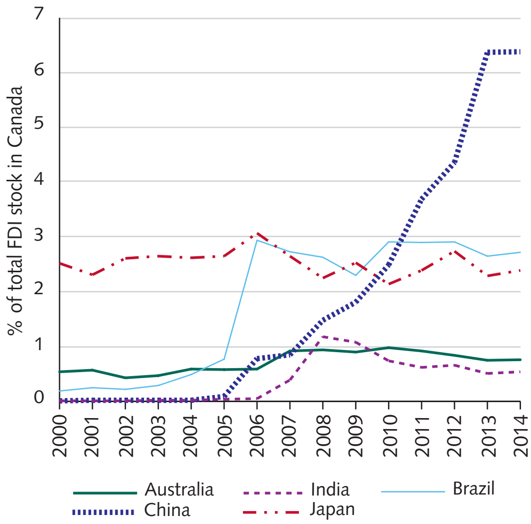
	Japan	China (excl. HK SAR)	India	Brazil	United States	World
Stock of inward FDI	17.479	46.726	3.973	19.948	361.732	732.263
Stock of outward FDI	6.052	6.794	1.128	10.318	349.965	828.812

Source: DFATD (2013a [2014]). Data on the stock of inward FDI from China are from the China Institute Investment Tracker database, http://chinainstitute.ualberta.ca. They are consistent with Statistics Canada measures but include many more transactions monitored by the China Institute.

[8] For a list in 2014, see Dobson (2014).

FIGURE 3

FDI stocks in Canada of selected investing countries as a proportion of the total, 2000-14



Source: Source: Statistics Canada, CANSIM, table 376-0051, China-Canada Investment Tracker (http://chinainstitute.ualberta.ca/).

role is now seen as producing public goods such as public housing and providing reliable electricity supplies and communication channels. Accounting and external audit practices are gradually becoming more independent and transparent as well.[9]

Even so, Canadian opinion on Chinese investment here is divided. Our discussions with industry players in late 2014 revealed views of SOEs such as "government run," "different from us with different standards" and "still learning." Such reservations worry Canada's junior producers, who are the innovators: their innovation ecosystems depend on foreign investors. Canada's policy restrictions on FDI create a chill that shrinks junior producers' options for raising risk capital or finding buyers. The large Canadian companies or established multinationals that remain tend to add acquisitions of these small firms to their global portfolios. This can lead to delays in the development of innovative assets unless they compete successfully with other assets in their global portfolios. As one interlocutor observed, "Potential foreign investors (like the Chinese) now see Canada as a 'can't do' country."

Other interlocutors in larger companies emphasized the steep learning curves faced by all Chinese investors. While their commercial objectives are similar to those of other multinationals, their understanding of host countries' regulatory regimes and rules of the road in international business is not. Canadian companies should engage with Chinese partners and teach them how to go 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 in a Changing Regional Order

Asia is at a formative geopolitical juncture, as significant as Europe was in the immediate postwar period. American dominance and leadership have been critical to Asia since the Pacific war,

[9] It should be noted that a number of SOE investments in Canada have been welcomed because they have saved jobs, created new ones and given troubled companies new life. Sinopec's 2009 investment in the Northern Lights Project, CNOOC Ltd.'s 2011 acquisition of insolvent OPTI and Chinese Investment Corporation's 2009 investment in Teck Resources all proceeded with little comment, as did Sinopec's 2009 acquisition of a 9 percent share of Syncrude.

but now US primacy as the dominant player is being actively contested by China. "With the rise of China," writes a former Australian prime minister, "we are observing the geopolitical equivalent of the melting of the polar ice caps. Slowly the ice thins, cracks appear and one day a large sheet of ice spectacularly peels away" (Rudd 2015, 1).

Geostrategic competition between the United States and China is a new reality as the two seek to manage their difficult, important and very complex bilateral relationship. Asians are searching for the leadership, institutions and norms to manage a dangerous strategic transition and address a host of dangerous hot spots, bilateral tensions and threats to human security ranging from extremism and terrorism to nuclear weapons. All require collective solutions and all are complicated by resurgent nationalism, unresolved historical memories and the absence of effective security institutions.

Power transitions have only rarely been accomplished without military confrontation. Asians are struggling with the dilemma of supporting America's continuing role while accommodating China peacefully in a regional order increasingly, but not exclusively, of China's making. Conflict is not inevitable. Chances of inadvertent conflict can be minimized, and unchecked strategic rivalry and competition can be avoided. But Asia's deep economic interdependence will not by itself ensure continued stability. Rather such stability must be a conscious choice and achieved through well-managed bilateral diplomacy and more effective regional institutions.

Canada is not insulated from these developments. A window is open for Canada to play a constructive role that could benefit both the Asian region and its own relations with China and the United States.

Not since the establishment of diplomatic relations in 1970 has Canada's China policy been directly connected to the geostrategic objective of reducing China's isolation. For 35 years subsequent governments claimed they were advancing global peace and security by facilitating China's participation in major institutions including the United Nations and the World Trade Organization, and most recently in creating the G20. The current situation is more fluid and presents a series of difficult choices. How do we understand the intentions of a more powerful and assertive Chinese government that is not only integrated into existing institutions but creating its own? What should be Canada's position in the increasingly complex relationship between the United States and China? What kind of redesigned middle-power function is in Canada's interest and that of the region?

Until recently China has regarded the institutions, norms and arrangements created by the Western countries after the Second World War and anchored by the United States as generally in accordance with Chinese interests. In advancing those interests, China has played a low-key role. It has been a generally constructive player in the United Nations, the international financial and trade institutions, and leadership forums such as the G20. It has been as responsible a player as any of the major powers in international efforts to address the collective issue of climate change, and in addressing natural disasters, piracy and pandemics. It has a strong record of compliance with the treaties it has signed and involvement in the international regimes it has participated in creating, such as peacekeeping operations. Regionally, China has been active in virtually all of the Asia-Pacific institutions including APEC and the processes sponsored by the Association of Southeast Asian Nations (ASEAN), including the ASEAN Defence Ministers Meetings Plus (the region's premier security forum, where ASEAN and its eight dialogue partners work to strengthen security and defence cooperation) and the East Asia Summit. It has signed FTAs with ASEAN, New Zealand and, more recently, South Korea and Australia. It participates in the Regional Comprehensive Economic Partnership negotiations and has joined APEC's ambitious Free Trade Area of the Asia-Pacific initiative.

But the current liberal world order is not *the* world order. China is proposing adjustments and changes to suit Chinese interests and reflect shifting power realities. China aims to be a responsible stakeholder in global affairs but is becoming a rule maker as well as a rule taker.

Since Xi Jinping became president in 2013, he has changed China's approach to managing bilateral relations with major countries such as the United States, Russia and Japan and its approach to regional institutions. The main lines of Xi's foreign policy are variously characterized as active, assertive and aggressive. China's defence spending and the sophistication and range of its military assets are expanding quickly. China not only sponsors security forums such as the Shanghai Cooperation Organisation but has created a new one, the Conference on Interaction and Confidence Building Measures in Asia. Neither includes the United States. China has also been more assertive in advancing its claims in maritime territorial disputes, especially in the South China Sea and the East China Sea, raising region-wide anxiety. The anxiety extends beyond China's approach to the immediate sovereignty and territorial issues. A more powerful China, some fear, may seek to settle old scores, establish a sphere of influence and undercut international law.

As noted earlier, OBOR, China's infrastructure investment initiative in Asia, has the potential to connect a number of poor countries into the global economy. Chinese direct project financing and its sponsorship of the Asian Infrastructure Investment Bank are also part of an effort to expand China's international influence, presenting what some see as a strategic challenge to the United States. Others note the financing risks associated with these major long-term projects and the likelihood that smaller participants will hedge against the closer Chinese embrace by seeking closer relationships with other large countries like the United States. Creation of the AIIB as an international financial institution is in large part a reaction to the long-standing failure by the US Congress to support the decision by the shareholders of the International Monetary Fund to adjust voting power to better reflect the rising roles of China and the large emerging-market economies in the world economy. The unintended consequence has been a ratcheting up of strategic competition.

This overlay of strategic competition is palpable even as China and the United States cooperate on such key collective issues as climate change and regional worries like North Korea. Neither desires a military confrontation, but China is contesting American primacy. Washington's rebalancing or pivot to Asia is a response to worries in the region about this challenge. All countries say they see a rules-based order and strategic stability as essential to continued economic dynamism. The question is, Who will make the rules and through what institutional networks?

Asian leaders are eager to avoid being forced by either China or the United States to choose between them. Most desire a strong and continuing American presence even as they recognize that the era of American economic dominance has ended. Up for debate are questions about the kind of regional security order and institutional architecture that safeguards economic cooperation, accommodates China's core interests, maintains the American presence and manages strategic rebalancing.

Canada's closest partners in the region — the United States, Australia, Japan and South Korea — all pursue policies embracing elements of continued or expanded engagement, hedging against China's rise, and countering 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-anchored rules must prevail in the region. Opinions outside of the US government are diverse. Some argue for a grand strategy to balance and contain rising Chinese power.[10] Others urge 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 (Rudd 2015, 25).

Canada's position on the strategic implications of China's rise and the appropriate response to it has 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. We maintain limited defence cooperation with Japan, South Korea and Singapore but without formal alliances. Canada is a member of some of the regional forums such as APEC, whose focus is mainly economic, and the ASEAN Regional Forum, whose focus is security. Canada has sought unsuccessfully to join the ASEAN Defence Ministers Meeting Plus and the East Asia Summit. Ties with China are ad hoc, maintained through an expanded frequency and seniority of bilateral exchanges between defence officials in Ottawa and Beijing and by confronting Chinese officials directly and sometimes publicly over allegations of government-sponsored cyber attacks.

Overall, Canada's involvement and voice in Asia-Pacific security matters have been declining. For more than a decade Ottawa has not made a major statement or launched a review of the changing security environment and balance of power in the region. The same is true of collaboration with regional partners: Canada has provided assistance to antiterrorism

[10] See, for example, Blackwill and Tellis (2015).

campaigns and efforts targeting human smuggling but has not initiated any substantive proposals in more than 10 years. In the 1990s unofficial forums known as "Track 2," which included nongovernmental experts and officials acting in their personal capacities, focused on cooperative security, management of potential conflicts in the South China Sea and later human security issues, including antipersonnel landmines and the Responsibility to Protect. Naval activities included occasional ship visits to Asian ports and periodic participation in regional naval exercises, but Canada's naval capabilities in the Pacific are shrinking.

Canada's silence and diminishing visibility undermine our credibility and help explain the lack of interest in having Canada join the leaders' forums. Asian thought leaders signal that Canada is no longer viewed as an engaged and full partner in the region. Canadian capacity and commitment to Asia's security agenda are frequently questioned. Many perceive Canada as a partial player of marginal impact, distant, aloof and reactive, and focused mainly on our own economic advantage.

Strategic silence may keep options open, avoid confrontation and allow a single-minded focus on business. Unlike other countries further inside the gravitational field of the Chinese economy, Canada does not face the "China choice": we are not forced to choose where we would stand in the event of direct Sino-American conflict. Nonalignment or aiming to stay above US-China rivalry is not an option. Beijing understands that in a crisis we would side with our American allies.

The real issue is what Canada, working with others, is prepared to do to prevent miscalculations, accidents and escalating rivalry that could spill over into conflict. Our middle-power role and credentials need to be refurbished. Even during the Cold War, when Canada was firmly in the Western camp and took up arms against China in Korea, the calculation was that bringing China into the international community would pay future dividends. Ottawa acted on such a calculation in establishing diplomatic relations with China in 1970, several years before the United States did. It paid special attention to multilateral institution building and conflict mediation, promoting cooperative security mechanisms in Asia along the lines that bridged Cold War differences in Europe.

The challenge and potential role for a middle power in the twenty-first century are different. China is more than another member of the international community. It is becoming a leader, acknowledged for its economic success and societal opening despite the lack of political liberalization. Canada's traditional middle-power role was to bridge great power differences whenever possible, not to exacerbate them. Finding 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. Canada could 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 objective should be to prevent a second one in Asia.

A new group of middle powers in Asia, including traditional ones like Australia and New Zealand and new ones like South Korea, Indonesia and Malaysia, have roughly similar outlooks and interests. The regional conversation is shifting from the design of individual institutions to questions about the kinds of regional security order and leadership that are needed. What adjustments need to be made by great powers to maximize accommodation, show restraint and offer reassurance to others in the region? What are the right venues for working out the norms, rules and practices of a new security order?

There is an added dimension of nontraditional security as well. The regional agendas of multilateral institutions are expanding to include cooperation on humanitarian assistance, disaster relief, and search and rescue. Canadian civil society has the reputation, credibility and domestic resources to be a leader in working with China and other countries on such matters as water management, climate change adaptation and mitigation, infectious disease prevention and managing cross-border tensions, including in the Arctic.

Canada's continuing strategic silence and the appearance of being a spectator on the sidelines are liabilities to any long-term economic agenda. The consequences of a direct military clash involving the region's great powers or even a new cold war against China would be devastating for global supply chains and Canada's commercial interests. 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.

Extended engagement is the superior option. Canadian interests are best served by a rules-based order and open regional institutions rather than competing regional structures or values-based mechanisms like an alliance of democracies. Competing regionalisms could lead to exclusive blocs led by either the United States or China. This might make sense to those who still think in narrow terms of strategic rivalry and balance of power. But they miss the historic opportunity to generate collective benefits that are essential in strengthening a dynamic and deeply integrated regional economy.

As the Australian government has found, it is difficult to play a role between Beijing and Washington. This is even more the case when China is both bold and assertive in its new initiatives. The adage "When big countries think and act big, it is hard for smaller countries to get attention" rings true. But, together with others, we should seek such attention.

Recommendations for a Comprehensive Framework for Canada's Relationship with China

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 and augments the heavy economic focus with a commitment to participate in managing the new and evolving security situation in Asia.

The framework should be based on certain principles. It should be generational, in that it encourages successive governments, regardless of political stripe, to follow through with a whole-of-country approach. China should be the central focus. The approach should be based on our interests and an informed calculus of our long-term economic and security objectives. It should also be based on the recognition that we will deal with China not as we might wish it to be but as an evolving social, political and economic system with values and institutions different from our own.

The operating principle should be to find common ground and shared interests while addressing differences with mutual respect. Precisely because of the differences in history, values and institutions, relations with China require steady and imaginative leadership to deepen understanding and look creatively at possibilities for shared initiatives that will be consistent with Canadian interests.

1. Lead from the very top in adopting a whole-of-country approach to economics, security and public education

Leadership at the highest official levels is essential to build long-term relationships with Chinese leaders and other governments in the region. In Asia, more so than in the West, key linkages among countries are built on foundations of state-to-state relationships maintained by prime ministers and presidents.

Relating to China

Canada was early to recognize China's Communist government in 1970. Canada and China signed a strategic partnership agreement in 2005. To facilitate transactions, official agreements exist in a number of areas like tourism, financial services, transportation, science and technology; a renminbi trading hub has been established, and memoranda of understanding have been signed on the environment and nuclear cooperation. Canada's Global Markets Action Plan, adopted in 2013, targets Asia-Pacific economies (DFATD 2013b); and a Foreign Investment Promotion and Protection Agreement with China was implemented in 2014. A steady stream of ministers and provincial premiers visit China each year.

Despite this history and these recent moves, Canada is not taken seriously for several reasons. Canada's focus is not strategic and is narrowly focused on commercial interests. Several of our Asian counterparts have indicated they expect Canada to engage on security issues as well. They recall Canada's history dating back to participation in the Korean War more than 60 years ago; Canada's assistance in laying foundations for the six-party talks on North Korea in the early 1990s; and its collaboration with Indonesia on regional discussions to manage potential conflicts in the South China Sea. Fiscal stringency in Canada in the late 1990s led to cutbacks and a narrower focus on areas of compelling national interest. As security issues enter a new phase in the region, there are pressures to reengage if Canada wishes to expand and deepen economic ties.

The bilateral relationship with China cannot be pursued effectively without high-level political engagement. In recognition of the different systems in the two countries, special political attention should be given to conducting regular high-level meetings, and to establishing and executing focused agendas to promote understanding and exchange. 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, China's top political decision-making body. Further, 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.

To see what a deeper approach might look like, we need look no further than Australia, which has developed an influential role in the region far out of proportion to its economic size (its economy is one-third smaller than Canada's). Almost 30 years ago, the Australian government initiated a major economic and political study of northeast Asia's prospects; the resulting report to the prime minister in 1989 painted a clear picture of the region's potential and recommended far-reaching policy changes that were followed through at the highest political levels and by successive governments regardless of party (Garnaut 1989). An explicit assumption in Australia is that its relationships with the United States (with which it has a military alliance) and with the Asian economies are complementary. Australian governments have invested heavily in maintaining personal relationships with Asian leaders. They have invested in improving diplomatic, educational and research capabilities with respect to the major Asian economies. Australians have been active in introducing new ideas for regional institutions, beginning with APEC in the late 1980s. In 2010 the Australian government created the Australian Centre on China in the World. In 2012 Prime Minister Julia Gillard issued the White Paper *Australia in the Asian Century*, which stressed a whole-of-country approach (Australia 2012). By June 2015 Australia had implemented FTAs with China, Japan and South Korea, its three largest trading partners.

There is of course a marked difference between Australia and Canada with respect to proximity to large markets. Next door to Canada sits the world's largest and wealthiest market, with similar values and institutions and people speaking a common language. Australia's nearest large markets are China and India. Just as Canadians know they must ensure the US relationship "works," so does Australia regard China and, more recently, India. Australians have learned about China as an existential obligation. That Canadians have seen no such priority puts them at a distinct disadvantage as the centre of global economic gravity shifts to Asia.

A useful step was taken during Prime Minister Stephen Harper's November 2014 visit to China, at which the Foreign Affairs Ministers Dialogue was agreed. The Economic and Financial Strategic Dialogue announced at the same time will also examine options for deeper cooperation. Chinese and Canadian participants will meet once in each country and issue a report. This is valuable but not yet at the same level as the efforts of some other Western countries, which have established annual meetings of heads of government.

Increasing our participation in the Asian region

Canada's framework for our relationship with China should include a new commitment to help build the regional institutions that will serve the interests of Asian governments in maintaining their security links with Americans while accommodating China's growing interests in its security relations with its neighbours. Even though Canada's proximity to the United States heavily influences our interests, rising security tensions in Asia serve no one's long-term interests. A reenergized cooperative security agenda with a major focus on building regional institutions is the best alternative. Canada can influence the content of such rules only if it is an active participant.

Convening and coordinating within Canada

More active involvement in such intergovernmental initiatives depends in part on changing the narrative in Canada and putting more effort into internal coordination of the activities of various levels of government, including municipalities, and of other stakeholders such as educators, civil society and business. Even so, the national interest will be served by a multitrack approach. Instead of waiting for governments, Canadians should inform themselves of opportunities and grasp them, regardless of what governments do. Governments should encourage such behaviour, and indeed, provincial premiers are, in their own ways, doing just that.

At the same time, more focus on China is desirable at the national level, where thoughtful and experienced individuals and groups have called for a cabinet committee to direct, coordinate and evaluate bureaucratic priorities so that actions across departments within the federal government aim for the same outcomes (Mulroney 2015; McKinsey & Company 2014). We agree.

The federal government will need to design and convene a mechanism that brings together all major stakeholders. Canadians must come to terms with the fact that Canada is an Asia-Pacific nation but does not yet think or act like one. Regular, perhaps annual discussions could help coordinate around long-term goals the actions of the many players who present themselves separately in Asian capitals. Premiers of three western provinces have commissioned expert advisory reports to shape their goals and strategies. Pulling these recommendations together to guide a common strategy would be a constructive step forward.

2. Build on the strong economic complementarities between Canada and China

The picture of economic collaboration is one of unfilled potential. China's recent FTAs with our competitors add to the urgency of more proactive engagement. 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 of food and energy 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. The APFC Canada-Asia Energy Futures Task Force (2012) recommended a public energy transportation corridor, one that would be 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; the proposed collective action framework can be constructed in ways that minimize risks, maximize public gains and fairly share the benefits. This is not to diminish the political difficulties of managing land use issues and rights of First Nations. But failing to try means denying all parties the benefits of a major collaborative opportunity.

Another potential signature bilateral project could respond to China's interest in clean energy. Innovations to improve management of energy and the environment are beginning to come out of western Canada. New technology that meets the COSIA target of cutting water use in oil sands developments by half would be a prime example of a project that China, with its large water-scarce regions, might collaborate on.

In infrastructure and transportation, Canadian firms have competitive advantages to be tapped in the surge of infrastructure and connectivity projects planned for OBOR projects announced in late 2014 and early 2015. These initiatives could offer new areas of fruitful long-term collaborations, including links with our own investments such as the Asia-Pacific Gateway and Corridor Initiative (begun in 2007 to improve logistics and transportation infrastructure) — but only if we turn up and participate. Canadian firms should also organize to participate in Asian and Chinese value chains for these projects.

Other supply chains should also be tapped to meet China's growing middle-class demand for sophisticated services, where Canadian suppliers are successful. More than a million Canadian suppliers are small and medium-sized enterprises, many in service industries. Yet only 41,000 in this group actually export, and mostly to the United States (DFATD 2013a [2014]). The ambitious new export development priority identified in Canada's Global Markets Action Plan is a step in the right direction, with a target of assisting up to a thousand new exporters annually (DFATD 2013b). Canada's participation in the 12-country TPP negotiations is another significant step; the aim is not only to penetrate Asian value chains but to safeguard Canada's access to the huge Japanese market.

Furthermore, goals should be set for 5- and 10-year two-way flows of trade and investment. In trade, the target should be to double the value of exports to China by 2020, to $40 or $50 billion from $21 billion in 2013. The additional exports could create more than 2 million new jobs. Setting a similar target for Canada's outward FDI is more problematic because it would depend on company strategies. To the extent that inward FDI is determined by Canada's regulatory regime, a transparent review process based on best practices would have to be introduced before any goal could be determined.

Canada's opaque and restrictive FDI screening system is a major issue. The December 2012 decision restricts SOEs from owning controlling stakes in Canadian oil sands companies "only in exceptional circumstances." Added to the already opaque net benefits test and national security screening, these have had the chilling effect noted earlier that has disadvantaged the energy industry at a time when it is also facing a dramatic plunge in oil prices. Canada's investment regime is ranked by the OECD as one of the most restrictive (OECD, n.d.). The system is counterproductive: although it aims to limit investment only by SOEs, it risks sending the message to China's increasing number of *private* enterprise investors that Canada is not a place they need to be.

Canada's restrictions on inward FDI have harmful long-term consequences: weakened competitive pressures on Canadian firms, increased cost of capital, discouragement of investors by increasing the uncertainties of the approval process, and higher transaction costs in Canada relative to those in countries with more transparent and predictable review regimes. Most important, the restrictions discourage private equity players who look to large companies for exit strategies from risky — and often innovative — investments in small companies, and they reduce access for smaller Canadian players to the global supply chains of large players. Yet big business is silent, with large players apparently content with their protected positions.

Canada's investment screening process should be rationalized into a single system under the jurisdiction of Industry Canada. The policy concern about control of Canada's natural resources is largely addressed by provincial ownership and National Energy Board rules on exports. The added focus on ownership is ill-advised. Not only does it tell the world's largest pool of capital that it is not welcome in Canada, but the focus on SOEs reflects outdated thinking about China. Instead the focus should be on firm behaviour. Canada has well-established regulatory regimes that should be used to monitor and influence firm behaviour with respect to fair competition, financial soundness and compliance with laws and regulations on the treatment of workers and environmental protection.

Finally, targets should be considered for two-way people-to-people engagements, such as friendship societies and urban twinning arrangements. Canadian students should be encouraged to learn an Asian language, as Australian students do.

3. Modernize our economic ties

China's recently concluded FTAs with Australia and South Korea are wake-up calls, telling us that China is willing to liberalize its bilateral trading regime.[11] As a relative latecomer to such trade liberalization in the region, Canada faces two options. One is to support and encourage China's inclusion in the next round of TPP talks, expected once the current 12-country agreement is ratified by national governments and legislatures. Chinese officials have been studying the TPP, and some see it as a way to push through difficult reforms, such as changes to SOEs, by blaming foreign pressures from such negotiations.

A second round of TPP negotiations, in which China, South Korea and Thailand (and possibly Indonesia) might participate, is likely to take some time to launch. In the meantime, Canada should launch a bilateral trade negotiation with China. The FTAs with Australia and South Korea indicate that China has moved beyond simple tariff reductions on goods to include a range of services and investments. Each agreement is of interest to Canada, but as noted earlier, the Australian agreement has particular potential for diverting trade away from Canada, because of bilateral concessions. It is also worth noting that Australia, which restricts SOE activities, made no concessions on this point — and must pay for its refusal in more limited access in some other key areas (Australia 2015).

Canada should also work collaboratively on APEC's Free Trade Area of the Asia-Pacific, an idea championed by Canada in APEC more than a decade ago. And Canada should serve its long-term economic interests by participating in the major infrastructure projects expected in the OBOR initiatives.

Canada refused to join the AIIB as a founding member, but it should join now. Canada can be a constructive participant supporting state-of-the-art governance and standards, a position that fits with our wider strategic interest in encouraging Chinese multilateralism. The main impact of Canada's initial reluctance is likely to be economic, hampering access by Canadian businesses to potentially significant long-term infrastructure opportunities.

4. Strengthen and shape the relationship at multiple levels

There are several dimensions to shaping the relationship, beginning with the actions of top leaders. The chill in public attitudes could be reduced by speaking to the main public worries and fears about China's growing international weight, its opposition to certain policies and institutions, and its expanding presence in Canada. Each can be addressed by better-informed public discussion of the opportunities in Asia and China along with the risks and problems.

A national dialogue should be considered, kicked off by senior leaders from the public, private and educational sectors. The goal should be simply to talk about China: to examine differences over contentious issues such as the role of Confucius Institutes, rules on foreign

[11] China and New Zealand implemented their bilateral FTA in 2008.

investment and concerns about Chinese homebuyers supposedly driving up prices. More accurate definition of the problems (for example, the impacts of market forces and land use and other policies as causes of high house prices) and fostering debate about ways to alleviate the pressures on house prices would help address the backlash.

Local-level actions also can inform Canadian public opinion. Lessons can be drawn from the APFC's National Conversation on Asia, which succeeded in introducing a number of new and younger participants. The next step is to consider policy options and recommendations through a series of moderated forums, for example; here individual citizens could interact with experts who would explain what is at stake, how to manage irritants and risks, and which solutions can be effective considering the trade-offs involved.

Differences in values, institutions and practices do not need to be hidden. Some Canadians argue for working directly with Chinese civil society and other agents of change in China that reflect aspirations of the Chinese people, but recent Chinese legislation and directives aim to restrict foreign influence and limit unsupervised activities of nongovernmental organizations. With imagination, ways can still be found to help build Chinese capabilities that are consistent with, for example, the very real changes under way in the legal system to increase judicial independence. Canadian educational and expert institutions can be organized to build on valued contributions Canada has made in the past, such as training of Chinese judges. Other possibilities might include introducing governance innovations and offering ways to resolve environmental issues.

The APFC's initiative to encourage more young Canadians to develop "Asia competence" is a foundation on which to build. Universities and colleges should aim to ramp up research and two-way flows of students through, for example, co-op placements and teaching programs in China. The public and private sectors should work together to expand the quality and reach of academic research and teaching to increase public knowledge and understanding.

Educational responses that recognize the differences in business environments in China and Canada are also desirable. Business and technical schools should offer courses to Chinese managers on Canadian regulations and the Canadian regulatory environment. Courses might also be offered to Canadian regulators on the main differences in the two regulatory environments. In addition, Canadian companies should invest in deepening their knowledge of Chinese business in international markets as well as opportunities in China by recruiting directors with relevant experience, skills and expertise.

5. Establish a credible middle-power engagement in Asia

The rising threats to political stability in the Asian region argue for investments by all major Asia-Pacific nations in the region's cooperative security institutions. As important as alliances and unilateral preparations are to maintaining regional stability, strong multilateral institutions are the best option to maximize economic benefits and preserve a durable peace in a context of remarkable diversity. To play a role in the creation of that institutional architecture and order, Canada should have a well-articulated security policy.

Its elements should include the following:

- Preparation of an Asia-Pacific security and defence White Paper. It should address Canadian concerns about the changing regional security environment and conflict management and provide estimates of the diplomatic and military assets required to play a distinctive role in the region. With respect to military assets, procurement decisions are needed that determine whether Canada should have a more robust naval capability for operations across the Pacific or whether Canada should invest in other capabilities such as airlift and humanitarian response assets for use in regional contingencies. The White Paper should outline the most important nontraditional security issues where Canadian capabilities match regional needs. It should also cover specific arms control and disarmament issues relevant to China, including missile defence and the weaponization of space.
- Strengthening the Canadian commitment to existing regional institutions that are inclusive in nature and that can amplify the impact of our role in advancing a rules-based system. Formal governmental processes are required as well as more creative use of the Track 2 and nongovernmental channels that are integral parts of regional governance and community building. Membership in the East Asia Summit can be achieved only with Canada's enhanced engagement on multiple fronts and recognition by other parties of Canada as a reliable regional partner.
- Deepening bilateral relations with Chinese officials and research institutes on a wide range of security-related issues, both global and regional, as part of a comprehensive Canadian institutional presence in regional forums, including those led by ASEAN.
- Linking Canadian trade and security policies to emphasize the importance of inclusive regional processes and to avoid the risks of dividing the Asia-Pacific region on ideological lines or into competing blocs or spheres of influence. It is still possible to shape Chinese thinking on the direction and viability of a cooperative, rather than go-it-alone, approach.
- Collaborating more closely with other middle powers in the region on initiatives to resolve specific conflicts and construct stronger multilateral processes to build confidence and trust and promote preventive diplomacy. Government support is required to define agendas and identify regional public goods that present feasible solutions.

Conclusion

Canada should up its game in Asia, beginning with China. A comprehensive long-term framework for the bilateral relationship with China is required. The election of a new national government in Canada provides a golden opportunity for a fresh start with high-level leadership of the whole-of-country approach recommended here.

The current approach lacks such leadership; it lacks a long-term framework; it focuses narrowly on our economic interests in a complex and multidimensional Asian region in which growing strategic rivalry between the United States and China is shaping the future. In light of this geostrategic shift, traditional Canadian assumptions that our location and wealth of natural resources will keep us comfortable need to be updated.

Windows of opportunity are open to deepen our interaction with China. One window is created by Chinese demand for security of supply of food, natural resources and energy sources; by rising middle-class demand throughout China and its Asian neighbours for better services, including tourism, health care, education, and financial and environmental services; and by China's major infrastructure plan for the One Belt, One Road initiatives in central Asia, which could open significant new business opportunities.

The other open window is in the broader Asian region, where Canada should also up its game. In the past Canada was early to recognize China's Communist regime in 1970 and engaged actively in regional initiatives. Today Canada is invisible, standing on the sidelines. Growing strategic rivalry is making Asia's middle powers increasingly concerned that they will have to pick sides between the two global powers. They are moving to strengthen regional economic and security institutions to encourage cooperation even as the two giants compete. Canada's long-term interests will be best served by making distinctive contributions to help maintain stability and by partnering with others to prevent inadvertent conflicts that would undermine our economic interests.

This call to action is urgent. The windows of economic opportunity could close — as aggressive competitors move to meet food and energy demands, as China's growth slows further and as concerns about climate change accelerate the shift away from the conventional energy sources we supply. The window of opportunity to restore a credible Canadian presence in the Asian region could also close unless we become more actively involved in helping to create a future regional order that includes both China and the United States.

We can no longer be complacent about our future prosperity or assume that Asia's comparative peace and stability will continue. As a matter of necessity and opportunity, expanding relations with China should be the centrepiece of a broader and deeper embrace of the Asian century. With verve, imagination and an effective policy framework, we can help make it an Asia-Pacific century.

Glossary

AIIB	Asian Infrastructure Investment Bank
ASEAN	Association of Southeast Asian Nations
APEC	Asia-Pacific Economic Cooperation
APFC	Asia Pacific Foundation of Canada
FDI	foreign direct investment
FTA	free trade agreement
OBOR	One Belt, One Road
OECD	Organisation for Economic Co-operation and Development
SOE	state-owned enterprise
TPP	Trans-Pacific Partnership

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