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Reassessing Canadian Trade in Asia

by Randolph Mank
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With the political and media frenzy fading, China probably did us a favour when it rejected Prime Minister Justin Trudeau's efforts to launch negotiations on a free trade deal in December. Now, at least, we know what they don't want – an ambitious and progressive set of trade and economic commitments and disciplines, along the lines of our Comprehensive Economic and Trade Agreement (CETA) with the EU. They have also given us time to pause and think carefully about the emerging new world order into which we may be inadvertently stumbling. It's worth taking the opportunity to look at the broader geopolitical context, examine the current state of Canada-China trade, consider our respective objectives, and from that basis, recalibrate our trade priorities in Asia and elsewhere.

The geopolitical context

Having led the creation of the new world order, post-Second World War, including a liberal rules-based global trade regime, the U.S. appears now to be in retreat from this role. Whether it will be a temporary phenomenon tied exclusively to the Trump administration's idiosyncrasies, or an enduring trend, is anyone's guess. But it does seem as though the high overhead costs of the role – a domestic market relatively open to the world, resultant structural trade deficits, a massive debt load, large payments to support the UN and NATO, not to mention a massive foreign aid commitment and occasional trillion-dollar wars abroad – would be difficult for any future administration to sustain.

Meanwhile, challengers to the unipolar world – in particular Russia and China, not to mention Iran and North Korea – have a deep interest in imposing limits on U.S. dominance. Russia has enormous influence profoundly disproportionate to its economic size by virtue of its nuclear-armed military, as well as its vast landmass and natural and human resources. While maintaining his own domestic power base, President Vladimir Putin appears intent on reasserting the expansionist global role that the former Soviet Union played following the Second World War.

Of course, the bigger geopolitical story is China. Ruled since 1949 by the Chinese Communist Party, it has far exceeded the economic command-and-control prowess of its failed Soviet Union counterparts. It has succeeded, ironically, by borrowing key lessons from the wealth-creating tenets of capitalism.

Starting in the 1970s, and steadily gathering pace with each successive decade, the Chinese government has orchestrated a remarkable flourishing of enterprise – public and private – resulting in an impressive accumulation of capital through world-beating industrial development. Urbanization, a growing middle class, individual prosperity and some circumscribed freedoms have followed, as part of a modified modern social contract that holds China's disparate peoples together.



The result today is a fast growing, \$15-trillion centrally planned economy that has been moving methodically from one successful five-year plan to the next, destined to become the biggest economy in the world. China's latest proclaimed ambition is to transition from an export-led, manufacturing economy to one based more on domestic demand, offering higher value-added products and services. In reality, China will be a powerhouse in both.

China's current leader, Xi Jinping, is a 64-year-old, highly experienced party apparatchik, who has been carefully groomed through a combination of education and experience in both policy and administration, steeped always in the ideological orthodoxy of an authoritarian communist system. Neither the American nor the Canadian political system produces leaders or cabinet members with anything near this depth of technocratic experience and training for their roles.



Figure 1: Chinese President Xi Jinping at the closing session of the 19th congress of the Communist Party. (Xinhua)

On attaining the top job, Xi set about consolidating power by offering a combination of Mao-like image building and his own inspirational vision. As Xi's recent 3½-hour speech to the 19th Party Congress revealed, these moves constitute the ultimate geopolitical strategy to achieve the "Chinese dream".¹

The vision includes the highly ambitious goal of developing so-called Belt and Road trade links via fresh overland infrastructure development connecting China to the rest of Asia, and all the way to Europe.² At sea, China has asserted aggressive sovereignty claims to the South China Sea



by building and then establishing military installations on strategically placed artificial reefs in previously open waterways. It has rejected international legal constraints in doing so.³

All the better to circumvent where possible, and challenge when and if necessary, the U.S. Pacific Fleet stationed in Japan as the guarantor of open trading routes in Asia. In the process, they aim to dominate the region and eventually reshape the world order.

The Canada-China baseline

This is what we are up against in our quest for a progressive free trade agreement with China. It's a mismatch of epic proportions and we should not delude ourselves into thinking that it's only about trade.

In addition to glaringly obvious differences in geopolitical ambition, ideology, governance, culture, language and so on, we face in China a population nearly 30 times larger than Canada's, an economy more than seven times larger and a trade imbalance more than three to one in their favour. Though it's our second largest trade relationship, its scale is far behind the nearly \$2 billion-a-day business we do with the U.S.

To China's nearly 1.4 billion people we sell only \$21 billion a year in merchandise, mostly raw materials – wood and paper products, oilseeds, mineral ores, animal and vegetable products and automotive parts. ⁴ That's about \$15 of Canadian goods for every Chinese citizen, and only about four per cent of our total merchandise exports to the world.

In return, they sell \$65 billion in largely manufactured goods – phones, data processors, toys, textiles, electrical equipment and televisions – to our 35 million people, or about \$1,857 per Canadian.⁵ On the investment side, China has \$21 billion in Canada, while we hold \$13 billion there.

And the trend line is clear, too. Our exports to them have grown by only about \$1.6 billion since 2012; theirs to us by almost \$14 billion. Logically, in view of the imbalance, our primary objective in pursuing a trade deal would be to increase our exports above all else.

However, unlike the Canadian economic system, largely based on free enterprise and open markets, modified by a distributive tax and social welfare system, and dependent on trade and economic integration with our neighbour next door, China's economy is centrally planned and led by a phalanx of state-owned enterprises, along with favourably treated private businesses. China has a whopping 150,000 SOEs, owned by both the central and local governments.⁶

Given their disproportionate size and ability to access cheap capital, Chinese businesses are capable of swallowing Canadian ones effortlessly. The Chinese National Offshore Oil Company's purchase of Nexen's oilsands business is a case in point. The original promises, made in order to satisfy Canada's net benefit rules, have mostly been broken, according to some observers, offering a further cautionary tale.⁷



From this basis of understanding, the China free trade project has to be assessed realistically. Those of us who favour free trade in principle everywhere, do so because it has been empirically proven that clear rules and open markets increase trade. We certainly want this with China. Yet, most realists have long recognized the limits of the theory of comparative advantage. When one partner has a gross preponderance of the advantage, and a system tilted to ensure that this will always be so, theory yields to practical considerations.

Combined with the geopolitical context, it's clear that we need to manage the trade relationship with China carefully.⁸

We can learn lessons from others, as well. Countries that are geographically closer to and have much greater experience dealing with China – such as South Korea, Japan, Singapore and Australia – have already felt the sting from becoming even more dependent.⁹ China has shown a heavy-handed tendency to punish or control the smaller partner. Examples include restrictions on tourism to South Korea following the decision to station THAAD missile defence systems there, restrictions on Australian coal imports in favour of local suppliers and even the cooling of relations with Singapore after that country's expression of support for the U.S.'s continuing role in regional security.

Finally, China's human rights and rule-of-law record shows little sign of reform, as detained human rights workers and even Canadian business people would attest.¹⁰

China's goals

So what does China want from Canada through a free trade deal? Though they are less transparent about their goals than we are, China's strategic interests in Canada are clear. They want a first free trade deal with a G7 country, and concluding one with the U.S.'s closest trade and security partner would be a significant strategic bonus. They want to sell even more manufactured goods, while gaining greater access to our supply chains with the U.S. market – our energy and natural resources, our agrifood and our advanced technology in everything from green tech to artificial intelligence to quantum computing. They will use aggressive means to attain these with or without a trade deal.

Specific Chinese negotiating goals would likely include:

- Canadian recognition of China as a market economy;
- Promoting Chinese services and high-value Chinese industries;
- Liberalizing export licences on high-tech exports to China;
- Liberalizing investment thresholds under our net benefit and national security foreign investment review regime;



- Increasing labour mobility of Chinese workers into Canada.¹¹

Few of these are shared interests, which underlines the core problem. For, as well as being a trading partner, China is also a strategic competitor in the changing geopolitical order.

The Chinese are capable of deploying people and businesses to pursue their interests, as well as paying local opinion-formers to help shape favourable public opinion in target countries. The Canadian government needs to be wary of this, just as Australia has recently learned.¹² It should also be especially careful about giving government research or advisory contracts to individuals who are also under contract with or receiving favours from the Chinese government, including paid travel to China.

Canada's goals

We should be clear-eyed about what we want and don't want from a trade deal with China. We have both consonant and dissonant interests. First, as much as minor trade imbalances are never a matter for panic, it is certainly not in our interests to have the current systemic and growing structural trade imbalance.

Second, it's clearly in our interest to sell more agrifood products, such as grains, oils, pulses, pork, beef, fish and so on. China shares an interest in having a diverse, high-quality food supply. It's not in our interests, however, to have the Canadian companies who export these products bought outright by Chinese enterprises, nor to have China buy up vast tracts of farmland and use Chinese labour to compete with our own exporters.

Third, it's in our interests to develop China as a market for our oil and gas exports and an investment partner in building our LNG production and transportation capacity, again without selling control of these outright. The energy sector is political dynamite, however, both domestically and internationally and China's participation compounds the controversy. The Nexen deal, as mentioned, is a case in point.

Fourth, it's in our interests to make business transactions in all other sectors as efficient and transparent as possible, unfettered by capricious barriers and interference. This includes service sector trade in such areas as banking, finance, engineering, education and tourism. On the first two, the Chinese financial system is under strain because of too much easy money given to inefficient SOEs. On the latter two, we have to be realistic about our inability to absorb, using existing infrastructure, the enormous numbers of students and tourists that China could easily generate.

Provided Canadian companies have the capacity, engineering opportunities stand out, especially with the possibility of participating in the Belt and Road infrastructure initiative in projects financed by the Asia Infrastructure Investment Bank (AIIB), which we finally joined last year. Participation should be carefully reviewed against strategic interests, however. We don't want Canadian engineering companies building artificial islands in the South China Sea.



Fifth, it's in our interests to make sure that any proprietary intellectual property content we sell in China should be protected from theft or infringement. It is unlikely, however, that we will succeed in this where so many others have failed. China is already a highly advanced technological power that can absorb and commercialize technological innovations rapidly. So, we have to play defence.

Last, a dispute settlement mechanism is another normal ambition in trade deals. But this cuts both ways, as well. China will view such a mechanism as a way of preventing Canadian regulators from blocking takeovers of strategic companies. As a rule-of-law society, we would be hard-pressed to resist. On their side, rule of law would be a less compelling factor than local favouritism in resolving appeals from the Canadian side. And non-tariff barriers are often the real blockage.



Figure 2: Prime Minister Trudeau takes part in a roundtable with business leaders in Rome to promote the newly-ratified CETA trade deal, May 30, 2017. (Adam Scotti/PMO)

This quick assessment suggests that, rather than a classical free trade deal, what we really need is a much more aggressive trade promotion program in China to boost exports. On the trade policy side, if we need anything at all, it would be a highly nuanced and focused sectoral strategy aimed at boosting our exports to China. And since this would never come for free, we need to find ways to hedge.

China's reluctance to incorporate labour, gender, environmental and human rights disciplines into a broad free trade deal reinforces this conclusion. It has become a cliché to tell ourselves in Canada that we have to give up something in our economic system (often supply management) in



order to get something in return from a free trade deal. But we are less inclined to think about what the other side is willing to give up or change, if anything at all.

Recalibrating our priorities

Generations of Canadians have understood that our first priority by far is to retain the economic advantages that accrue from our proximity to the generally friendly and open U.S. market. The U.S. also remains our preeminent security partner, with a vast web of closely aligned interests and values.

However, current worries about NAFTA are well founded and extremely serious. So too are sector-specific disputes with the U.S., such as softwood lumber and aviation. Accounting for just under 80 per cent of our exports, North American trade has to remain our principal focus.

Beyond that, everything else is small by comparison. Our priorities shouldn't just be about pursuing new trade agreements. It is equally important, if not more so, to prioritize trade promotion efforts in markets where we already have free trade deals. The Canadian Senate recommended boosting trade promotion globally in 2015 and the government has followed through to some extent by boosting and reallocating trade commissioner support in key markets.¹³ More is needed, however, including from the provinces.

The Canada-South Korea free trade agreement, for example, has generated criticism from some and has not yielded the hoped-for increase in Canadian exports,¹⁴ leaving us with a considerable trade deficit and the need for a trade promotion push.

CETA, a huge win in terms of both trade and geopolitics, similarly requires a huge effort at trade promotion if we are to realize the opportunities of freer trade with the EU.

The Brexit process means that we will also need to focus on devising a trade arrangement that draws on our long historical relationship with the U.K., as well. After all, not only is it our fourth largest trading partner, but our head of state also resides there, making it clearly a special case. The CETA model, already cited by our respective PMs as the basis for a bilateral deal, gives us a headstart.¹⁵ Yet, inevitably, the devil will be in the details. While we have to wait until Brexit is complete, a Canada-U.K. trade agreement should be on the priority list of our trade negotiators and ready to go.

As a side note, if NAFTA collapses, it would also be prudent to consider the option of a trilateral deal between Canada, the U.S. and the U.K. in its place. In that scenario, our trade relations with Mexico could be maintained under the now renamed Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) deal.

Turning to Asia, rather than bilateral deals, our priority should be to complete the CPTPP agreement. It meets most of our progressive goals and is well within grasp.



But this deal is only partly about access to the growing Asian markets. Several of the parties – Chile, Mexico, Peru – are not Asian at all. Each of these already have a free trade agreement with Canada. The only Asian participants are Brunei, Japan, Malaysia, Singapore and Vietnam. Among these, Japan, the world's third largest economy and our fifth largest trading partner, is the main opportunity, though Vietnam has seen remarkable growth as well.



Figure 3: Canada's seat remains empty during a meeting of the Trans-Pacific Partnership on the sidelines of the Asia-Pacific Economic Cooperation summit in Danang, Vietnam, earlier this month. (Mick Tsikas/The Canadian Press)

CPTPP participants from Oceania – Australia and New Zealand – are as much competitors for Asian markets, as they are market opportunities for Canada.

This means that, once we accede to the CPTPP, we should of course pursue broader access to Asia, including the giant markets of China, India and Indonesia.

We have choices for how to do this. We can pursue bilateral deals, in keeping with our current approach. Or we can attempt to join in on the ongoing Regional Comprehensive Economic Partnership (RCEP) process already well advanced among the giants of Asia and ASEAN.¹⁶ Or we could advocate for other Asian countries to join CPTPP once concluded.

In the meantime, and to shore up our qualifications to join RCEP, the government is right to pursue a Canada-ASEAN free trade deal. We are the only ASEAN dialogue partner never to have done so.



This doesn't completely eliminate the possibility of a bilateral trade deal with China. If they can be turned around on the merits of a progressive deal, fine. Otherwise, Canada should try to negotiate a sector-specific agreement aimed at bringing trade into much closer balance. Obviously, this is asking a lot from our trade negotiators.

In the end, while nice to have, a Canada-China free trade agreement is no more make-or-break for them than it is for us.

Conclusions

Canada has played a significant role in shaping the postwar, rules-based global trading system. With the exception of our close relationship with the U.S., our trade policy experts have always been cautious about a strategy of pursuing willy-nilly bilateral trade deals around the world. With WTO progress halted, caution about bilateralism appears to have been thrown to the wind in recent years.

So, too, have geopolitical considerations fallen out of fashion. Some cling to a naïve belief that the existing international order will endure. Evidence points, however, to a changing global order, with China the ascendant power. While we clearly need beneficial relations with rising China, we need to ask ourselves to what extent we are willing to abet it by granting even less fettered access to our resources and technology.

Canada has a tradition of multilateralism, which relies on credible international institutions to maintain global order and advance human progress. We have always striven for fundamental human rights, rule of law and respect for democracy. Rather than casting these aside at the very time when the global order is shifting, it is as important as ever to align with those who share those enduring interests.

In that light, though some criticize it, our pursuit of progressive free trade deals is absolutely correct and in our interests.

There is another problem underlying all of our efforts to conclude trade deals around the world. Trade accounts for more than 60 per cent of GDP, and one in five Canadian jobs.¹⁷ Yet the pool of Canadian companies that take advantage of new markets is relatively small; 40 per cent don't export at all.¹⁸ The ease of doing business with our immediate neighbour to the south makes companies risk-averse about looking farther afield. While this is especially true of SMEs, even our large corporations have been slow to exploit opportunities in new markets. Where they have, they have naturally pursued low-effort, lucrative partnerships that are understandably in corporate interests rather than national ones. That our legendary Candu nuclear reactors are mostly being built in China for domestic use and re-export to third countries is a good illustration.¹⁹

Without a change in business culture, negotiating new trade agreements is largely moot for all but the producers of bulk raw materials and those who can take advantage of cheap labour via global supply chains and profitable partnerships.



Can we ever hope to fully realize the opportunities of freer trade around the world without our own industrial strategy? Probably not. Alas, we should admit that China's five-year planning strategies offer an impressive model for that.

As a trading nation, there is no doubt that we need access to other markets. But, in a rapidly changing world, we must also be careful what we wish for.



¹ <https://thediplomat.com/2017/10/reading-between-the-lines-xis-epic-speech-at-the-19th-party-congress/>

² https://www.newyorker.com/magazine/2018/01/08/a-new-silk-road?mbid=social_twitter

³ <https://www.newyorker.com/magazine/2018/01/08/making-china-great-again>

⁴ Data in this paper are taken from:

Bilateral fact sheet: http://www.canadainternational.gc.ca/china-chine/bilateral_relations_bilaterales/China-FS-Chine-FD.aspx?lang=eng.

Trade overview: http://www.international.gc.ca/economist-economiste/performance/state-point/state_2017_point/index.aspx?lang=eng.

Comprehensive data: http://www.international.gc.ca/economist-economiste/statistics-statistiques/annual_merchandise_trade-commerce_des_marchandises_annuel.aspx?lang=eng

⁵ While the per-person figures are largely a function of population size, and would look similar with the U.S., bringing the Canada-China trade into a balance similar to that with the U.S. would ameliorate the disparity.

⁶ <https://www.export.gov/article?id=China-State-Owned-Enterprises>

⁷ <https://www.bnn.ca/a-parade-of-broken-promises-how-cnooc-stumbled-with-its-nexen-takeover-1.857533>

⁸ This argument has been presented to the Canadian government by others:

<https://www.policyalternatives.ca/publications/reports/canada-china-free-trade-agreement>

⁹ <https://www.lowyinstitute.org/publications/australia-needs-engage-china-and-hedge-risks-relationship>.

For China's perspective: http://news.xinhuanet.com/english/2017-12/08/c_136811619.htm

¹⁰ <https://www.amnesty.org/en/countries/asia-and-the-pacific/china/report-china/>

¹¹ <https://www.fasken.com/en/knowledgehub/2017/06/chinaprioritiesforafree-20170606>

¹² <https://www.ft.com/content/7ac14e70-ded8-11e7-a8a4-0a1e63a52f9c>

¹³ http://publications.gc.ca/site/archivee-archived.html?url=http://publications.gc.ca/collections/collection_2015/sen/yc23-0/YC23-0-412-11-eng.pdf

¹⁴ http://www.huffingtonpost.ca/jerry-dias/let-canadas-ill-advised-korea-deal-be-a-warning-about-free-trad_a_23027261/

¹⁵ <https://globalnews.ca/news/3752561/justin-trudeau-theresa-may/>

¹⁶ <https://www.japantimes.co.jp/news/2017/11/14/business/agreeing-rcep-chinas-favorite-trade-deal-set-drag-2018/#.WkvY-1S7811>

¹⁷ http://publications.gc.ca/site/archivee-archived.html?url=http://publications.gc.ca/collections/collection_2015/sen/yc23-0/YC23-0-412-11-eng.pdf

¹⁸ <http://www.canadianbusiness.com/lists-and-rankings/profit-500/export-tips-from-some-of-canadas-fastest-growing-companies/>

¹⁹ https://motherboard.vice.com/en_us/article/ypam77/canada-china-nuclear-power-candu-thorium.

And: <http://www.world-nuclear-news.org/NN-Argentina-and-China-sign-contract-for-two-reactors-1805175.html>

▶ **About the Author**

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► **Canadian Global Affairs Institute**

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