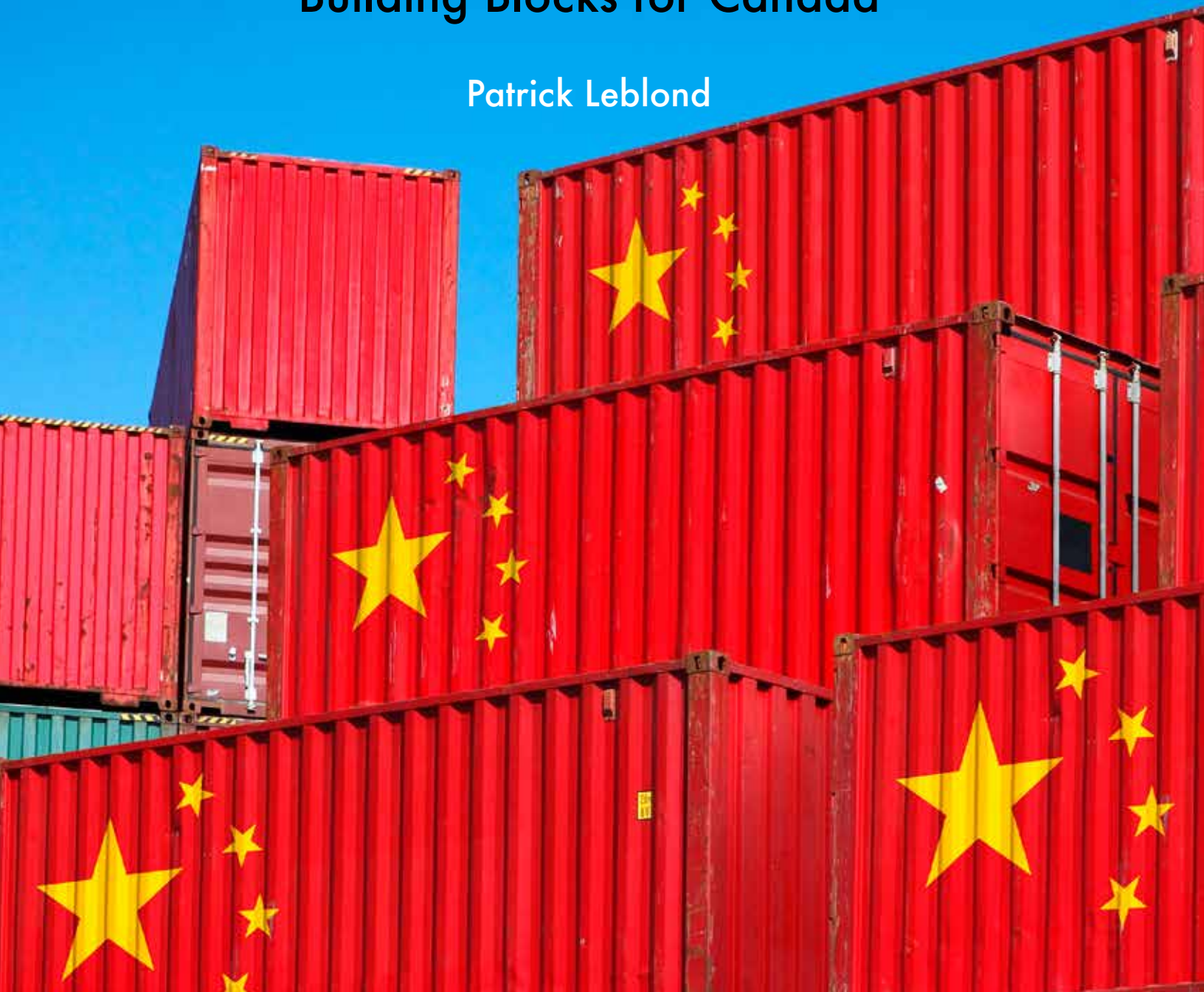

Centre for International
Governance Innovation

Special Report

TOWARD A FREE TRADE AGREEMENT WITH CHINA

Opportunities, Challenges and Building Blocks for Canada

Patrick Leblond



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About the Author

Patrick Leblond is a CIGI senior fellow with the Global Economy Program. He is an expert in global economic governance and international political economy, regional economic integration, financial regulation, and business and public policy. At CIGI, Patrick specializes in the investigation of Canada's international trade agenda. Alongside his CIGI appointment, Patrick is associate professor and holder of the CN-Paul M. Tellier Chair on Business and Public Policy at the University of Ottawa's Graduate School of Public and International Affairs. Prior to his current professorship, Patrick was an assistant professor of international business at HEC Montréal and the director of the Réseau économie internationale at the Centre d'études et de recherches internationales de l'Université de Montréal. Patrick also holds the designation of chartered accountant and, before his career in academia, worked as a senior accountant and auditor at Ernst & Young in Montreal. He went on to work as a senior consultant, first in economic and financial consulting with Arthur Andersen & Co., and then later in business strategy consulting with SECOR Consulting.

About the Global Economy Program

Addressing limitations in the ways nations tackle shared economic challenges, the Global Economy Program at CIGI strives to inform and guide policy debates through world-leading research and sustained stakeholder engagement.

With experts from academia, national agencies, international institutions and the private sector, the Global Economy Program supports research in the following areas: management of severe sovereign debt crises; central banking and international financial regulation; China's role in the global economy; governance and policies of the Bretton Woods institutions; the Group of Twenty; global, plurilateral and regional trade agreements; and financing sustainable development. Each year, the Global Economy Program hosts, co-hosts and participates in many events worldwide, working with trusted international partners, which allows the program to disseminate policy recommendations to an international audience of policy makers.

Through its research, collaboration and publications, the Global Economy Program informs decision makers, fosters dialogue and debate on policy-relevant ideas and strengthens multilateral responses to the most pressing international governance issues.

Acronyms and Abbreviations

AIIB	Asian Infrastructure Investment Bank	MOA	Ministry of Agriculture
AmCham China	American Chamber of Commerce in China	MOFCOM	Ministry of Commerce (China)
ASEAN	Association of Southeast Asian Nations	MOU	Memorandum of Understanding
CPC	Communist Party of China	NDRC	National Development and Reform Commission
CETA	Comprehensive Economic and Trade Agreement	NTMs	non-tariff measures
ChAFTA	China-Australia Free Trade Agreement	SOEs	state-owned enterprises
CSOEs	centrally administered state-owned enterprises	TBT	Agreement on Technical Barriers to Trade
DSMs	dispute-settlement mechanisms	TPP	Trans-Pacific Partnership
FDI	foreign direct investment	TRIPS	Trade-related Aspects of Intellectual Property
FIPA	Foreign Investment Promotion and Protection Agreement	WTO	World Trade Organization
FIRB	Foreign Investment Review Board (Australia)		
FTA	free trade agreement		
GATS	General Agreement on Trade in Services		
GPA	Agreement on Government Procurement		
IFA	Investment Facilitation Arrangement		
IP	intellectual property		
MIIT	Ministry of Industries and Information Technology		
MFN	most-favoured nation		

Executive Summary

A possible free trade agreement (FTA) with China represents a great opportunity for Canada, since it would give the latter preferential access to the world's third-largest economy after the European Union and the United States. It would also help level the playing field for Canadian businesses vis-à-vis their Australian, New Zealand and Swiss competitors, which operate under FTAs that their countries have signed with China.

In addition to offering an overview of Canada's economic relations with China, upon which a possible FTA will build, and examining the main FTAs that China has negotiated with developed countries, this special report examines the opportunities and challenges of a possible FTA between Canada and China in order to provide a road map of ideas that the federal government should consider were it to enter into proper negotiations.

This road map of ideas aims to ensure that a potential FTA allows Canada to profit from the opportunities associated with free trade with China while managing the risks or challenges posed by China's particular political economy (i.e., state capitalism marked by a vigorous private sector in certain areas of the economy). Achieving both ends is the only way to address Canadians' concerns about an FTA with China and convince them that such an agreement is worthwhile for Canada's economy and society.

As a result of China's political economy, Canada faces particular challenges in ensuring that Canadians are able to compete in a fair and free way with their Chinese counterparts in both Canadian and Chinese markets. To address these challenges, Canada should push the FTA negotiations to be based on high-standard agreements such as the Comprehensive Economic and Trade Agreement (CETA) and the Trans-Pacific Partnership (TPP), both of which it has negotiated and signed.

Canada should also ensure that the FTA includes a comprehensive, multi-level governance structure to help resolve disputes and frictions in an informal way, as such an approach can be very effective in the Chinese context. It should nevertheless provide for a broader application of state-to-state dispute-settlement mechanisms

(DSMs) than in the CETA and TPP cases, in order to provide a formal DSM as a last resort if informal negotiations and discussions prove ineffective.

Introduction

During Chinese Premier Li Keqiang's visit to Canada in September 2016, Canada and China announced that they were launching a collaborative process to explore the possibility of negotiating an FTA between the two countries (Blanchfield 2016). Since then, two rounds of exploratory discussions have been held: one in Beijing in early March 2017 and another in Ottawa in late April 2017. These discussions have served to determine the scope of a potential free trade negotiation between Canada and China. At the same time, the Canadian federal government is conducting public consultations with stakeholders in order to inform the exploratory discussions with its Chinese counterparts as well as prepare for the potential negotiations.¹

With the TPP² and CETA concluded and on their way to being ratified at this time,³ it made sense for Canada to explore ways to deepen its economic relationship with the world's third-largest economy after the United States and the European Union. If Canada could agree to some form of free trade with China, it would have preferential access to approximately 80 percent of the world's markets. No other country would be in such a favourable commercial position. Furthermore, after years of ambivalent engagement

1 www.international.gc.ca/trade-commerce/consultations/china-chine/index.aspx?lang=eng.

2 The TPP's members are: Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam. The agreement was signed by all 12 members on February 4, 2016, in Auckland, New Zealand, but has yet to be ratified by all member states. The agreement's text can be found at <http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/ppp-tpf/text-texte/toc-tdm.aspx?lang=eng>.

3 In order for the TPP to come into force, both Japan and the United States have to ratify it. However, upon his inauguration as the 45th president of the United States, Donald Trump signed a memorandum to the United States Trade Representative to "withdraw the United States as a signatory to the Trans-Pacific Partnership" (Office of the Press Secretary 2017). The remaining TPP members are currently exploring ways to keep the TPP alive (Ananthalakshmi and Nguyen 2017). For its part, CETA is expected to come into force in the summer of 2017, on a provisional basis until all EU member-state parliaments have ratified the agreement.

with Asia generally and China in particular (Dobson and Evans 2015; Leblond 2016a), exploring the possibility of an FTA with China provides an opportunity for the government of Prime Minister Justin Trudeau to send a strong signal, at home and abroad, that confirms its stated goal of reinforcing Canada's relationship with China (Smith 2016).⁴ China has been called a "strategic imperative" (Ciuriak 2017) for Canada and an FTA should be the first step in a more strategic engagement with Asia's largest economy.

This special report examines the opportunities and challenges for Canada of a possible FTA between Canada and China. It also provides a road map of ideas that the federal government should consider were it to enter into proper negotiations of an FTA with its Chinese counterpart, in order to maximize the opportunities offered by free trade with China while managing the challenges posed by China's particular political economy. Since a large portion of the Canadian population is skeptical of an FTA with China,⁵ it is especially important for an agreement to offer mechanisms that address these challenges.

In doing so, the report first offers an overview of Canada's economic relations with China, upon which a possible FTA will build. Second, it examines the existing FTAs that China has negotiated with developed countries, and identifies the main opportunities and challenges that Canada would face should there be free trade with China. Third, the report proposes a road map of ideas to address the identified opportunities and challenges. It does so by considering the most important chapters that an FTA with China would contain.

4 At the same time, Canada announced that it was seeking membership of the China-led Asian Infrastructure Investment Bank (AIIB), a position that the previous Conservative government rejected (Blatchford 2016). Canada's AIIB membership was confirmed on March 23, 2017 (VanderKlippe 2017).

5 According to the 2017 National Opinion Poll on Canadian Views on Engagement with China (Asia Pacific Foundation of Canada 2017, 15-16), although 55 percent of respondents are favourable to an FTA with China, 51 percent of respondents feel that it would benefit China more than it would benefit Canada. Fifty-six percent of respondents worry that cheap Chinese goods will compete with Canadian products in the Canadian market. A large majority of Canadians have also expressed concerns about Chinese state-owned enterprises' (SOEs') access to the Canadian market (Fife and Chase 2017).

Canada–China Economic Relations

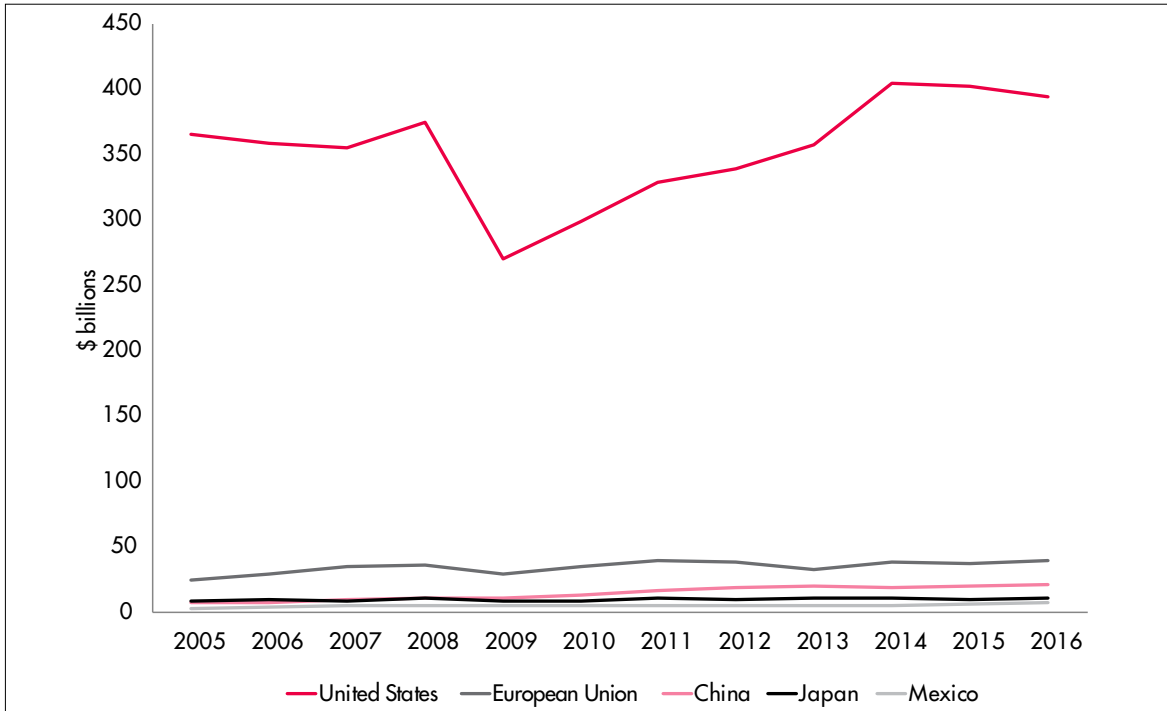
After the United States and the European Union, China is Canada's third most important trade partner. In 2016, China accounted for four percent and 12 percent of Canada's product exports and imports, respectively. In comparison, the United States accounted for 76 percent and 52 percent of Canada's product exports and imports, respectively (see Figures 2 and 4). The US economy's relatively large importance for Canada is a result of what economists call "gravity": i.e., the power of attraction created by the size of the American economy, the latter's geographical closeness to the Canadian economy, and Americans' cultural proximity to Canadians in terms of language, history, television, movies, radio and so on (see Anderson 2011). Eugene Beaulieu and Yang Song (2015) argue, however, that Canada's trade dependence on the US economy is not unusual, in that many countries have a large proportion of their trade concentrated regionally.

While Canada's trade is dominated by the United States, trade with China has experienced rapid growth since the mid-2000s. For instance, while Canadian product exports to the United States in 2016 were slightly above their 2005 level, exports to China trebled, from \$7.2 billion in 2005 to \$21 billion in 2016 (see Figure 1).⁶ During the same period, Canadian product imports from China more than doubled, from \$30 billion to \$64 billion, thereby slightly surpassing Canadian imports from the European Union (see Figure 3).

In terms of the top products that Canada exports to China, the majority are derived, perhaps not surprisingly, from natural resources and agriculture (see Figure 5). For instance, wood pulp and wood products were Canada's top exports to China in 2016, accounting for close to one-quarter or \$5 billion of Canada's exports to the middle kingdom. Oil seeds, such as canola, were the second-largest product category to be exported to China from Canada, with a value of more than \$3 billion or 15.4 percent of total Canadian exports to China. For their part, exports of meat, fish and seafood products amounted to \$1.4 billion in 2016, compared to \$366 million in 2005. Of the top-10 categories of Canadian product

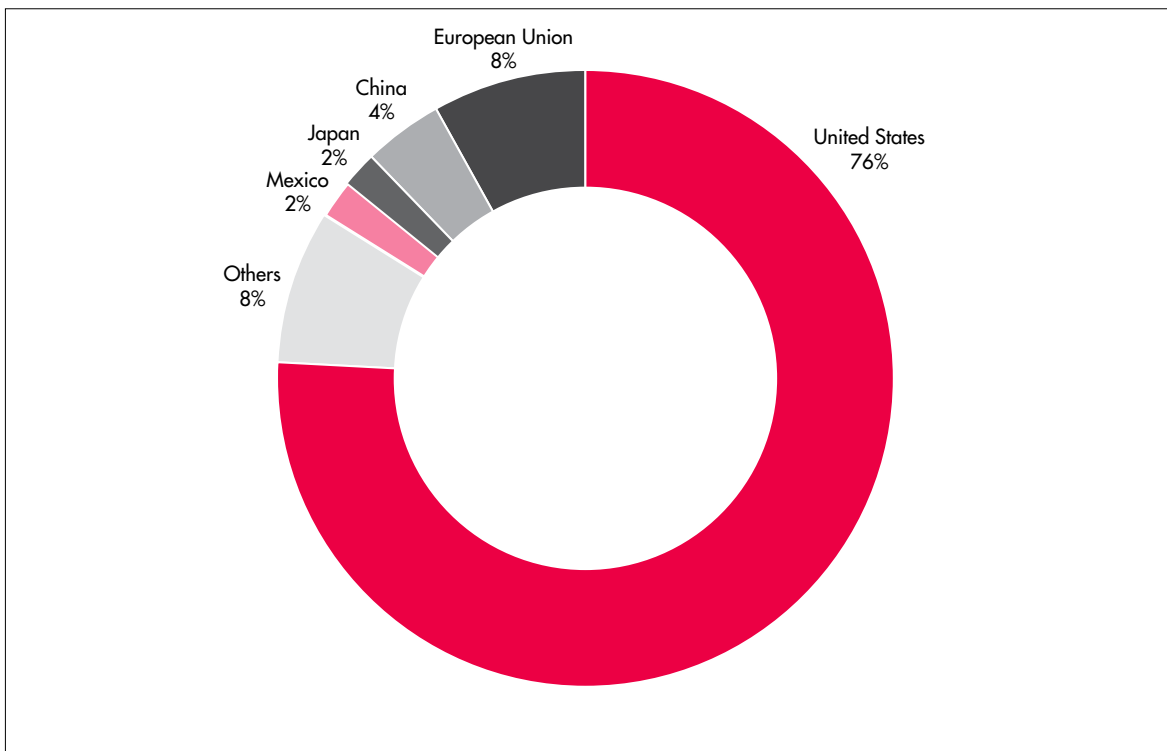
6 All dollar figures shown are in Canadian currency unless otherwise indicated.

Figure 1: Canadian Total Product Exports (2005-2016)



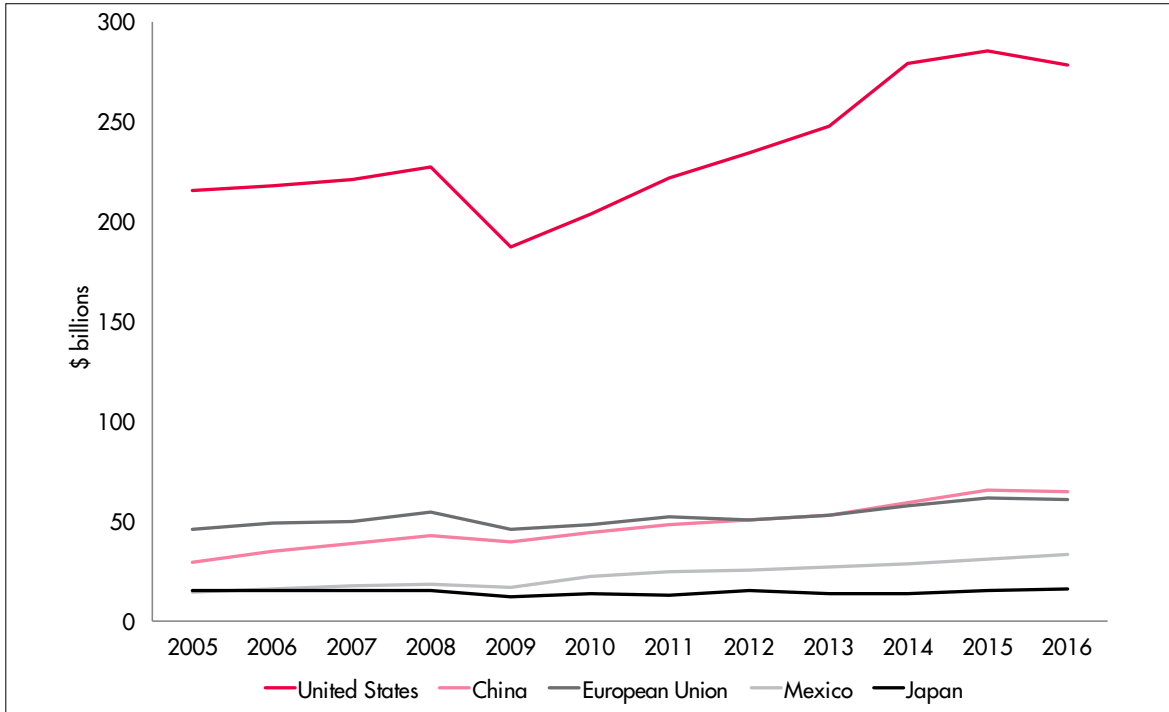
Data source: Government of Canada, Trade Data Online.

Figure 2: Share of Total Canadian Product Exports (2016)



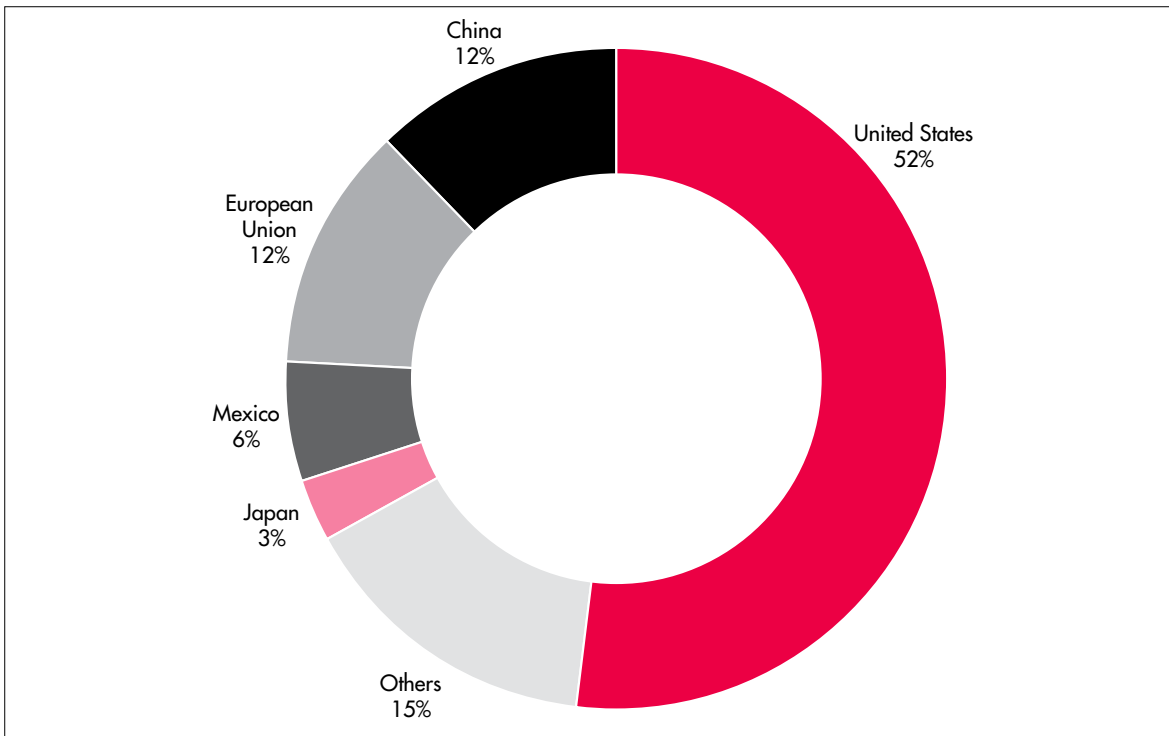
Data source: Government of Canada, Trade Data Online; author's calculations.

Figure 3: Canadian Total Product Imports



Data source: Government of Canada, Trade Data Online.

Figure 4: Distribution of Canadian Product Imports (2016)



Data source: Government of Canada, Trade Data Online; author's calculations.

exports to China 2016, the following were not based on natural resources: automotive vehicles, nuclear machinery and organic chemicals. These three categories accounted for 14 percent of Canada's total exports to China in 2016, with a value of \$2.8 billion.

In terms of Canadian imports from China, electrical or electronic machinery and equipment was the dominant category in 2016, worth \$16 billion (see Figure 6) and representing one-quarter of total imports from China. This category includes: computer and peripheral equipment, broadcasting and wireless communications equipment, and telephone equipment as well as audio and video equipment. This is representative of the move by electronic and electrical equipment manufacturers to move their final product assembly to China over the last 20 years or so in order to take advantage of the country's cheaper labour, even if a large part of the end products' added value is exported to China in the form of higher-value intermediate inputs (see Van Assche 2012). Aside from nuclear machinery and equipment, Canada's top product imports from China are fairly traditional in nature, in that they include furniture, clothing, apparel and footwear as well as toys, games and sporting goods.

With respect to trade in services with China, Canada exported \$2.6 billion in value while it imported \$2.4 billion in value in 2015. This compares to \$1.1 billion and \$1.2 billion worth of services exports and imports, respectively, in 2006.⁷ As such, trade in services between Canada and China has grown much less rapidly than trade in goods. In terms of China's market share of Canadian services trade, it has increased from 1.5 percent to 2.6 percent for exports between 2006 and 2015 while it has increased from 1.4 percent to 1.9 percent for imports during the same period.⁸ In 2015, business and personal travel accounted for 54 percent of Canada's services exports to China, while the same category represented 25 percent of Canada's services imports from China.⁹

Finally, there has been significant growth in direct investment between Canada and China in the last decade. Between 2005 and 2016, the stock of Canadian direct investment in China has grown from \$1.8 billion to \$13.3 billion, while the stock of

Chinese direct investment in Canada has increased from \$928 million to \$21.4 billion.¹⁰ In spite of such growth, the stock of Canadian direct investment in China remains only one percent of Canada's total stock of direct investments abroad, while China's stock of direct investment in Canada represents only three percent of the total stock of foreign direct investment (FDI) in Canada.¹¹ Such percentages are far behind those of the United States and Europe.¹² According to the University of Alberta's Canada–China Investment Tracker, the large majority of China's direct investment in Canada was done by SOEs. Investments were also primarily done in the energy sector.¹³

In sum, Canada's trade relationship with China is now close behind that with the European Union in terms of the value of product exports and imports. However, it remains far behind the United States as well as Europe when it comes to services trade and direct investment, in spite of rapid growth in the latter domain over the last decade.

China's FTAs

China has so far signed 14 FTAs (see Table 1) and is currently negotiating eight others.¹⁴ Of the agreements signed, six are with developed countries (if Hong Kong is excluded, which is not an independent country): Australia, Iceland, New Zealand, Singapore, South Korea and Switzerland. It is worth observing that in many cases, the time periods for phasing in tariff eliminations are quite long, from 10 to 20 years. The section below takes a closer look at China's FTAs with Australia, New Zealand and Switzerland. Before doing so, however, it is important to gain a better understanding of China's strategic motivations for negotiating FTAs.

7 w05.international.gc.ca/Commerce_International/Commerce_Indicateur-Indicateur.aspx?lang=eng.

8 Ibid.

9 www.international.gc.ca/trade-commerce/consultations/china-chine/canada_china_fact_sheet-chine_fiche_information.aspx?lang=eng.

10 Statistics Canada, Table 376-0051.

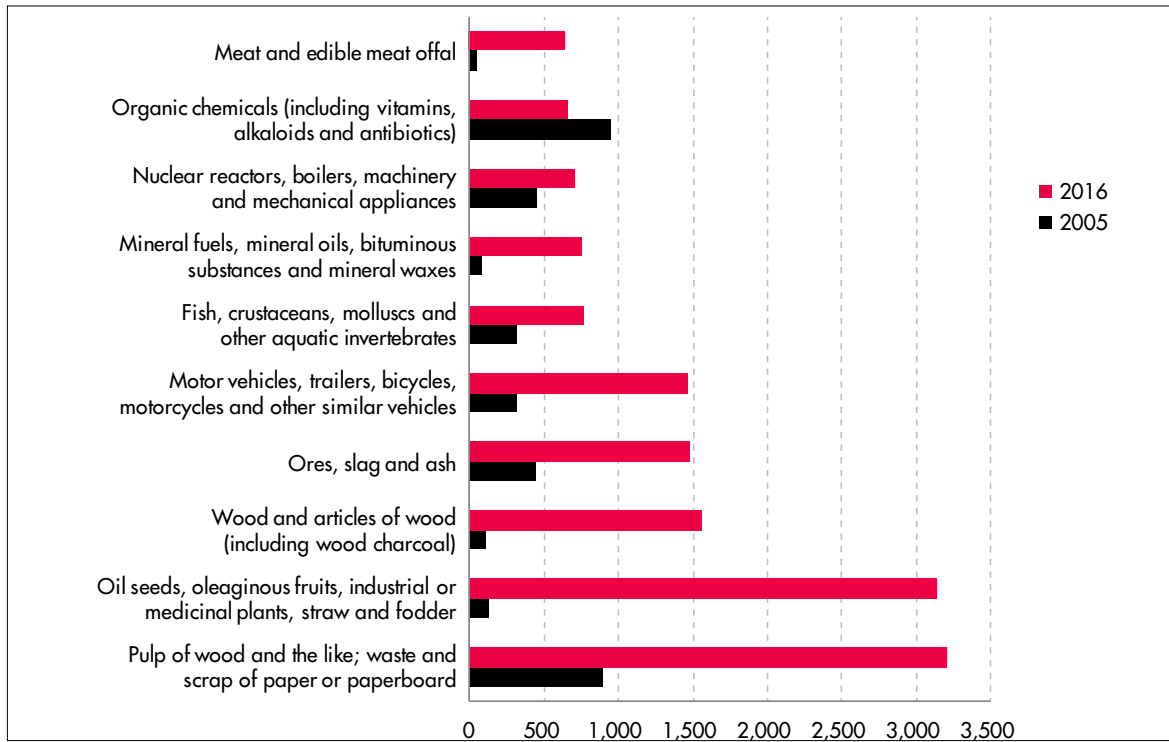
11 Ibid.

12 In 2016, the stock of Canadian direct investment in Europe and the United States represented 23 percent and 45 percent, respectively, of the total stock of Canadian direct investment abroad. With regard to the stock of FDI in Canada, the European and US shares were 37 percent and 47 percent, respectively. Source: Statistics Canada, Table 376-0051, author's calculations.

13 www.chinainstitute.ualberta.ca/tracker_lite.

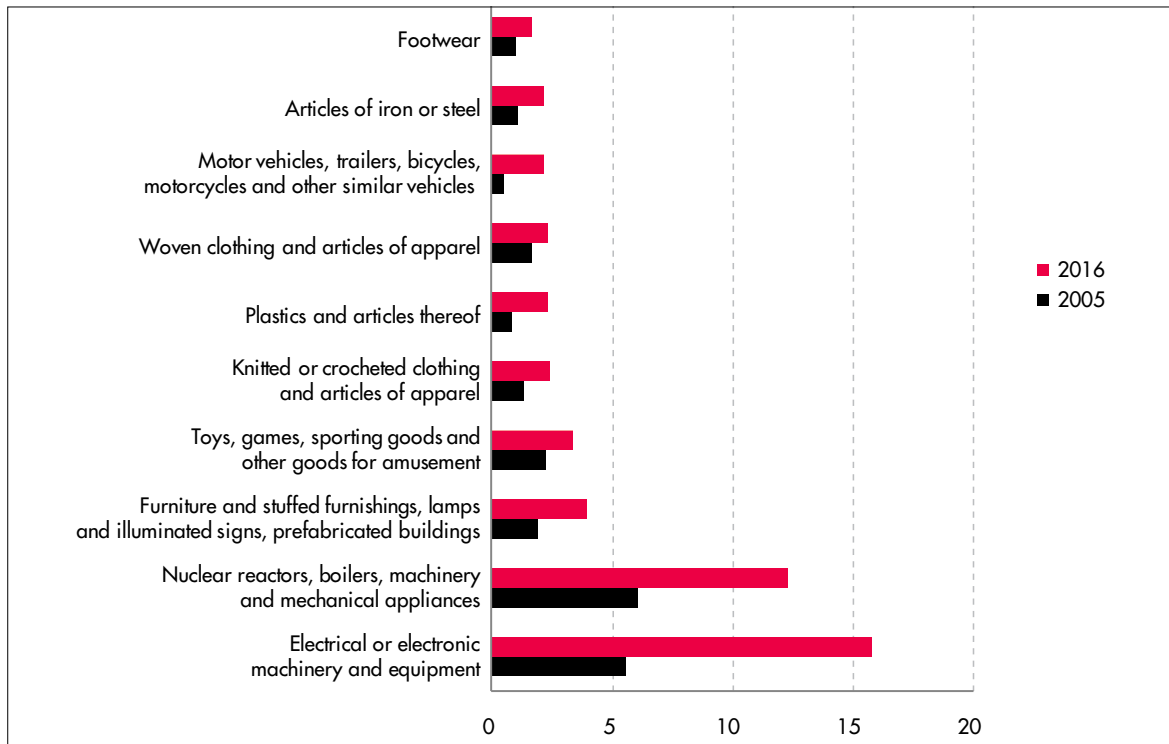
14 fta.mofcom.gov.cn/english/.

Figure 5: Top-10 Canadian Product Exports to China



Data source: Government of Canada, Trade Data Online; author's calculations.

Figure 6: Top-10 Canadian Product Imports from China



Data source: Government of Canada, Trade Data Online; author's calculations.

Table 1: China's FTAs

Partner	First Signed	Phasing in of Agreement
ASEAN	2002	Framework (2002), goods (2004), services (2007), investment (2009)
Hong Kong	2003	Single undertaking
Macau	2003	Single undertaking
Chile	2005	Goods (2005), services (2008)
Pakistan	2006	Goods (2006), services (2009)
New Zealand	2008	Single undertaking
Singapore	2008	Single undertaking
Peru	2009	Single undertaking
Costa Rica	2010	Single undertaking
Switzerland	2013	Single undertaking
Iceland	2013	Single undertaking
Republic of Korea	2015	Single undertaking
Australia	2015	Single undertaking
Georgia	2017	Single undertaking

Sources: China's Ministry of Commerce (MOFCOM)¹⁵ and Salidjanova (2015, 6).

China's FTA Strategy

China's negotiations of FTAs, which occurred mainly in the last decade or so, is in line with the proliferation of bilateral and regional agreements that have sprung up in response to the Doha Round negotiations faltering. According to Nargiza Salidjanova (2015, 3), there is no "modus operandi" to China's FTA strategy: "Some appear exceedingly generous to the trade partners, while others aggressively promote and protect domestic industries." Moreover, pre-existing trade volumes have not been a key driver in selecting FTA partners (Qingjiang 2012, 1201). Salidjanova (2015) argues that there are several potential motivations to explain China's FTA strategy. These motivations are not mutually exclusive. One motivation is that China pursues narrow regional security interests. This would explain the agreements with Hong Kong, Macau and the Association of Southeast Asian Nations (ASEAN). Another motivation for China's FTAs is resource security, whereby it aims to ensure access to natural resources that are vital to its manufacturing, energy and agricultural sectors. FTAs with Australia, Chile, Iceland, New Zealand and Peru can be seen in this light. A third motivation is that trade agreements with

smaller countries make it easier to avoid taking on protectionist interest groups in government and industry during the FTA negotiations, since fewer concessions are needed to reach an agreement. A fourth reason that would explain China's "quite random" selection of FTA partners (Qingjiang 2012, 1201) is that having small, geographically dispersed partners allows it to access regional trade networks as well as gain negotiating experience at minimal risk. Finally, China has made recognition of its status as a "market economy" one of the prerequisites for undertaking FTA negotiations (ibid., 1203); therefore, countries that have been unwilling to reconsider China's non-market economy status under the latter's World Trade Organization (WTO) accession agreement are less likely to be considered for FTA negotiations.¹⁶

¹⁶ In its accession protocol to the WTO, China agreed to be classified as a "non-market economy" for a period of 15 years after its accession (see article 15). This status allows WTO members to select alternative or surrogate markets for calculating the "normal" value of Chinese exports, which tends to result in higher anti-dumping duties imposed on targeted Chinese goods. The key question is whether article 15(d) makes the expiry of China's non-market economy status automatic (Bown 2016; Huotari, Gaspers and Böhnke 2016). For the time being, WTO members such as Canada, the European Union and the United States have decided that China has not yet made the complete transition to a market economy. As such, they are in the "non-automaticity" camp (ibid.). In response, China has launched a legal challenge against the European Union and the United States under WTO rules (Donnan, Hornby and Beesley 2016). If it wins, China would be in a position to retaliate against EU and US goods exported to China.

¹⁵ fta.mofcom.gov.cn/english/.

For its part, MOFCOM provides the following justification for FTAs on its English-language website: “The Chinese Government deems Free Trade Agreements (FTAs) as a new platform to further opening up to the outside and speeding up domestic reforms, an effective approach to integrate into [the] global economy and strengthen economic cooperation with other economies, as well as particularly [sic] an important supplement to the multilateral trading system.”¹⁷ It is interesting to note that references to domestic economic growth and job creation are not part of MOFCOM’s justification for negotiating FTAs, unlike the rationales generally offered in Western countries. This does not mean, however, that jobs and growth are not important for MOFCOM in particular and the Chinese government in general. It is simply an implicit reflection of China’s growth model, which has, until recently, relied heavily on exports for creating economic growth and jobs. And MOFCOM’s main *raison d’être* has been the promotion of exports.¹⁸

By viewing FTAs as a “platform” to stimulate or underpin domestic reforms toward (further) opening up the Chinese economy to the rest of the world, MOFCOM puts China’s export performance within the larger framework of a market-led economy, as opposed to a state-led one. This reflects MOFCOM’s generally liberal stance on economic policy making: “MOFCOM officials are in general proponents of reform and liberalization, believing competition enhances productivity and free trade benefits consumers, but it has a lot of difficulty in persuading domestic sectors to subscribe to this belief” (Jiang 2010, 247).

If market liberals were more influential around the time of China’s accession to the WTO, they have subsequently seen their power recede vis-à-vis protectionist forces in the Chinese government (ibid., 242). Although MOFCOM is the lead agency to negotiate FTAs in China, the National Development and Reforms

Commission (NDRC) has become a “veto player” in such negotiations (ibid., 247).¹⁹ The NDRC’s increasing power lies at the heart of this pendulum swing toward more protectionism in China:²⁰ “Coinciding with the relative empowerment of the NDRC, MOFCOM’s political power among state agencies declined in general with the change of leadership. Zhu [Rongji] was enthusiastic and forceful about reform and liberalization, and MOFCOM was a major arm in the government that Zhu used for implementing his ideas. However, the Hu-Wen leadership has raised ‘constructing a harmonious society’ as the highest policy objective because of increasingly serious social problems in China, and the NDRC’s power was strengthened as an instrument to control rampant marketization” (ibid., 247).

In addition to MOFCOM, the MOA, the MIIT, the NDRC, as well as the State Council and the CPC’s Politburo, Guoyou Song and Wen Jin Yuan (2012) point out that China’s SOEs also play an important role in China’s FTA negotiations. According to these authors, SOEs have “a disproportionately strong voice in FTA negotiations” (ibid., 116) because chairpersons of large SOEs often outrank senior officials from MOFCOM and other ministries. SOEs’ influence in FTA negotiations is further underpinned by the revolving door that exists between SOEs and ministries (ibid., 115).

Another institutional element that constrains China’s ability to effectively negotiate FTAs is that “China’s administrative structure is decentralized, resulting in small agencies at the central level and uneven implementation of central directives by the larger bureaucracies at the provincial and municipal level” (Salidjanova 2015, 23).

As a result of the above institutional constraints, China generally prefers to launch FTA negotiations

17 <http://fta.mofcom.gov.cn/english/>.

18 I thank an anonymous reviewer for this insight.

19 According to Qingjiang (2012, 1197), “MOFCOM is no more than a coordinating body or even the first among peers for the making of those trade-related decisions that involve both the MOFCOM and other ministries. These relevant ministries include the National Development and Reform Commission (NDRC), Ministry of Agriculture (MOA), Ministry of Industries and Information Technology (MIIT), etc.” Other decision-making bodies in China’s trade policy are the State Council (headed by the prime minister), the Communist Party of China’s (CPC’s) Central Committee, especially its Politburo (led by China’s president, who is also the CPC’s general secretary), and the Standing Committee of the National People’s Congress, which is responsible for ratifying trade agreements (Qingjiang 2012, 1197-1198). Of these three bodies, however, the State Council and the Politburo are the most important ones.

20 The European Union of Commerce in China (2017a, 2) calls it the “masters vs. markets” struggle.

with a more limited list of product categories covered by the agreement than is usually the case with countries such as the United States (ibid., 17). It also tends to limit access to individual industries, in spite of its official free trade rhetoric:²¹

In the agriculture sector, for example, Beijing's selective market opening is offset by its extreme protection of grain and meat products. Rising incomes and urbanization are increasing demand in China for high-quality protein, but the Chinese government uses unscientific sanitary and phytosanitary (SPS) standards to slow imports of meat products, in violation of its WTO commitments. A self-sufficiency mandate preempts imports of wheat, rice, and corn beyond a certain level. Not surprisingly, the ASEAN goods agreement excludes rice and corn. The exception to China's grain mandate is soybeans, which are an indispensable feedstock for China's outsized pork, poultry, and farm-raised fish industries. (Ibid.)

Similarly, Ka Zeng (2016, 302) finds that many of China's FTAs are "trade light," in that they include "many carve-outs for politically-sensitive sectors in goods and services and little discipline as regards antidumping duties, agricultural subsidies, or domestic regulatory barriers." She says that this reflects general FTA patterns in Asia.

Kong Qingjiang (2012, 1193) identifies one of China's basic principles of trade negotiations as "mutual benefit and win-win result." It is clear, however, that Chinese negotiators are able to apply such a principle selectively: "it is found that China does not appear to be consistently negotiating in true 'win-win' terms, however, and this principle at times seems to provide mere window dressing for its preferred quid pro quo approach to negotiation, especially regarding market access issues" (ibid., 1196). Although it may appear to be a contradiction in terms, "mutual benefit," "win-win" and "quid pro quo" are in fact synonymous, in line with

the "reciprocity" norm or principle that has been the bedrock of trade negotiations for decades.²²

In terms of what might be considered "advanced" areas such as government procurement, intellectual property (IP), ownership restrictions, labour and the environment, China has also shown itself to be conservative in its approach to FTAs. For instance, Salidjanova (2015, 18) finds that "China generally opts either to (a) repeat the same commitments it has already made in its WTO accession agreement; (b) completely exclude certain advanced provisions; or (c) restrict advanced provisions to certain sectors, by avoiding detailed legal language or placing them in a separate document, such as a memorandum of understanding." For example, China's government procurement market remains relatively closed to private Chinese and foreign companies, in spite of China's pledge, when it acceded to the WTO in 2001, to join the WTO Agreement on Government Procurement (GPA) "as soon as possible" (ibid.)²³ Another example is China's requirement that foreign firms keep their data on servers located on Chinese soil, thereby prohibiting the free transfer of digital data across its borders (ibid.). An additional example is China's restrictions on foreign ownership, which have generally remained in line with China's WTO commitments: foreign investors continue to be limited to joint ventures with Chinese companies if they want to operate in certain industries (ibid.). A final example concerns IP provisions, whereby China's FTAs have remained within the country's commitments under the WTO's Agreement on Trade-related Aspects of Intellectual Property (TRIPS) (ibid., 19).

A final noteworthy limitation found in China's FTAs is the absence of detailed language on dispute settlement. For instance, when comparing Chinese and US FTAs with Peru and Chile, Salidjanova (ibid.) finds that they lack transparency and openness: i.e., open nature of panel hearings, possibility of stakeholder consultations, final report rendered public within 15 days of its release. Salidjanova (ibid.) also observes that US agreements provide "tough rules for material compensation if the defendant does not follow through on the

21 For example, see Chinese President Xi Jinping's keynote speech in support of globalization and free trade at the World Economic Forum's meeting in Davos, Switzerland, in January 2017: america.cgtn.com/2017/01/17/full-text-of-xi-jinping-keynote-at-the-world-economic-forum. For a skeptical view of President Xi's commitment to liberal reforms, see the following leader from *The Economist*: www.economist.com/news/leaders/21717041-reality-very-different-chinas-president-talks-reformer.

22 Robert O. Keohane (1986) argues that reciprocity applies to international relations more broadly, not just international trade. He argues that it lies at the heart of international cooperation between sovereign states in an anarchical world (i.e., without a supranational authority).

23 According to Salidjanova (2015, 18), China's offer to join the revised GPA in 2014 was rejected, because it was "unwilling to include the lucrative procurement contracts given out by subnational governments."

panel's recommendations," whereas China's FTAs contain less well-defined provisions of the "mutually acceptable compensation" type.

China's FTA with New Zealand

China's FTA with New Zealand, which entered into force in October 2008, was the first one that China negotiated with a developed country.²⁴ In order to begin negotiating the FTA, New Zealand had to recognize China as a "market economy" under WTO rules (Salidjanova, 9). This was done in April 2004. All the FTA's provisions are to be implemented by 2019. According to New Zealand's Ministry of Foreign Affairs and Trade, the "FTA provides for elimination over time of tariffs on 96 percent of New Zealand's current exports to China."²⁵ Table 2 offers a broad overview, provided by New Zealand's Ministry of Foreign Affairs and Trade, of the overall outcomes for New Zealand in terms of goods and services from its FTA with China.

New Zealand's FTA with China "included significant liberalization in the goods sector" but was much more limited with respect to the liberalization of investment and services, notably as a result of the use of the positive-list approach in the latter case (*ibid.*). Nevertheless, the FTA with China seems to have had a positive impact on New Zealand's economy. According to Tim Beal and Yuanfei Kang (2016, 8), New Zealand exports to China jumped from NZ\$2.1 billion in 2008 to NZ\$11.6 billion in 2014, while New Zealand imports from China increased from NZ\$5.5 billion in 2008 to NZ\$8.1 billion in 2014. Consequently, New Zealand's trade deficit of NZ\$3.4 in 2008 became a surplus of NZ\$3.5 billion in 2014, as a result of a "combination of the higher prices for New Zealand's exports of agriculture-based commodity products and the lower prices for New Zealand's imports of manufacturing prices" (*ibid.*, 22-23).

Dairy and wood products have been the main drivers of New Zealand's rapid growth in exports to China since 2008 (*ibid.*, 116). In dairy's case, China's growing demand for New Zealand products during that period may also have been driven

by Chinese parents' desire for clean or untainted infant formula after six Chinese babies died and tens of thousands were rendered seriously sick after consuming milk powder tainted with melamine produced by Sanlu Group in 2008.²⁶

To conclude on New Zealand's FTA with China, Helena Quinn (2015, 6) offers the following summary: "The perception of the FTA has been mixed. Overall, it is not doubted that there has been a beneficial impact brought about by reductions in tariff barriers and greater trade with China. The diversion in perception comes with reflection on the extent to which market access has been brought about by the FTA. Nontariff barriers (NTBs) and behind-the-border barriers remain significant. Utilisation of tariffs remains a challenge. Investment faces significant obstacles."

China's FTA with Switzerland

China's FTA with Switzerland is the second with a European country, after Iceland. It was signed in July 2013 and entered into force in January 2014.²⁷ The FTA called for the abolishment of tariffs on 99.7 percent of products imported from China into Switzerland (Salidjanova 2015, 12). This includes more than three-quarters of agricultural imports from China (*ibid.*, 25). For its part, China would eliminate tariffs on 84.2 percent of imported Swiss goods (*ibid.*, 12). For Swiss exports to China, tariffs on a majority of goods are to be reduced year by year over transition periods ranging from five to 15 years (Wenfei Law 2013, 4). For some products, tariffs will not be eliminated but partially reduced. However, for Chinese goods exported to Switzerland, there was no transition period for eliminating tariffs; they came down (to zero for the most part) on the day the FTA entered into force (*ibid.*).

Along with Germany, Switzerland is one of very few European countries that have a trade surplus with China, reaching US\$37 billion in 2014 (Salidjanova 2015, 12). According to Wenfei Law (2013, 13), "Switzerland's most important exports to China are machinery, mechanical appliances, precision instruments, chemical and

24 www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-in-force/nz-china-free-trade-agreement/text-of-the-new-zealand-china-fta-agreement/.

25 www.mfat.govt.nz/assets/_securedfiles/FTAs-agreements-in-force/China-FTA/Key-outcomes.pdf.

26 Fonterra, New Zealand's largest company, was a partner in the joint venture that was Sanlu Group; however, its reputation does not seem to have been negatively affected by the scandal.

27 www.seco.admin.ch/seco/en/home/Aussenwirtschaftspolitik_Wirtschaftliche_Zusammenarbeit/Wirtschaftsbeziehungen/Freihandelsabkommen/Partner_weltweit/china/Abkommenstexte.html.

Table 2: FTA Outcomes for New Zealand

Goods	Services
<p>Manufactured Goods</p> <p>Tariffs on all non-agricultural goods, other than milking machines (nine years) and certain processed wood and paper products (see below), will be phased out over a maximum of six years with the majority of trade in manufactured products being duty free in five years (2012).</p> <p>Forestry Products</p> <p>The FTA binds China's current applied zero tariff rate on logs and sawn timber (which represent approximately 80 percent of New Zealand's wood exports to China) and provides some additional tariff preferences for New Zealand on a limited number of products made from radiata pine.</p> <p>Agricultural Products</p> <p><i>Dairy</i></p> <p>China's tariff on butter, liquid milk and cheese will be phased out over 10 years (2017).</p> <p>Tariffs on skim and whole milk powders will be removed over 12 years (2019). Milk powders are subject to a mid-term review mechanism that, if triggered, could extend the phase out by a maximum of one year.</p> <p>Dairy products facing a 10- or 12-year phase out will be subject to a quantity-based safeguard, which extends five years after the tariffs have been eliminated (i.e., for up to 15 or 17 years in total). Duties can be applied on sendings above the safeguard trigger levels.</p> <p><i>Meat</i></p> <p>Tariffs on beef and sheep meat, and edible offal, will be phased out over nine years (2016).</p> <p><i>Seafood</i></p> <p>Other than products for which current tariffs are five percent or less (which become duty free immediately), tariffs on seafood products will be phased out over a period of five years (2012).</p> <p><i>Fruit and vegetables</i></p> <p>Tariffs on apples will be phased out over five years (2012), while kiwi fruit tariffs will be phased out over nine years (2016).</p>	<p>In sectors included in each country's services schedule and subject to specific reservations as set out in those schedules, the FTA establishes the general obligations of "market access" and "national treatment." In sectors where they apply, these obligations will entitle New Zealand service suppliers access to China's market (without quotas) and an ability to operate in China on the same basis as domestic suppliers.</p> <p>The FTA also includes a reciprocal most-favoured nation (MFN) clause that applies in specified sectors. This means that, in the sectors specified, New Zealand service suppliers will automatically receive the benefit of any commitments China makes in future FTAs that are more liberal than those in the New Zealand-China FTA. This will help to ensure that the competitive position in the Chinese market of New Zealand exporters of these services is not eroded.</p> <p>MFN applies to the following sectors: environmental services, construction, agriculture and forestry, engineering, integrated engineering, computer and related services, and tourism.</p> <p>The FTA uses a positive list approach to scheduling services commitments, similar to that used in the WTO General Agreement on Trade in Services (GATS).</p> <p>The obligations on services do not apply in respect of subsidies or government procurement.</p> <p>The FTA incorporates China's existing WTO services commitments. China has also made commitments (across modes 1, 2 and 3) going beyond its WTO commitments in the following sectors:</p> <ul style="list-style-type: none"> → computer and related services — including software implementation services, data processing services, and input preparation services; → services related to management consulting; → environmental services — an improved Mode 3 (investment in environmental services) commitment permitting wholly foreign-owned enterprises; → sporting and other recreational services; → air transport services — aircraft repair and maintenance services, and air travel computer reservation services; and → road transport services — freight transportation by road in trucks or cars; maintenance and repair of motor vehicles; storage and warehousing services; and freight forwarding agency services. <p>In the sectors included in China's services schedule (see above), New Zealand services suppliers will receive better or more certain treatment than those of other countries in the following areas:</p> <ul style="list-style-type: none"> → a commitment providing entry of up to three months for installers and servicers; and → an improved commitment covering business visitors providing for a maximum period of stay of six months as compared to the 90 days maximum under China's GATS commitments.

Source: Taken directly from www.mfat.govt.nz/assets/_securedfiles/FTAs-agreements-in-force/China-FTA/Key-outcomes.pdf.

pharmaceutical products, and watches. The bulk of China's exports to Switzerland is made up of data processing machines, electronic appliances, textiles and chemicals." Salidjanova (2015, 12) writes that "the FTA with Switzerland is an important step in economic diplomacy in Europe" for China, especially since any FTA negotiations with the European Union are blocked because the latter does not want to recognize China as a market economy under WTO rules (see also Lanteigne 2014).²⁸

According to Salidjanova (ibid., 17), "Swiss exporters were disappointed with the China-Switzerland FTA." This is because almost half of Swiss machine tools' export volume did not benefit from any tariff elimination. On the other hand, China agreed to exempt tariffs on 99 percent of textile imports from Switzerland, which account for only 1.3 percent of Swiss exports to China. "For the goods that comprise three-quarters of Swiss exports to China — mechanical and electrical industries (30 percent of exports), chemical and pharmaceutical industries (24 percent), and precision instruments, watch making and jewelry (21 percent) — the share of products benefiting from tariff exemptions ranges from just 64 to 78 percent" (ibid.).

In terms of services, a "comparison of China's commitments made under the FTA with those currently made under GATS and the Catalogue for the Guidance of Foreign Investment Industries reveals that the former are largely consistent with the latter" (Wenfei Law 2013, 6). For the construction, distribution, information technology, business consulting and advertising sectors, Wenfei Law (ibid.) sees "no improvements compared to the GATS framework." This means that Swiss banking and insurance firms have not seen immediate benefits from the FTA with China; however, for Swiss financial services firms brokering securities, the FTA does go beyond China's GATS schedule (ibid., 8). These companies are permitted to establish joint ventures with up to 49 percent foreign ownership to launch funds and to engage in underwriting of shares as well as government and corporate debt, whereas the general rule at the time the FTA was signed (according to the Chinese Catalogue for the Guidance of Foreign Investment Industries) was a maximum foreign ownership of one-third (ibid.). With respect to

environmental services (waste water treatment, solid waste disposal, emission and noise control services) and some real estate services, the FTA allows Swiss companies to set up wholly owned foreign enterprises in China instead of joint ventures, as per China's GATS schedule (ibid., 9). Finally, the FTA also allows certain suppliers of, for example, architectural, engineering, installation and maintenance services to stay in China for six months to one year (Salidjanova 2015, 19).

According to Wenfei Law (2013, 18), Switzerland's FTA with China "reaffirms the WTO's Agreement on Technical Barriers to Trade (TBT) and the application of international technical standards." It also creates a sub-committee on TBT cooperation between China and Switzerland to "monitor the implementation of the measures and facilitate technical consultations." Nevertheless, Wenfei Law (2013, 18) offers the following warning: "Despite this comprehensive legal framework, past experience with other free trade agreements in China has shown that the implementation of smooth import and export procedures can be tricky in practice and that there is often a lack of clarity when it comes to Chinese customs requirements. Trading companies should be aware that administrative hurdles, slow processes and unexpected difficulties at the border are likely to persist also under the new FTA framework. Hence, carefully examining customs requirements, planning ahead and maintaining good relations with the authorities will continue to be of crucial importance when conducting trade with China."

Wenfei Law (ibid., 19) also notes that the FTA is unlikely to prevent "random and lengthy inspections or audits by customs authorities at the border."

China's FTA with Australia

Australia's FTA negotiations with China began in May 2005, right after it had granted China market economy status. An agreement was finally announced in November 2014. Following its signature in June 2015, the China-Australia FTA (ChAFTA) entered into force at the end of December 2015 (Zhang 2016).²⁹ According to Salidjanova (2015, 10), it was the liberalization of services that delayed the negotiations: "Australia [was] keen on greater opening but China [was]

28 Lanteigne (2014, 3) indicates that Switzerland conferred market economy status to China in July 2007, which set the stage for beginning FTA negotiations.

29 dfat.gov.au/trade/agreements/chafta/official-documents/pages/official-documents.aspx.

reluctant to liberalize beyond what it agreed to at WTO accession.” Moreover, Jiang (2008; 2013) argues the negotiations’ slow pace was, in part, the result of China’s rather limited offensive interests: obtaining market economy status³⁰ and securing access at a stable price to certain natural resources such as iron ore.³¹ Finally, Australia’s and China’s different economic and regulatory structures also contributed to slowing down the negotiations: “the negotiators spent a long time in getting to know each other’s systems and in drafting the architecture of the agreement in the first five rounds of negotiations” (Jiang 2008, 181).

Upon its entry into force, ChAFTA allowed 85 percent of Australian goods to enter China free of tariffs or at reduced duty rates. This percentage will rise to 93 percent by January 2019 and 97.9 percent by the time the agreement is fully implemented on January 1, 2029 (Zhang 2016). Products derived from agriculture and natural resources are the mainstay of Australia’s exports to China. According to Xiaobo Zhang (2016), the FTA with China will result in the following benefits for Australia’s agricultural products:

The FTA provides Australia with an advantage over its major agricultural competitors, including the United States, Canada and the European Union. It also counters the advantages Chile and New Zealand currently enjoy through their FTAs with China. FTA completely eliminated tariffs on barley and sorghum on 20 December 2015, and a rapid tariff reduction on other agriculture exports, including seafood, sheep meat, pork and a variety of horticulture. Other key agriculture outcomes include: Dairy: tariffs up to 20 per cent eliminated by 1 January 2026; Beef: tariffs of 12 to 25 per cent eliminated by 1 January 2024; Wine: tariffs of 14 to 20 per cent eliminated by 1 January 2019; Wool: a new Australia-only duty free quota (commencing 1 January 2016), in addition to continued access to China’s WTO quota.

When ChAFTA entered into force, 92.8 percent of Australia’s exports of resources, energy and manufactured products could enter China duty free. Upon the agreement’s full implementation (January 1, 2029), this percentage will rise to 99.9 percent (Zhang 2016).

In terms of trade in services, ChAFTA “represents the biggest opening of China’s services sector to foreigners” (*The Economist* 2014). This is an important benefit for the Australian economy as China is the largest market for Australian services. However, as with China’s FTA with New Zealand, Australia had to settle for a positive list approach to services liberalization, even if it would have preferred a negative list one. Zhang (2016) outlines the following key outcomes for Australia resulting from ChAFTA:

Legal services: Guaranteed market access for Australian law firms to establish commercial associations with Chinese law firms in the Shanghai Free Trade Zone (SFTZ); Education services: Within one year of entry into force, China will list on a key Ministry of Education overseas study website 77 Australian private higher education institutions registered on the Commonwealth Register of Institutions and Courses for Overseas Students; Telecommunications services: Guaranteed market access for Australian companies investing in specified value-added telecommunications services in the SFTZ; Financial services: China has committed to deliver new or improved market access to Australian financial services providers in the banking, insurance, funds management, securities, securitisation and futures sectors; Tourism and travel-related services: China has guaranteed that Australian services suppliers will be able to construct, renovate and operate wholly Australian-owned hotels and restaurants in China; Health and aged care services: China will permit Australian service suppliers to establish profit-making aged care institutions throughout China, and wholly Australian-owned hospitals in certain provinces.

Investment is another important feature of ChAFTA. According to Shiro Armstrong (2017), the threshold under which potential FDI are not automatically reviewed by Australia’s Foreign

30 In Australia, there were fears that China would be much less interested in the FTA once it obtained market economy status (Jiang 2013, 80).

31 Jiang (2013, 96) reports that as a result of China agreeing to energy contracts with several Australian companies on the sidelines of the Asia-Pacific Economic Cooperation summit in Sydney in 2007, China had a diminished incentive to complete the FTA rapidly.

Investment Review Board (FIRB) was raised from AU\$248 million to AU\$1,074 billion,³² “unless the investment is in agriculture, real estate, or a few other sectors, or is from a state-owned enterprise,” in which case it is subject to FIRB screening.³³ During the FTA’s negotiations, China requested that SOE investment under AU\$1 billion not be subject to mandatory scrutiny by the FIRB. It perceived Australians as hostile, to some extent, to Chinese firms’ investment projects in Australia. The Australian government retorted that the FIRB had approved more than 200 investment proposals from Chinese companies between 2007 and 2012, the majority of which were by SOEs (He 2013, 685-86). Ultimately, Australia rejected China’s request: “it reserved the right to mandatory screening for SOEs” (Salidjanova 2015, 11).³⁴ Nevertheless, ChAFTA’s investment chapter calls on the parties to review their investment relationship within three years of the agreement coming into force with a number of issues already identified, including turning investment commitments to a negative list basis (Armstrong 2017).

ChAFTA also contains similar built-in review mechanisms with regard to trade issues, with the hope of making the agreement a “living” one (ibid.). Whether the quid pro quo between investment thresholds for Chinese SOEs on the one hand and Chinese tariffs on agricultural goods on the other will be maintained in the future remains to be seen.³⁵ For the time being, it appears that there is little appetite in Australia for making it easier for Chinese SOEs to invest in Australia (Smyth 2016).

The FTA between Australia and China also contains provisions dealing with labour mobility. These provisions are found in chapter 10 (Movement of Natural Persons)³⁶ and the Memorandum

of Understanding (MOU) on an Investment Facilitation Arrangement (IFA).³⁷ Chapter 10’s Annex 10-A specifies Australia’s commitment toward China, which is summarized as follows:

- general business visitors from China can enter and stay for a period of up to 90 days;
- service sellers from China can enter and stay for a period of up to six months, with the possibility of an extension of up to one year;
- intra-corporate transferees from China can enter and stay for a period of up to four years, with the possibility of an extension;
- independent executives from China can enter and stay for a period of up to four years;
- contractual service suppliers from China can enter and stay for a period of up to four years, with the possibility of an extension; and
- installers and servicers from China can enter and stay for a period of up to three months.

China’s labour mobility commitment toward Australia can be summarized as follows:³⁸

- business visitors can enter and stay for a maximum of 180 days;
- intra-corporate transferees can enter and stay for an initial stay of three years;
- contractual service suppliers can be granted a stay permit for an initial duration not exceeding one year;³⁹ and
- installers and maintainers can enter and stay for no more than 180 days.

Article 10.4, paragraph 3, further stipulates: “In respect of the specific commitments on temporary

32 This brings the threshold for Chinese private investments in line with those available to firms from Japan, New Zealand, South Korea and the United States (Sun 2015, 9).

33 The review thresholds for Chinese investments in agricultural land and agribusiness are set by ChAFTA at AU\$15 million and AU\$53 million, respectively (ibid., 9).

34 According to Sun (2015, 7), China accepted Australia’s position on SOE investment in exchange for maintaining tariffs on certain agricultural products such as sugar and rice.

35 On March 24, 2017, China and Australia signed a declaration of intent to begin the review of the services and investment chapters (dfat.gov.au/trade/agreements/chafta/official-documents/Documents/declaration-of-intent-review-elements-chafta.pdf).

36 dfat.gov.au/trade/agreements/chafta/official-documents/Documents/chafta-chapter-10-movement-of-natural-persons.pdf.

37 dfat.gov.au/trade/agreements/chafta/official-documents/Documents/chafta-mou-on-an-investment-facilitation-arrangement.pdf.

38 China’s commitment on the movement of natural persons is actually found in ChAFTA’s Annex III, 1057-59 (Chapter 10’s Annex 10-A simply refers to Annex III in China’s case): dfat.gov.au/trade/agreements/chafta/official-documents/Documents/chafta-annex-iii-services-schedules-of-australia-and-china.pdf.

39 The services provided are limited to the following specific sectors: medical and dental services; architectural services; engineering services; urban planning services (except general urban planning); integrated engineering services; computer and related services; construction and related engineering services; education services; tourism services; and accounting services.

entry in this Chapter, unless otherwise specified in Annex 10-A, neither Party shall: (a) impose or maintain any limitations on the total number of visas to be granted to natural persons of the other Party; or (b) require labour market testing, economic needs testing or other procedures of similar effect as a condition for temporary entry.” Finally, the MOU on IFA “allows a project company registered in Australia but with 50 percent Chinese ownership to bring in Chinese workers for a proposed infrastructure development project” with capital expenditures of AU\$150 million or more over its term (Howe 2015).⁴⁰

The latter provisions (i.e., article 10.4, paragraph 3, and the MOU) have caused much concern in Australia, namely about the fear that Chinese workers will be able to come to Australia and take away jobs from Australian workers (Australian Broadcasting Corporation 2015; Howe 2015).⁴¹ In reality, it is the MOU that should be the main cause for concern, since it does not require a labour market test to be conducted before an IFA can be authorized, although one could be required by Australia’s Immigration Department (Australian Broadcasting Corporation 2015). Otherwise, Australian visa and immigration rules apply, although with some discretion with respect to English-language skills (Howe 2015).⁴² Such discretion allowed by the MOU is considered problematic for many experts, because it provides for a less transparent process than other temporary visa programs (Australian Broadcasting Corporation 2015). In any case, the fact that project companies with IFAs must “comply with all Australian laws and regulations, including applicable Australian workplace law, work safety law and relevant Australian licensing, regulation and certification standards” could act as a deterrent to bringing in Chinese workers. It does not make sense to go through all the paperwork if the Chinese workers have to be treated the same way as Australian workers, as long as the latter are available (ibid.).

In sum, China has been an active negotiator of bilateral and regional FTAs since it became a WTO

member, in line with the global trend toward bilateral and regional trade agreements rather than multilateral ones under the WTO’s aegis. China’s FTA strategy has been driven mainly by regional security interests, access to natural resources for its development, willingness by partners to recognize it as a “market economy,” and improving access to regional trade networks for its firms. China has gradually increased the scope of its FTAs as it has gained negotiating experience. This explains why ChAFTA is considered the most “comprehensive” FTA that China has negotiated so far. Logically, for China, ChAFTA should be the starting point for its FTA negotiations with Canada. This would make even more sense given the similarities between Australia and Canada in terms of economic and political structures.

Opportunities and Challenges of Free Trade with China for Canada

The possibility of rendering easier economic exchanges between Canada and the world’s third-largest economy, after the European Union and the United States, offers undeniable opportunities to Canadian firms. However, China’s particular political economy also presents a number of difficult challenges that an FTA will need to address to ensure that it is a “win-win” agreement for both sides in the long run.

Opportunities

According to Laura Dawson and Dan Ciuriak (2016), an FTA with China would boost Canadian exports and GDP by \$7.7 billion and \$7.8 billion, respectively. The authors claim that an agreement would contribute an additional 25,000 jobs to Canada’s economy by 2030. The importation of lower-priced goods from China would also be beneficial to consumers as well as manufacturers. Finally, an FTA with China would help level the playing field with Australia, which already has privileged access to the Chinese market through ChAFTA: “Australia will benefit from reduced or eliminated tariffs for key export sectors and increased access for service providers...its firms will displace Canadian exporters of competing goods

40 Infrastructure projects covered by the MOU are limited to the following sectors: food and agribusiness, resources and energy, transport, telecommunications, power supply and generation, environment and tourism.

41 For a more skeptical view, see Giovanni Di Lieto (2016).

42 The Australian government provides the following flow chart to help explain how the IFA process works according to the MOU: www.border.gov.au/WorkinginAustralia/Documents/ifa-operation-flowchart.pdf.

and services until Canada achieves similar market access commitments” (ibid., 2) with China. As such, an FTA with China should also be considered as a defensive move to re-establish Canadian firms’ competitiveness in Chinese markets vis-à-vis their Australian, New Zealand and Swiss competitors.

According to Susan Baka (2017, 11), natural resources industries (including agricultural products), business services and the food manufacturing industry are “the most promising sectors for Canada in China.” For their part, Dawson and Ciuriak (2016, 2) forecast that Canadian exports to China in the automotive sector would shoot up by more than \$1.4 billion, while oil seeds and vegetable oil exports would jump by approximately \$1.7 billion. Exports of chemicals/rubber/plastics, as well as machinery and equipment, would experience an increase of \$688 million and \$584 million, respectively.

China’s economy is undergoing an important transition at the moment. Its meteoric rise over the last decades was driven mainly by massive investments in production capacity (including infrastructure) and exports of labour-intensive manufactured goods, generally using inputs and technology from abroad. Nowadays, China is slowly moving toward a more consumption-driven, service-based economy, although there are strong vested political and economic pressures working against such restructuring of the economy in order to slow down the pace of change, if not actually preserve the existing system.

The fear among the country’s leadership, as well as among economists, is that China will be stuck in the so-called “middle-income trap,”⁴³ and will not manage to grow into a highly developed, rich economy. As a result, the question is whether China should pursue a more market-based (and *laissez-faire*) economy through liberalization reforms or maintain a more state-directed economy with targeted industrial policies for “scaling up” (Yifu Lin 2017). With the adoption of the Made in China 2025 strategy (see below for details), it appears that China’s leadership has opted for the latter approach.

Such an approach seems surprising, given that China is “already at the technological frontier

in some areas and rapidly converging to that frontier in many others” (Ciuriak 2017, 4) and that it is the private sector, including foreign multinational firms, that has been leading the innovation charge (Vaitheeswaran 2015, 10-11). For instance, China’s research and development spending, at US\$220 billion, is now second to the United States (Ciuriak 2017, 4). The country also dominates the world in terms of filing patents, industrial designs and trademarks (ibid., 5); however, a lot of these patents are filed by China’s SOEs and are generally considered to be of low quality (Vaitheeswaran 2015, 10). Therefore, it is questionable whether a state-directed approach to innovation and productivity growth is the right one for China to become a high-income country.

What is most likely is that China will continue its “dual-track” or “bifurcated capitalist” approach to economic development in the foreseeable future (Hsueh 2016; Yifu Lin 2017). As such, the economy will be driven by both market and state. Where the private sector drives China’s economic development, foreign firms, including Canadian ones, should see opportunities for trade and investment. Where the state drives the economy, opportunities should be much more limited. In fact, there are real concerns that the Chinese state’s demonstrated interest in driving innovation and development in high-value sectors could have detrimental effects on European and North American economies (see the Challenges section below).

This hybrid context about the Chinese economy’s future development would explain why Baka (2017, 4) expects that commodities will continue to account for a large share of Chinese imports from Canada, even if “other goods will likely represent an increasing share of the mix.” Nevertheless, there are strong expectations that China’s future economic development should offer new opportunities in services as well.

Agriculture and Agri-food

As mentioned above, Dawson and Ciuriak (2016) foresee exports of Canadian oil seeds and vegetable oil to China increasing by approximately \$1.7 billion should there be an FTA between the two countries, mostly as a result of the elimination of tariffs that China imposes on such products. China’s rapid urbanization is a cause for greater demand for imported food, as “fewer people are in the countryside growing their own food” (ibid., 7).

43 According to Justin Yifu Lin (2017, 6), the middle-income trap “is a result of a middle-income country’s failure to have faster labor productivity growth through technological innovation and industrial upgrading than high-income countries.”

Moreover, as Chinese people become richer, their food and beverage consumption patterns change in favour of greater variety and quality, including more meat, fish and wine. For example, according to Dawson and Ciuriak (ibid.), China's demand for meat is expected to increase by 60 percent by 2030, which will translate into more imports.

A similar pattern is said to apply to grains and legumes and represents added opportunity for Canada should tariff barriers come down (ibid.). Canola, for example, is expected to be a great benefactor of a potential Canada-China FTA. According to the Canola Council of Canada (2017), the elimination of current Chinese tariffs on Canadian canola "would increase exports of seed, oil and meal by up to \$1.2 billion per year." Currently, China's tariffs on canola oil and canola meal are nine percent and five percent, respectively (ibid.). Canola is already Canada's number one export to China (Dawson and Ciuriak 2016, 7). In 2016, Canada's exports of canola products to China were worth \$2.7 billion: "While China is a major producer of oilseeds, it is unable to meet demand through domestic production alone. Canola is an obvious choice to fill the gap because China's increasingly affluent population is seeking out healthier oils, and canola provides one of the healthiest. In addition, people in China are eating more meat and fish, which in turn increases the demand for a good-quality protein source like canola meal for animal feed and aquaculture" (Canola Council of Canada 2017).

An added, even if defensive, benefit that an FTA with China would have for Canada's agricultural and agri-food business is that it would reestablish the playing field with competitors in Australia, New Zealand and Switzerland, which currently enjoy preferred access to the Chinese market as a result of their countries' FTAs with China. Otherwise, Canadian producers will see their market shares in China decrease permanently (Sun 2015, 6). If Chinese tariffs on wine and seafood are between 14 percent and 20 percent, then Canadian producers face a huge competitive disadvantage vis-à-vis their Australian counterparts, which face no such tariffs (ibid.).⁴⁴ Such a scenario actually took place when the European Union and the United States signed FTAs with South Korea.

⁴⁴ It should be observed that, for the time being, canola (or rapeseed) and other vegetable oils have been excluded from ChAFTA, which means that Canadian producers do not currently face a competitive disadvantage vis-à-vis their Australian counterparts in this area.

Canada's agricultural and agri-food industry lost market shares on the Korean market until Canada negotiated its own FTA with Korea, which allowed the industry to recover (ibid., 16).

Energy and Natural Resources

The opportunity story is similar when it comes to energy and (non-agricultural) natural resources. China's demand for energy and natural resources will continue to grow significantly over the next decade, even if the rate of growth will be slower than before as China's economy grows at rates that average five to six percent rather than eight to 10 percent. For instance, Dawson and Ciuriak (2016, 6) report an estimate by McKinsey & Company that "China will account for over 40 percent of the global growth in energy demand by 2030." This would explain why Chinese officials and experts often mention agriculture and natural resources as "objects of desire" (Mazereeuw 2016). It is also good news for Canada's energy and natural resources sector that it is deemed to have the necessary capacity to meet China's demand (Baka 2017, 10). For Wendy Dobson and Paul Evans (2015, 6), Canada and China are a natural economic fit: "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."

In addition to oil and gas, should their exports be made easier with the building of pipelines to the Pacific coast, potash is a likely beneficiary of a Canada-China FTA as China has a strong demand for fertilizer (Dawson and Ciuriak 2016, 6). Forestry products may also be a sector that would benefit from free trade with China. Figure 5 shows that the export of Canadian forestry and wood products to China has expanded significantly since 2005. This is, in part, the result of a diversification strategy adopted by the Canadian softwood lumber industry to sell more to the Chinese market (Lunn 2017). China's residential construction boom has certainly helped sustain this growth. This is why Zhang (2016) sees the Canadian forestry industry benefiting from a potential FTA with China. For their part, Dawson and Ciuriak (2016, 25) forecast very few additional exports to China for Canadian forestry products as a result of a Canada-China FTA. Members of the industry, however, certainly see

benefits arising from a reduction in Chinese tariffs for Canadian forest products (Canada Cleantech 2017, 7). Finally, clean technology is poised to take advantage of China's growing environmental challenges and its leadership's commitment to reduce pollution and carbon emissions. According to Dawson and Ciuriak (2016, 6), this "represents a major opportunity for Canada."

As with agriculture and agri-food, a final benefit that could arise from a Canada-China FTA is that it would put an end to the competitive advantage that producers in resource-rich countries such as Australia, Chile and Peru have in Chinese markets vis-à-vis their Canadian counterparts because their countries have signed FTAs with China. The same levelling effect as a result of an FTA with China would apply to investments from Chinese firms in Canada's natural resource sector; Chinese investment opportunities might otherwise bypass Canada because of the absence of an FTA with China (Sun 2015, 7).

Manufacturing

In their quantitative assessment of the economic benefits that could arise for various sectors of the Canadian economy as a result of a Canada-China FTA, Dawson and Ciuriak (2016) identify a number of manufacturing sub-sectors that would see their exports to China increase: \$1.4 billion for automotive products; \$688 million for chemicals, rubber and plastics; \$584 million for machinery and equipment; and \$110 million for textiles and apparel. Baka (2017, 5) also identifies aerospace and wood product manufacturing as Canadian industries that could benefit not only from China's growing demand, but also from easier access to the Chinese market (see also Sun 2015, 9). However, she points out that these industries will need to boost their production capacity if they wish to take advantage of the opportunities that greater access to the Chinese market can offer.

Services

Baka (2017, 13) has identified the following types of services as potential beneficiaries from free trade with China as a result of growing demand: personal, cultural and recreational services; technical services; financial services; computer and information services. She writes that such opportunities will arise because of "China's plan to move from an export- and investment-led growth model toward a services- and consumption-based

economy." For their part, Dawson and Ciuriak (2016, 26) identify two service sectors that would see their exports to China increase substantially as a result of an FTA: transportation services and business services. In the first case, an FTA would mean \$666 million in additional exports. In the second case, the increase would be \$810 million. Kerry Sun (2015) adds education services to the list of potential service sectors that could profit from freer access to the Chinese market. He points out that education services (and health care) are an important component of ChAFTA (ibid., 13):

By securing favourable conditions to expand the trade in services, Australia will be prepared to capitalize on the next stage of China's economic transition. The broader Australian approach can serve as an instructive model for any future Canada-China discussions, particularly on education and health services, even though these sectors are not normally part of Canadian trade negotiations, being predominantly provincial responsibilities.

Conclusion on the Opportunities of a Canada-China FTA

In sum, perhaps not surprisingly, Canadian sectors associated with natural resources, including agri-food and clean technology, are expected to be among the biggest winners from an FTA, since the Chinese demand for such products continues to grow as China develops a more consumer-based economy. Free trade with China should also benefit key Canadian manufacturing sectors: aerospace; automotive; chemicals, rubber and plastics; machinery and equipment. Given the size of China's economy, Canadian producers will have to ensure that they have the necessary capacity to meet this demand. Finally, China's transition to a consumer- and innovation-driven economy will also boost the demand for services. The following Canadian service sectors stand to benefit from an FTA: business services; computer and information services; educational services; financial services; health services; personal, cultural, and recreational services; technical services; and transportation services.

Challenges

Although the Chinese economy offers opportunities to Canadian firms as a result of its size, growth and transition to a different economic model,

which an FTA would help leverage, there are important challenges or risks that need to be considered so as to manage expectations and identify policy options for addressing them, whether within or beyond the context of an FTA.

An overarching challenge that Canada faces when it comes to China is what the Chinese economy will look like 20 years from now, which is a reasonable time horizon when it comes to FTAs' impacts. As it seeks to avoid the middle-income trap and rebalance its economy toward consumption, services and higher value-added manufacturing, China is experiencing a serious struggle between "masters and markets," as the European Union Chamber of Commerce in China (2017a) calls it. Whether China will manage its transition to a new economic model and get out of the middle-income trap remains very much an open question. How this question will ultimately be resolved will have a decisive impact on the world economy in general and on Canada's economy in particular. Some of the challenges discussed below stand at the heart of this much-debated question.

Agriculture and Agri-food

When closely examining ChAFTA, Sun (2015) worries that exclusions from the agreement between China and Australia could also apply to Canada's FTA with China. For example, he indicates that rapeseed (canola in Canada) and vegetable oils were excluded from ChAFTA. "In addition to a discretionary safeguard on beef imports above a certain quota [set at 170,000 tonnes per year but increasing over time], these provisions underscore China's continuing concern with food security and the effects of imports on the development of its domestic agricultural industry" (ibid., 2).⁴⁵ He also notes that sugar, rice, cotton and wheat are not part of the agreement either, because they are considered "significantly sensitive staples" (ibid., 6).

Energy and Natural Resources

Given China's interest in having greater access to Canada's energy and natural resources, no

⁴⁵ For instance, in 2016, China threatened to impose restrictions on the importation of canola from Canada because of alleged quality concerns relating to blackleg, a fungus that can destroy canola crops (Hui 2016). In September 2016, when Chinese Premier Li Keqiang visited Ottawa, the Canadian government announced that China would not curtail canola imports from Canada while both countries cooperated to conduct additional scientific research on the risk of disease transmission (McGregor 2016).

challenges should be expected here, except with respect for investments by Chinese SOEs in the sector, which are discussed more broadly below.

Sun (2015, 8) notes, however, that China has specifically excluded wood and paper products from ChAFTA, which could present a significant problem for Canada's FTA negotiations with China, considering that these products are among the most important Canadian exports to China (see Figure 5 above). With respect to the pulp and paper industry, Sun (ibid.) writes that the government has "promoted domestic pulp production by setting targets for production capacity and offering financial incentives for pulp and paper projects." Furthermore, according to Usha C. V. Haley and George T. Haley (2013), China tripled its paper production between 2002 and 2009 as a result of US\$33 billion in government subsidies. This would explain why the Chinese government insisted on its exclusion from the FTA with Australia. Should it wish to maintain the same position vis-à-vis Canada in the FTA's negotiations, this could become an offensive interest for Canadian negotiators.

Capacity

Canada potentially faces an important challenge when it comes to selling goods and services to China: do Canadian firms have the productive and financial capacity to serve the vast and demanding Chinese market? As Baka (2017) points out, not all sectors and firms in Canada have the capacity to meet demand in China. It is interesting to note, however, that while the latest Canada-China Business Survey indicates that only two percent of respondents reported "insufficient capacity to meet demand" as the primary restraint on increased profitability for the company's operation in China (Kutulakos et al. 2017, 23), the survey does not include Canadian firms that do not have dealings with or in China, which could be due to a lack of capacity. According to John Gruetzner and Phil Calvert (2017), capacity seems to be an issue to be considered: "Is Canada ready for an agreement with China? Canada will need sufficient capacity and focus at the corporate level to take advantage of the new opportunities presented by a new economic agreement."

Manufacturing

The main manufacturing challenge for Canadian companies vis-à-vis China has to do with the competitive environment. John Gruetzner (2017)

sums it up well when he writes that “China’s natural economies of scale and the Chinese government’s support for a Made in China 2025 strategy make competing in the manufacturing sector difficult.” The incredible scale achieved by some Chinese companies, both private and state-owned, makes it hard for their relatively smaller competitors to compete. In last year’s Fortune Global 500 list of the world’s largest firms, 110 were Chinese, up from 106 in 2015 (Zhu 2016). This number has more than doubled in five years — only 46 Chinese firms made the list in 2010 (Cendrowski 2015).⁴⁶ This increase in scale might explain why 35 percent of Canadian firms that responded to the 2016 Canada-China Business Survey indicated that Chinese competitors were getting stronger (Kutulakos et al. 2017, 26).

In light of this challenge, some firms outside China are considering merging their activities in order to increase their scale. For instance, Bombardier and Siemens recently announced that they were exploring a possible merger of their train-making and signalling operations in order to compete more effectively with CRRC of China, which itself is the result of a 2015 merger between China’s two largest train manufacturers (Henning, Webb and Tomesco 2017). CRRC recently won subway contracts worth hundreds of millions of US dollars in Philadelphia and Los Angeles, in addition to previous winning bids in Chicago and Boston (Lu and Yang 2017). A month or so later, it was announced that CRRC had won a US\$51 million bid against Bombardier to supply commuter train cars to Montreal’s Agence Métropolitaine de Transport (Lu, Zhang and Yang 2017). CRRC’s success has been described as follows: “China has spent trillions of yuan over the last decade building up state-of-the-art subway and high-speed rail systems throughout the country, providing greater mobility within and between cities as part of its transition from a planned to a free-market economy. That process has created a group of companies like CRRC, which have developed cutting-edge technologies that many are now trying to export” (ibid.).

Support from the Chinese state (at all levels) often plays an important role in helping Chinese companies scale up.⁴⁷ This support can take many forms. Government procurement is one type of support, as the above-mentioned quote about CRRC demonstrates, but there are many others, such as subsidies, cheap financing, import barriers and restrictions on foreign investment.⁴⁸ Haley and Haley (2013) argue that “[g]overnment subsidies to produce technologically advanced products and undercut foreign manufacturers have buttressed China’s trade prowess.” They indicate that subsidies, at all levels of government (central, provincial and local) have annually financed more than 20 percent of China’s manufacturing capacity expansion since 2001. Chinese subsidies have taken the form of “free to low-cost loans; artificially cheap raw materials, components, energy, and land; and support for R&D [research and development] and technology acquisitions” (ibid.).

One direct consequence of China’s state subsidies has been overcapacity in many sectors (ibid.). For instance, the European Union Chamber of Commerce in China (2016, 3) shows that utilization rates in six sectors (steel, aluminium, cement, refining, flat glass, paper and paperboard) decreased significantly between 2008 and 2014, a clear sign of increased overcapacity in these sectors. It argues that the following reasons explain industrial overcapacity in China: local protectionism and the fragmentation of industries that are driven by regionalism; weak enforcement of regulations; low input prices due to government policies; a fiscal system that encourages local governments to attract excessive investment; widespread availability of inexpensive technology; environmental, health and safety standards and laws that are not fully implemented; and a philosophy of market share versus profitability (ibid., 4).⁴⁹ According to the American Chamber of Commerce in China (AmCham China), “unemployment concerns, vested interests, and an unclear message from the central leadership have caused these efforts at cutting overcapacity to

⁴⁶ In 2000, the number was 10.

⁴⁷ State support for many sectors would explain why one-fifth of respondents in the 2016 Canada-China Business Survey indicated that one of their main concerns regarding competition in China was unfair advantage to Chinese firms, whether state-owned or not (Kutulakos et al. 2017, 26).

⁴⁸ Such state support is in accordance with the precepts of strategic trade theory or policy (Spencer and Brander 2008).

⁴⁹ For another excellent discussion of China’s industrial overcapacity, see U.S.-China Economic and Security Review Commission (2016).

flounder,” in spite of “supply-side structural reform” being identified as a major policy objective by the central government in 2015 (AmCham China 2017, 4).

Made in China 2025 (sometimes called China Manufacturing 2025 or CM2025) is China’s latest industrial policy plan. “Covering the 10-year period 2016 to 2025, and with targets set for both 2020 and 2025, the CM2025 initiative constitutes the first of a three-stage plan for establishing China as a leading global manufacturing power by 2049, the 100th anniversary of the founding of the People’s Republic of China” (European Union Chamber of Commerce in China 2017a, 8). The plan targets the following 10 sectors:

- information technology;
- high-end numerical control machinery and robotics;
- aerospace and aviation equipment;
- maritime engineering equipment and high-tech maritime vessel manufacturing;
- rail equipment;
- energy-saving and new energy vehicles;
- power equipment;
- agricultural machinery and equipment;
- new materials; and
- biopharmaceuticals and high-performance medical devices.

To achieve its goals, the Made in China 2025 plan calls for significant financial support from central and local governments, amounting to hundreds of billions of (US) dollars (European Union Chamber of Commerce in China 2017a, 1). It also includes a number of “problematic” policy tools such as “subsidies; protectionism; new pressures on foreign business to transfer core technology; the acquisition of companies with advanced technology in Europe and elsewhere, often with support from state-backed investment funds; and the establishment of ever-larger state-owned enterprises (SOEs) that are being positioned as national champions while their management is often simultaneously politicized” (ibid., 1n2).

As a result of these so-called problematic policy tools, there are serious concerns about the likely results of Made in China 2025, although the plan is welcomed in terms of its principles and objectives.

The European Union Chamber of Commerce in China (2017a, 1) concludes that Made in China 2025 ultimately amounts “to an import substitution plan,” which will reduce access to the Chinese market in the 10 targeted sectors. Jost Wübbeke et al. (2016, 7) agree that Made in China 2025 “aims for substitution,” whereby “China seeks to gradually replace foreign with Chinese technology at home — and to prepare the ground for Chinese technology companies entering international markets.” The authors conclude that a small number of Chinese manufacturers will reach higher levels of efficiency as a result of Made in China 2025. They expect them to “dominate their sectors on the Chinese market and become fierce competitors on international markets” (ibid., 8). Otherwise, it is expected that the strategy will lead to continued overcapacity and inefficiencies. In other words, it is unlikely to lead to the wished-for deep transformation of the Chinese economy, at least within the set time frame.

Beyond-the-Border Obstacles

From the above, it is clear that the Made in China 2025 strategy/plan contains worrisome language for foreign firms operating in the targeted sectors, although some companies could benefit in the short to medium term by providing “critical components, technology, and management” to help move the plan forward (Kennedy 2015). Many of the goals, tools and policies contained within Made in China 2025 suggest, with varying degrees of explicitness, numerous “beyond-the-border” obstacles (as opposed to at-the-border barriers such as tariffs or quotas) for foreign firms doing business in China. In the view of Wübbeke et al. (2016, 7), “While Chinese high-tech companies enjoy massive state backing, their foreign competitors in China face a whole set of barriers to market access and obstacles to their business activities: the closing of the market for information technology, the exclusion from local subsidy schemes, the low level of data security and the intensive collection of digital data by the Chinese state.”

According to the 2016 Canada-China Business Survey, the following beyond-the-border obstacles were identified by respondents as the top-10 most important for their firms in doing business in China: lengthy and complicated certification; local content requirements; custom procedures; labelling requirements; limitations to market access due to national security concerns; IP

rules and practices; technical barriers to trade; restrictions for entities in China to make offshore payments; inconsistent interpretation of regulations and laws and lack of transparency; and labour law and practices (Kutulakos et al. 2017, 36-37). These 10 obstacles occupied the top 16 obstacles of all 29 that respondents were asked to rank. American businesses also ranked “inconsistent regulatory interpretation and unclear laws” as their top challenge for doing business in China (AmCham China 2017, 10).

In its most recent Business Confidence Survey, the European Union Chamber of Commerce in China (2017b, 7) finds that European businesses in China generally doubt “whether China is truly committed to creating a simpler administrative environment and ensuring a level playing field.” According to the survey, 54 percent of respondents report that so-called “foreign-invested companies” in China are treated unfairly when compared to domestic Chinese firms.⁵⁰ Moreover, 61 percent of respondents are of the opinion that environmental regulations are more strongly enforced against foreign companies than against Chinese companies (ibid., 8).

Clearly, non-tariff measures (NTMs) or beyond-the-border obstacles are key concerns when it comes to doing business in China. For instance, Sun (2015, 15) mentions that “Chinese NTMs in conjunction with broader, more systematic or institutional constraints, can be more consequential and costly than tariffs alone.” In other words, NTMs can easily amount to protectionism through the back door. Hence, these obstacles will need to be addressed one way or another through commitments on regulatory cooperation within a Canada-China FTA (Dawson and Ciuriak 2016, 10).

Investment

According to the FDI Regulatory Restrictiveness Index of the Organisation for Economic Co-operation and Development, China has some of the highest levels of restrictions on inward FDI (based on 2016 data).⁵¹ With an index of 0.33, China ranks alongside Indonesia (0.32), Myanmar (0.36), the Philippines (0.40) and Saudi Arabia (0.36). The US Department of State (2016) explains

this result in the following way: “China has a legal and regulatory framework that provides the government with discretion to promote investment in specific regions or industries it wishes to develop, and to restrict foreign investment deemed not to be in its national interest or that would compete with state-sanctioned monopolies or other favored domestic firms. Foreign investors report that many regulations contain undefined key terms and standards, and that regulations are often applied in an inconsistent manner by different regulatory entities and localities. Potential investment restrictions in China are thus much broader than those of many developed countries, including the United States.”

Following recent announcements by various Chinese government bodies, it appears that China wishes to ease these restrictions on foreign investment in the hope of bringing more foreign capital to support its economic growth (Jin 2017). For example, in late May 2017, the CPC Central Committee’s Central Leading Group for Deepening Overall Reform approved a revised version of the Catalogue for the Guidance of Foreign Investment Industries (Zhang 2017). This revised version of the catalogue would see a relaxation of investment restrictions in traditionally “sensitive” sectors such as automobile manufacturing, electric vehicle batteries, motorcycles, services and mining, with the number of restrictive measures falling from 93 to 62 (Chen and Song 2017).

Although there is certainly cause to doubt that there will be real and sustained easing of Chinese investment restrictions in practice, considering the criticisms levelled at the Made in China 2025 plan, Yong Wang optimistically states that “pushing forward the further opening up of its economy seems to be the only choice for the country [i.e., China]” (Wang 2017, 1). According to Wang, since the Xi-led leadership came to power in 2013, it has pushed to open China’s economy to foreign investment, pursued “high-standard” bilateral investment treaties with the United States and the European Union, concluded FTAs with developed economies, introduced Pilot Free Trade Zones (in Shanghai, Tianjin, Guangdong and Fujian), and put together the AIIB and the Belt and Road Initiative. These policies form what he calls “version 2.0 of China’s vision of reform

⁵⁰ The results are the same for US firms doing business in China (AmCham China 2017, 10).

⁵¹ The data can be found at www.oecd.org/investment/fdiindex.htm.

and opening up” (ibid., 2). He sees the recent announcements by the State Council, MOFCOM and others about easing restrictions on foreign investment in the same (positive) light (ibid., 5).

Which reality will pan out remains to be seen. After all, the “masters vs. markets” tension lies at the heart of China’s political economy. The continued predominance of SOEs in China’s economy is a good example of this tension.

SOEs

Chinese SOEs are deemed to control 38 percent of industrial assets in China and account for 86 percent of the revenues generated by China’s 500 largest firms (U.S.-China Economic and Security Review Commission 2016, 92-93). According to Hong Yu (2014, 161), “SOEs serve as the key tool for Beijing to implement its national policies and pursue its development strategy.” He points out that they are also the most important contributors to China’s outward FDI. Wendy Dobson (2017, S31) indicates that a number of industries in China are reserved for the state, either as sole owner or majority owner: defence; power generation and distribution; petroleum and petrochemicals; telecommunications services; coal; aviation; and shipping.

China’s largest SOEs are the 113 centrally administered SOEs (CSOEs) that fall under the responsibility of the State-owned Assets Supervision and Administration Commission.⁵² They are said to control about one-third of all SOE assets (U.S.-China Economic and Security Review Commission 2016, 93). The remaining Chinese SOEs are mainly found in the hands of provincial and municipal governments. According to Dobson (2017, S31), CSOEs have been “directed to become heavyweights in ‘pillar’ industries, including machinery, automobiles, Internet technology, construction, steel, base metals, and chemicals, in which non-state enterprises are also active.” These sectors are in addition to the ones mentioned above, which are reserved to SOEs. The presence of CSOEs in these sectors “leads to unequal market competition, overall low efficiency of China’s industries, and inhibits China’s efforts to pursue industrial upgrading

and economic restructuring through conducting indigenous innovation” (Yu 2014, 176).

Given their size and state support, SOEs are Chinese state banks’ preferred clients, at the expense of small and medium-sized enterprises (Yu 2014, 176). They also get cheap and easy financing due to their state backing. Given that SOEs tend to show poor financial performance, because they are “expected to carry out government’s strategic goals” (Dobson 2017, S32), they have accumulated a lot of debt and have seen their leverage (debt in relation to assets) increase to alarming levels: “Since 2008, nonfinancial SOEs have increased their loans relative to assets from 53 percent to 64 percent — nearing the United States’ 70 percent debt-to-asset ratio before the 2008–2009 financial crisis — while private companies’ loans relative to assets declined over the same period” (U.S.-China Economic and Security Review Commission 2016, 94). This situation provided part of the rationale for the recent decision by Moody’s, the credit-rating agency, to downgrade China’s debt, on the assumption that the state is ultimately responsible for the debts incurred by its financial system, which is state-owned for the most part (Monaghan 2017).

The challenge of China’s SOEs for Canada is twofold. First, their size and state support, including their monopoly or oligopoly status in strategic sectors, severely restricts Canadian firms’ ability to compete with them, in China certainly but also in Canada in some instances. The above-mentioned case of CRRRC versus Bombardier is a good example of this challenge. Second, China is putting pressure on Canada to treat its SOEs like any other firm when it comes to Canada’s investment rules. Currently, the Investment Canada Act provides particular considerations and restrictions with regard to SOEs (from China and other parts of the world), including lower value thresholds for the federal government to approve the investment. Finally, Chinese SOEs, given their political ties with government (central, provincial or municipal) and party, create particular national security concerns, which the Canadian federal government needs to consider when it determines the “net benefit” of an investment by a Chinese SOE.

⁵² For a detailed analysis of Chinese SOE’s governance, see Li-Wen Lin (2017).

IP Rights

The protection of IP is a major challenge for businesses (domestic and foreign) operating in China. According to Andreas Schotter and Mary Teagarden (2014), “The effects from IP leakage in China are ubiquitous. They are visible in counterfeited items including toys, luxury goods, automotive and aircraft parts, pharmaceuticals and other complex high-tech products. But IP violations go beyond products. They extend to pirated operational processes and the replication of entire business and service models. For many multinational corporations, IP leakage frequently becomes a barrier to Chinese sites becoming fully integrated partners in global innovation activities.”

In spite of significant improvements made to its IP protection regime over the last decade, China still has some distance to go before offering a strong IP environment (AmCham China 2017; United States Trade Representative 2017). The enforcement of existing IP laws is of particular concern. The International Property Rights Index ranked China number 55 in the world in 2016 with a rating of 5.4. Canada, for its part, came in tenth place with a score of 8.0, while Finland was first with a rating of 8.4.⁵³

Another key area of concern is trade secrets. “Trade secrets remain one of the most vulnerable forms of IP in China, in part because Chinese government authorities jeopardize the value of trade secrets by demanding unnecessary disclosure of confidential information for product approvals” (AmCham China 2017, 86). According to AmCham China, current laws are inadequate. For instance, “onerous burdens of proof and constrained powers of discovery” result in very few successful lawsuits in Chinese courts (ibid.). The Chinese government is undertaking a review of its laws relating to trade secrets; however, concerns remain that any resulting reforms will be insufficient.

A further important IP protection challenge is the registration of trademarks in bad faith. “Although China has taken some steps to address this problem, U.S. companies across industry sectors continue to face Chinese applicants registering their marks and ‘holding them for ransom’ or seeking to establish a business building off of U.S. companies’ global reputations (United States Trade Representative 2017, 9). In this case, the issue has

been enforcement of the Trademark Law, either lax interpretation of legal provisions by Chinese courts or inadequate review standards by the Trademark Office (AmCham China 2017, 94–96). The Chinese government and the courts have begun addressing these issues and it is hoped that matters will continue improving so that enforcement of bad-faith trademarks becomes more effective.

Online counterfeit constitutes an additional area where IP protection has been lacking in China, although recent central government efforts have increased transparency and the “notice and takedown processes” have improved to some degree (AmCham China 2017, 92). Nevertheless, the problem “remains acute,” especially for smaller businesses, because counterfeit operations are able to change identities rapidly in order to avoid detection (ibid). So “the benefits of recent improvements are generally only available to those brand owners who can invest significant resources to regularly monitor e-commerce sites and proactively petition those sites to take down links to infringing products” (ibid).

Conclusion to the Challenges of a Canada-China FTA

China presents a number of significant challenges to foreign (and domestic) enterprises that do business in or with its territory. For instance, there are important restrictions on investing in China. In terms of free trade, China seems intent on continuing to impose tariff and/or quota protection in certain sectors of its economy. Competition in many sectors is skewed, especially in favour of SOEs, as a result of central and regional government support (for example, ample cheap financing). In particular, the Made in China 2025 plan is causing a lot of concern for foreign businesses operating in the plan’s targeted sectors. Finally, the implementation and enforcement of laws and regulations generally remain lax and uncertain.

⁵³ <http://internationalpropertyrightsindex.org/ipri2016>.

Toward a Canada-China FTA

As discussed above, an FTA with China offers a number of opportunities for Canadian businesses; however, it also poses several challenges, many of them as a result of China's peculiar political economy focused on state capitalism. To allow for opportunities to materialize, a Canada-China FTA will have to eliminate tariffs imposed by China on imports from Canada as well as ensure fairly unrestricted market access to China's goods and services markets underpinned by the national treatment principle. For this purpose, the China-Australia FTA should be a good starting point for the negotiations; however, Canadian negotiators will need to push China to go further in terms of market opening (for example, in the wood and paper sector). The fact that the Chinese government seems to be increasingly comfortable with the negative list approach is good news for Canada, since it is likely to limit restricted sectors as well as make it easier for a possible agreement to evolve along with the Chinese and Canadian economies. Ultimately, it seems that the only way for Canada to deal with the challenges identified above is to aim for a comprehensive FTA similar to CETA and the TPP. Whether the Chinese are willing to pursue a high-standard agreement is unclear. In any case, Canadian negotiators should work hard to push them in that direction.

The main issue for Canada is how to deal with China's beyond-the-border obstacles to trade and investment, as discussed in the previous section. Given China's often weak, varied and uncertain implementation and enforcement of laws, rules, regulations and procedures, a Canada-China FTA will need an extensive, multi-level committee structure. CETA's committee structure offers a good starting point;⁵⁴ however, the Canada-China FTA committees should be required to meet much more often than CETA's statutory "once a year," perhaps on a quarterly basis. These committees would allow Canadian and Chinese officials not only to pursue a regulatory cooperation agenda but also to informally address problems relating to China's tendency to apply rules and regulations

in an inconsistent, ad hoc manner. Given that such behaviour often takes place at the provincial and municipal levels, the committee system should have built-in statutory mechanisms for engaging effectively with provincial and municipal officials when necessary. This multi-level governance committee system should apply to China as well as Canada, where provinces and, to a lesser extent, municipalities are increasingly involved in FTAs. The possibility of first resolving problems or disputes in an informal and non-public manner can go a long way in China. The committee system would allow Canadian and Chinese officials to rapidly gain greater knowledge of their respective ways of doing things. It would also help build trust and informal communication channels between the two sets of officials.

If not already done during the negotiations, the FTA should also mandate the relevant committees to establish equivalencies between the two countries with regard to regulations, standards and conformity assessments within a specified period of time. It should provide clear principles and procedures for doing so. CETA's Chapter 5 on sanitary and phytosanitary measures offers a good model to build on. Unlike CETA, however, a Canada-China FTA should make regulatory cooperation compulsory rather than voluntary. Moreover, it should be a continuous process, unlike ChAFTA's review of NTMs on any good on a case-by-case basis. To be most effective, regulatory cooperation should not only have specific time frames but also be covered by the state-to-state DSM, in case one of the parties fails to cooperate effectively.

An FTA between Canada and China will need a chapter on electronic commerce or digital trade. The TPP's Chapter 14 is probably the best model available for the time being.⁵⁵ For instance, the TPP's Chapter 14 guarantees that foreign businesses cannot be compelled to build specific computing facilities in the territory of a member state in order to conduct business in that country. It also protects the free flow of digital data across the parties' borders. However, safeguard clauses allow parties to derogate from these protections, as long as the derogation is to "achieve a legitimate public policy objective,"⁵⁶ and as long as it can be

⁵⁴ For a discussion of CETA's extensive committee structure, see Patrick Leblond (2016b).

⁵⁵ Chapter 14 on electronic commerce: <http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-tpf/text-texte/14.aspx?lang=eng>.

⁵⁶ See TPP article 14.11, paragraph 3, and article 14.13, paragraph 3.

clearly demonstrated that such derogation is not a means to benefit domestic competitors.

China would certainly claim that its Internet restrictions serve only to “achieve a legitimate public policy objective,” namely to ensure societal security and stability. As such, transposing the TPP’s Chapter 14 to a Canada-China FTA would likely allow China to continue imposing heavy Internet restrictions on businesses, foreign and domestic, as long as they apply in a non-discriminating manner to all firms operating in China. At a minimum, a state-to-state DSM should cover the electronic commerce chapter to offer the possibility for a panel of arbiters to decide on the legitimacy of China’s public policy objective with possible trade retaliation in case of restrictions considered illegitimate.

A Canada-China FTA will also need a chapter on IP protection. As such, the TPP’s Chapter 18 provides an excellent basis for the negotiations.⁵⁷ According to Carlos Braga (2016), the TPP currently offers the “highest standards” of IP protection. For instance, it addresses issues related to electronic commerce such as Internet domain names and Internet service providers. To help make IP protection efficient and effective, Chapter 18’s Section B calls for close cooperation between the member parties. In the Canada-China case, such a section could be beefed up with a committee structure that goes beyond the TPP’s “contact points.” This committee could also be involved in IP protection enforcement issues, before resorting to the formal DSM procedure. Section I provides extensive provisions on the enforcement of IP protection measures, including the application of criminal procedures and penalties in some cases (for example, trademark counterfeiting or copyright piracy). It also addresses the issue of trade secrets.

Granting market access to government contracts presents a particular challenge for Canada as a result of the size and economies of scale of some of China’s firms. For example, if Chinese firms are given unfettered access to Canada’s government procurement markets (at all levels of government), there would be a danger that Chinese firms could, over time, drive their Canadian competitors out of the market as a result of winning all contracts, since their scale allows them to bid at much lower costs, as CRRC has done in the case of Montreal’s Agence

Métropolitaine de Transport. If Chinese firms gain a monopoly position after a certain amount of time, they would be able to reap substantial benefits by charging much higher (monopoly) prices, at the expense of Canadian taxpayers.

In order to prevent such a potential scenario from arising, it would make sense to include some kind of competition safeguard in the FTA’s government procurement chapter. For example, if a Chinese firm is considered to have potentially a dominant position in the Canadian or world market, then a government could legitimately discriminate against the Chinese bidder and give the contract to a Canadian firm in order to maintain sufficient competition in the market.⁵⁸ The safeguard’s application could be assessed in a transparent manner following clear criteria by the relevant competition/anti-trust authority in the country (for example, the Competition Bureau in Canada’s case). The competition authority’s decision should be subject to review by the DSM. This type of provision could be linked to a chapter on competition policy as well as a chapter on state enterprises and monopolies, similar to the TPP’s Chapter 17.⁵⁹

Following the above line of thinking, it makes sense for a Canada-China FTA to have a chapter on competition policy. For this purpose, the TPP’s Chapter 16 provides a good starting point for the negotiations. However, it should contain stronger language than the TPP’s Chapter 16.⁶⁰ For example, TPP article 16.1, paragraph 2, stipulates that “Each Party shall endeavour to apply its national competition laws to all commercial activities in its territory.” Given the many situations where competition is restricted in China, the word “endeavour” should be removed in the Canada-China FTA so that it reads: “Each party shall apply its national competition laws...” In order to be effective, this stronger language would require that the chapter’s provisions be covered by the DSM, which is not the case for the TTP (see article 16.9).

In terms of a DSM, the mechanism should be such that the multi-level governance structure

57 Chapter 18 on intellectual property: <http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/18.aspx?lang=eng>.

58 If there were no available Canadian firm, preference could be given to a firm from another country.

59 Chapter 17 on SOEs and designated monopolies: <http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/17.aspx?lang=eng>

60 Chapter 16 on competition policy: <http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/16.aspx?lang=eng>.

proposed above is given some time to resolve disputes in a more informal manner. However, to focus minds and make the discussion process more effective, time limits should be specified in the FTA. These time limits could vary by chapter, depending on the complexity of the matter that needs to be resolved. The creation of an independent panel of arbitrators and the possible trade retaliation that could ensue should come as a last resort to resolving the dispute.

With regard to investment, the FTA should build on the Canada-China Foreign Investment Promotion and Protection Agreement (FIPA). For instance, it should allow a commitment to market access for Canadian investors into China, something that the FIPA currently gives Chinese investors into Canada. For this purpose, the FTA's investment chapter should provide for national treatment at the pre-establishment phase of the investment, and not only once the investment has occurred. For the time being, only Chinese firms have this opportunity because the FIPA provides for MFN treatment, meaning that Canada has granted national treatment rights in other FIPAs, but China has not (Van Harten 2014). Finally, in order to be consistent with the above, the investment chapter would have to restrict China's so-called "carve-out," which Gus Van Harten (2014, 2) considers too broad since it covers any of China's "laws, regulations and rules relating to the regulation of foreign investment," thereby allowing any level of government to block Canadian investments. In exchange, Canada could offer to make the Investment Canada Act more transparent with clearly established definitions and criteria, especially with respect to SOE investments (Dobson 2017).

The main challenge that Canada will face in negotiating an FTA with China is beyond-the-border obstacles to trade and investment. This will require an FTA that imposes the highest standards of doing business in order to ensure free and fair competition. For this reason, CETA and the TPP represent the best starting points for negotiating a Canada-China FTA. In some areas (such as investment), CETA is stronger than the TPP, while the TPP is stronger in others (such as IP rights). In any case, to deal with the particular challenges posed by China's political economy, the Canada-China FTA will have to go beyond CETA and the TPP in two ways: through a comprehensive multi-level governance structure that allows for regular interactions and more informal

discussions to help resolve disputes and frictions; and through broader application of a state-to-state DSM, as a last resort to resolving disputes in case informal discussions are unsuccessful.

Conclusion

A possible FTA with China represents a great opportunity for Canada, since it would give the latter preferential access to the world's third largest economy after the European Union and the United States. It would also help level the playing field for Canadian businesses vis-à-vis their Australian, New Zealand and Swiss competitors. As a result of China's particular political economy — state capitalism marked by a vigorous private sector in certain sectors — Canada faces particular challenges in ensuring that Canadians are able to compete in a fair and free way with their Chinese counterparts in both Canadian and Chinese markets.

To address these challenges, Canada should push the FTA negotiations to be based on high-standard agreements such as CETA and the TPP, both of which were negotiated and signed by Canada. Moreover, it should also ensure that the FTA includes a comprehensive, multi-level governance structure to help resolve disputes and frictions in a more informal way, as such an approach can be very effective in the Chinese context. It should nevertheless provide for a broader application of state-to-state DSM than in CETA and the TPP cases in order to provide a formal DSM as a last resort if informal negotiations and discussions prove ineffective.

The following lists offer a summary of what should be Canada's most important offensive and defensive interests in FTA negotiations with China.

Offensive Interests

- Improved market access for agricultural staples such as canola, and wheat
- Improved market access for wood and pulp products
- Improved access to China's services markets

- Fewer restrictions for Canadian investments in China
- Stronger IP protection standards and enforcement
- Strong competition policy chapter
- Strong electronic commerce chapter
- Comprehensive multi-level governance structure
- Wider application of DSM

Defensive Interests

- Chinese SOE investment in Canada (no discrimination)
- Access to Canadian government procurement markets (competition safeguard)
- Non-market economy status

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