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MOVING BEYOND RHETORIC

Understanding the practical consequences of a Canada-China Free Trade Agreement

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True North in Canadian public policy

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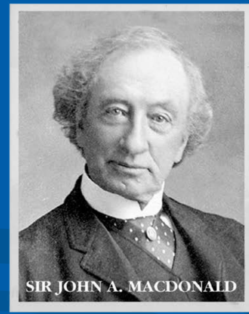
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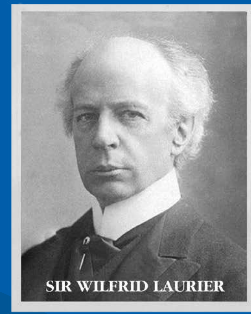
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Executive Summary

With North America's tumultuous free trade negotiations and Donald Trump's America-First rhetoric, Canadians may be receptive to the counter-rhetoric coming from those in our policy circles pushing for trade "diversification" in general and a Canada-China Free Trade Agreement (CCFTA) in particular. Our current federal government's enthusiasm for trade talks with China has been exceedingly high, at least until China's aggressive response to the arrest of Huawei executive Meng Wanzhou in Vancouver in December 2018.

Unfortunately, those pushing most strongly for a CCFTA seem to forget the conceptual differences between free trade and free trade agreements. They downplay the institutional incompatibility between China and Canada, and tend to mislead the public into believing that China's potential market size is so critical to our national interest that we couldn't afford any deep thinking before inking a CCFTA. US President Donald Trump's unpredictability may have helped reinforce the case of those who wanted a CCFTA. Yet we should remember that the self-disruptive Trump will leave the White House long before the self-coroneted Xi Jinping relinquishes control of China, if he ever does.

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Simply put, we need a reality check. Given the Chinese government's command power over its economy, its persistent violations of World Trade Organization (WTO) rules, and underhanded actions against the interests of its existing FTA partners, Canada should not rush headlong into FTA negotiations with China.

This paper, drawing on Canadian, international and Chinese literature and data, provides its own thorough review of Canadian and Chinese trade and economic policy, and China's general approach to the FTAs with other nations. It reveals the following:

- The stark differences in Canadian and Chinese policy will create major barriers to completing a Canada-China FTA. In contrast to Canada's free-market system and rather high ranking of openness, China is a command economy dominated by state-owned enterprises and "remains one of the most closed markets," according to the World Economic Forum.
- China has been a systematic breaker of the WTO rules. Beijing has also made it clear that its focus in any trade negotiation with Canada is to remove Harper-era barriers to takeovers of Canadian firms by Chinese SOEs. Such "unfettered entry" to our economy could directly disrupt our free market system.
- Canada has a trade imbalance with China that would likely not improve with an FTA. Our annual trade deficit with China in 2017 exceeded $44 billion. Within our dismal

exports to China, less than 9 percent were machinery and equipment – the Canadian champion products that accounted for almost 29 percent of our total exports. This is due to punishing Chinese import duties for protecting its own manufacturing sectors.

- Canada, as a well-known net contributor to the global total foreign direct investment, has been a consistent net taker of FDI from China. This arises from China's appetite for Canada's resources and government-backed outpouring of global investment, and its own excessively tight restriction on foreign direct investment into its "strategically critical" sectors, all of which are driven by its national strategy.

- Systemic theft of technology is a hallmark of the China model, whether through forced technology transfer, espionage or disguised control through investment. According to an official US estimate, this has led to billions of dollars of losses by China's foreign competitors.

- China's FTAs with its existing partners have been lopsided and frequently have led to abuse by China, which should alarm Canadians:

  - it manipulated tariff negotiations with its double standard to quickly gain foreign market shares at the cost of both wealthy (Switzerland) and poor (Pakistan) countries;

  - it gained wider openings of services sectors in its FTA partners' territories while keeping its protection for domestic services untouched;

  - it tricked other small open economies to gain a one-sided open-door policy for its SOEs, which have gobbled up arable land in New Zealand, threatening to make New Zealanders "tenants in their own land," and have taken over numerous critical Australian infrastructure assets, directly threatening its national security; and

  - it coerced its FTA partner South Korea using tactics ranging from safety regulation to popular boycott, simply because of the latter's decision to install an anti-missile system for its national defence.

So, we need to answer some important questions. What does the term reciprocity mean when China does not share our belief in the free market economy? Should we allow Chinese SOEs to enter our market while we have nothing reciprocal to request from them? Should we allow Chinese investors to buy our land when both they and we are not allowed to own land in China? Would the Chinese government protect our business properties in their country the way we do theirs, particularly when our government's future actions in defending our beliefs or safeguarding our national security could "hurt their feelings"?

If in the name of its national interest China can blatantly violate WTO rules with an all-out industry policy including outright theft of foreign IP, we have the right to slow down this entire CCFTA matter for the sake of our national security. If negotiating an FTA with Xi Jinping's China becomes so irresistible to our government, the best response would be to take one very careful step at a time.

Don't start with a comprehensive FTA. Attempting to negotiate an FTA only on merchandise trade, for example, would test whether it's possible for Canadians to get a fair deal by tearing down China's tariff wall and pre-empt economic coercive tactics like the newly-erupted canola ban. Then we will truly appreciate who we are dealing with.

Sommaire

Avec en perspective les tumultueuses négociations de libre-échange nord-américain et la rhétorique « Les États-Unis d'abord » de Donald Trump, les Canadiens pourraient être sensibles au contre-discours évoqué dans nos milieux politiques, qui préconisent la « diversification » du commerce en général et un accord de libre-échange Canada-Chine (ALECC) en particulier. Notre gouvernement fédéral actuel s'est montré extrêmement enthousiaste à engager des négociations commerciales avec la Chine, du moins jusqu'à la réaction agressive de ce pays à l'arrestation à Vancouver en décembre 2018 de Meng Wanzhou, haute dirigeante de Huawei.

Malheureusement, ceux qui exercent les plus fortes pressions en faveur de l'ALECC semblent oublier les différences conceptuelles entre le libre-échange et les accords de libre-échange. Ils minimisent l'incompatibilité entre la Chine et le Canada sur le plan des institutions et ont faussement incité le public à croire que le potentiel du marché chinois est si essentiel pour notre intérêt national que nous ne pouvons nous payer le luxe d'une réflexion approfondie sur la question de notre adhésion à l'ALECC. L'imprévisibilité du président des États-Unis, Donald Trump, pourrait avoir contribué à renforcer les arguments à l'appui de l'ALECC. Cependant, il convient de rappeler que l'autoperturbateur Donald Trump quittera la Maison-Blanche bien avant que l'autocouronné Xi Jinping ne cède le contrôle de la Chine, s'il le fait éventuellement.

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En termes simples, nous avons besoin d'examiner attentivement les faits. Compte tenu du pouvoir de contrôle qu'exerce le gouvernement chinois sur son économie, de ses violations continues des règles de l'Organisation mondiale du commerce (OMC) et de ses actions sournoises contre les intérêts de ses partenaires actuels d'accords de libre-échange (ALE), le Canada ne devrait pas se précipiter pour négocier un accord de libre-échange avec la Chine.

Ce document, qui s'appuie sur la littérature et des données canadiennes, internationales et chinoises, présente un examen particulier et approfondi de la politique commerciale et économique du Canada et de la Chine et de l'approche générale de la Chine en ce qui a trait à ses accords de libre-échange conclus avec d'autres pays. Il révèle ce qui suit :

- Les différences marquées entre les politiques canadienne et chinoise créeront des obstacles majeurs à la conclusion d'un ALE Canada-Chine. Alors qu'un système de libre marché avec un degré plutôt élevé d'ouverture existe au Canada, la Chine est une économie dirigée dominée par des entreprises d'État et « demeure l'un des marchés les plus fermés » au monde, selon le Forum économique mondial.

- La Chine a transgressé les règles de l'OMC de façon systématique. Pékin a également clairement indiqué que son intérêt central dans toute négociation commerciale avec le Canada était de supprimer les obstacles aux prises de contrôle au Canada érigés à l'époque Harper à l'encontre des sociétés d'État chinoises. Une telle « entrée sans entraves » dans notre économie pourrait directement perturber notre système de libre marché.

- Le déséquilibre commercial du Canada avec la Chine ne s'améliorerait probablement pas dans le cadre d'un ALE. Notre déficit commercial annuel a dépassé 44 milliards de dollars en 2017. Moins de 9 % de nos exportations totales vers la Chine, dont le niveau était affreusement bas, étaient constituées de machines et d'équipements – pourtant nos produits phares, qui représentent près de 29 % de nos exportations mondiales. Nos exportations sont pénalisées par les droits d'importation imposés par la Chine pour protéger ses propres secteurs manufacturiers.

- Le Canada, pays renommé comme contributeur net aux investissements directs étrangers mondiaux, a longuement été un preneur net d'investissement direct étranger en provenance de la Chine. Une telle situation résulte de l'attrait des ressources du Canada et de la vague d'investissements mondiaux sortants avalisée par le gouvernement chinois, ainsi que de ses propres limitations excessives aux secteurs d'investissements directs étrangers « stratégiques », toutes motivées par sa stratégie nationale.

- Le vol systémique de technologie est une caractéristique du modèle chinois, que ce soit par la voie d'un transfert forcé de technologie, de pratiques d'espionnage ou d'un contrôle déguisé au moyen d'investissements. Selon une estimation officielle des États-Unis, cela aurait entraîné des milliards de dollars de pertes pour les concurrents étrangers de la Chine.

- Les accords de libre-échange entre la Chine et ses partenaires existants, ordinairement à sens unique, ont souvent conduit à des abus, ce qui devrait préoccuper les Canadiens :

    - elle a utilisé les négociations tarifaires de façon abusive et donc sans tenir compte du « principe d'impartialité » pour gagner rapidement des parts de marché aux dépens de pays riches (Suisse) comme de pays pauvres (Pakistan);

    - elle a élargi ses accès dans les secteurs des services sur les territoires de ses partenaires d'accords de libre-échange, tout en préservant la protection de ses propres services nationaux;

    - elle a usé de ruse auprès d'autres petites économies ouvertes pour tirer profit d'une politique de porte ouverte unidirectionnelle qui a permis à ses entreprises d'État de s'emparer de terres arables en Nouvelle-Zélande – menaçant de faire des Néo-Zélandais des « locataires sur leurs propres terres » – et de nombreux actifs d'infrastructure australiens essentiels, un risque direct pour la sécurité nationale de ce pays; et

    - elle a contraint son partenaire d'accord de libre-échange sud-coréen à recourir à des tactiques allant de la réglementation de la sécurité jusqu'à une campagne de boycott, simplement en raison de la décision de ce dernier d'installer le système antimissile pour sa défense nationale.

Nous devons donc répondre à d'importantes questions. Que signifie le terme « réciprocité » si la Chine ne croit pas comme nous dans l'économie de libre marché? Devrions-nous offrir aux entreprises d'État chinoises l'accès à notre marché lorsqu'il n'y a rien d'équivalent à demander en retour? Devrions-nous autoriser les investisseurs chinois à acquérir nos terres agricoles alors même qu'ils ne peuvent eux-mêmes en posséder en Chine et que cet accès nous est aussi interdit? Le gouvernement chinois protégera-t-il nos actifs commerciaux en Chine aussi bien que nous protégeons les actifs commerciaux chinois au Canada, en particulier si les mesures futures de notre gouvernement visant à défendre nos convictions ou à protéger notre sécurité nationale sont susceptibles de le « vexer »?

Si, au nom de son intérêt national, la Chine peut violer de manière flagrante les règles de l'OMC en portant à son point extrême sa politique industrielle pour inclure le vol absolu de propriété intellectuelle étrangère, nous avons le droit de ralentir les choses pour ce qui est de toutes les questions relevant de l'ALECC afin de préserver *notre* sécurité nationale. Si négocier un accord de libre-échange avec la Chine de Xi Jinping devient un enjeu incontournable pour notre gouvernement, la meilleure réponse à mettre en œuvre exige d'y aller de façon prudente, une étape à la fois.

L'accord de libre-échange avec la Chine ne devrait pas initialement être exhaustif. Faire porter d'abord les négociations uniquement sur le commerce des marchandises, par exemple, permettrait de déterminer s'il est possible pour les Canadiens d'obtenir un accord équitable qui passe par l'abolition du mur tarifaire chinois et l'adoption de mesures visant à contrer les tactiques de coercition économique telles que la nouvelle interdiction frappant le canola. Les Chinois pourront alors vraiment comprendre à qui ils ont affaire.

Introduction

In early 2017, following the entry of Trump and his “America First” rhetoric into the White House, China’s strongman Xi Jinping, a true protectionist, was able to fool World Economic Forum (WEF) attendees into believing that he was a defender of free trade (Anderlini, Feng, and Mitchell 2017). Xi’s stage acting played well to the eyes and ears of many WEF elites even though, by the ranking of the WEF itself, the United States has always been a much freer trading country than China.

Around the same time, Canada’s decades-old fixations and worries about our so-called trade “vulnerability” – often said to be due to our historical and geographical reliance on the US market – took the form of a decisive pivot towards lauding a Canadian free trade agreement (FTA) with China. It seemed that the wider and stronger our trade ties were with the US, the louder the rhetoric was from some within our policy circles for “diversification” in general and a Canada-China FTA (CCFTA) in particular.[1] Our government has expressed considerable enthusiasm for trade talks with China (McKenna and Decloet 2018), at least until China’s aggressive response following the arrest of Huawei executive Meng Wanzhou in Vancouver in December 2018 (Burton 2019).

Canada should carefully reassess the prospects for a CCFTA and approach such a deal vigilantly.

Why the blind rush towards China? A fundamental reason is that some in our policy circles seem to forget the basic differences between free trade and free trade agreements, downplay the institutional incompatibility between China and Canada, and mislead the public into believing that China’s potential market size is so critical to our national interest that we couldn’t afford any deep thinking before inking a CCFTA. US President Donald Trump’s unpredictability may have helped reinforce the case of those who wanted a CCFTA. Yet we should remember that the self-disruptive Trump will leave the White House long before the self-coroneted Xi Jinping relinquishes control of China, if he ever does.

It is therefore critical to straighten out our thinking and look at any possible CCFTA with greater conceptual clarity. Simply put, we need a reality check. Canada should carefully reassess the prospects for a CCFTA and approach such a deal vigilantly. Should we push for a CCFTA, we must take every step possible to ensure what we will get from a CCFTA is what we truly understand and want to attain.

The first section of this paper will revisit the concepts of free trade vs. free trade agreements in order to set the stage for a sensible discussion of any proposed CCFTA. The conflict between the so-called China model and free trade will then be explored in Section two, with particular emphasis on the incompatibility between the respective trade policies of Canada and China. Based on the characteristics of our current bilateral trade relationship with China, Section three will investigate what China really wants from a CCFTA and what a CCFTA might benefit or cost Canada. Section four will further substantiate such analysis by reviewing common traps in existing foreign FTAs with China. Lastly, given the opposing views on trade policies between our two countries, the paper will conclude that an FTA with Xi Jinping's China at the current stage is a non-starter. Instead, before initiating any FTA talks with China, our government should conduct a rigorous cost-benefit-feasibility study that takes into consideration the realistic consequences of any CCFTA.

Free Trade vs. Free Trade Agreement: Two distinctly different concepts

By classic definition, *free trade* is "a policy of non-intervention by the state in trade between nations, where trade takes place according to the international division of labour and the theory of comparative advantage. Such a policy would lead to the most efficient allocation of resources on a world scale and to the maximization of world income."[2] In other words:

- The essence of free trade is *non-intervention* by the state. Therefore, the precise picture of free trade contains zero tariffs, zero quotas, zero subsidies, zero industry policies, and zero regulatory barriers to trade. Needless to say, unlawful intrusion, such as forced technology transfer and even theft of technology, has no place in the concept of free trade.
- The guiding principle of free trade is *comparative advantage*, which demonstrates that in a free-trade setting, any country, regardless of its stage of development, may benefit by trading its domestically more productive goods (and services) for its domestically less productive goods (and services), even if it can produce both categories of goods (and services) at lower (or higher) costs as compared with its trading partners.
- Therefore, the natural outcome of a *true* global free trade system would lead to the most efficient labour division around the globe, where each country as a trading partner would become highly specialized in producing certain goods and services and trade them for everything else produced by its trading partners.

Obviously, geopolitical divisions are in direct conflict with such a theoretical and ideal free trade system, because the latter requires *universal* protection of private property rights, a *universal* free market system that guarantees competitive neutrality, and the *universal* rule of law that abides by all trading countries. Therefore, a true free-trade system has never existed in modern history and is not likely to appear in the foreseeable future.

That is, in modern history no state on earth has practiced free trade in full. Instead, all have intervened in cross-border trade in the name of various self-justifications such as economic development (for instance, claiming the need to foster an infant industry), national security (the need to safeguard the defence industry), and social protection (for example, the need to insulate the agricultural sector). Means used for such intervention include, but are not limited to, import tariffs and quotas, export subsidies or restrictions, industry policies implemented through conventional measures (such as making heavy doles to state-owned enterprises (SOEs) while banning the free entry of others), and also nonconventional ones (including forced technology transfers and outright stealing), legal and regulatory discrimination against foreign competitors, and even coercive economic measures (Harrell, Rosenberg, and Saravalle 2018).

Such state intervention in cross-border trade is where free trade agreements come in. The word “free” in the concept of a free trade agreement is in essence a verb rather than an adjective in the theory of “free trade”; it means to *liberate* the trading partners from their existing trade barriers – tariffs, quotas, subsidies, industry policies, and regulatory interventions – to the degree that is agreeable and enforceable between them. To that extent, the concept of a free trade agreement is better understood as a “managed trade agreement.”[3]

It is in the sense of a “managed” trade agreement that the coverage of free trade agreements has expanded from its early stage of mutual duty reduction on imported goods (as originating from the *1823 Reciprocity of Duties Act* passed by the British Parliament (2019)) to today’s broad inclusion of goods, services, investments, and even labour for *freer* flow across borders, as can be seen in the “Comprehensive and Progressive Agreement for Trans-Pacific Partnership” (CPTPP), or TPP-11 (Government of Canada 2016). The more comprehensive an FTA is for cross-border free flows, the higher the institutional compatibility required among partners for their signed FTAs to be mutually enforceable so as to benefit all.

The key to an FTA is reciprocity in a specified degree of non-intervention in trade.

Therefore, signing an FTA is only a step moving towards a trade arrangement with fewer disagreeable interventions between trading partners. Negotiations for any such FTAs always involve making compromises among partners in a *reciprocal* manner. The degree of reciprocity, however, strictly depends on the institutional compatibility between FTA partners, and this is because institutional *incompatibility* is bound to challenge the very sense of *reciprocity*. For example, how sensible would it be to include a reciprocal clause of “unrestricted state-owned enterprise entry” in an FTA between China, an SOE-dominant economy, and Canada, which does not even allow its own SOEs any free entry into its own economy? This is the very reason that TPP-11, the most comprehensive regional FTA to date, contains many chapters to mandate institutional compatibility.[4]

In summary, the key to free trade is *zero* intervention. This is a theoretical concept. And the key to an FTA is *reciprocity* in a specified degree of non-intervention in trade. This is the basic principle between trading partners and is based on their institutional compatibilities. Therefore, the most vocal pursuer of FTAs is not necessarily a true free trader but definitely a pursuer of perceived benefits from FTAs.

Canada vs. China: Two contrasting sets of trade policies

As argued above, a true free trader is a non-interventionist who would unilaterally practice the policy of "five zeros": zero tariffs, zero quotas, zero subsidies, zero industry policies, and zero regulatory barriers to trade. A true free trader would hence not need any FTA for a cover. But in reality, no such pure free trader could survive. Instead, everyone intervenes; countries can be benchmarked against a set of free-trade criteria and ranked accordingly by their levels of freedom for cross-border trade.

An example of such rankings is the "enabling trade index" (ETI) formulated by the World Economic Forum (WEF). This index "assesses the extent to which economies have in place institutions, policies, infrastructures and services facilitating the free flow of goods over borders and to their destination" (World Economic Forum 2016, 13). It may therefore help gauge the level of difficulties by those who are contemplating negotiations with the potential FTA partners: the farther apart two countries are on this ranking, the harder it will be for them to reach an FTA satisfying both parties. If we think the recent *transparent* NAFTA 2.0 renegotiation with the US (whose ETI ranking was 22nd in 2016 vs. Canada's 24th) was agonizing, we should anticipate much greater difficulties in negotiating an FTA with China (whose ETI ranking was 61st).[5]

To support my contention of institutional incompatibility between China and Canada, I will first borrow the WTO country trade policy review to illustrate the trade-policy incompatibility between our two countries. I will then draw on Chinese materials about the linkage of the China model and persistent Chinese violation of WTO rules, which have largely escaped the attention of the Canadian public and rarely caught the eyes of our government officials.

How does China match up with Canada in trade policy?

The World Trade Organization periodically provides a trade policy review for all its member countries. The latest such review for Canada was dated June 2015 for 2011–2014 (WTO 2015a); for China the latest review was dated July 2018 for 2015–2017 (WTO 2018). Additionally, the World Bank publishes annual trade statistics by country through its World Integrated Trade Solution (WITS) (2019). The latest year for which WITS data are available is 2017.

Below are my summaries of these latest publications, focusing on the overall picture of trade and foreign direct investment (FDI) policies as well as specific views on tariffs, quotas, and government subsidies for Canada and China respectively.

Canada:

Trade: Canada's merchandise trade is about five times the size of its services trade for imports and exports. Canada relies heavily on the United States as its major market, with 76 percent of its merchandise exports destined for US markets, and 51 percent of its imports from the US. Canada's second largest trading partner is China, which accounts for 5 percent of Canada's exports and 13 percent of its imports.

Foreign investment policy: Canada's framework for foreign direct investment is broadly based on its 1985 *Investment Canada Act*, which requires notification or review to ensure net benefit and national security. Recent changes to the *Act* focused on provisions related to SOEs and in the meantime relaxed the FDI restrictions for telecom companies. Nevertheless, FDI inflows were outpaced by FDI outflows.[6]

Import tariff and quota: The simple average import tariff rate in 2017 was 2 percent, with over 80 percent of tariff lines being duty-free, an average of 22.5 percent for agriculture products, and 2.4 percent for the rest.

Subsidies and SOEs: Canada maintains an overall open economy but does provide support in the form of subsides and incentives, with 58 subsidy programs sent in notification to the WTO. The SOEs at both federal and provincial levels accounted for 3.4 percent of overall GDP.

China:

Trade: China's merchandise trade is also about five times the size of its trade in services. The top three destinations of exports are the US, the European Union (EU), and Hong Kong, and the top sources of imports are the EU, South Korea, and the US.

Foreign investment policy: China's main instrument guiding inward FDI is the periodically revised Investment Catalogue covering both sectors and regions, in which FDI projects are classified in the encouraged category, the disallowed category (the "Negative List"), and other categories in between (which are further subdivided into a specific catalogue that requires approval and others subject to record-filing).

Import tariff and quota: The 2017 simple average import tariff rate is 8.5 percent,[7] with 20.5 percent of tariff lines being duty-free, and an average of 14.6 percent for agricultural products and 8.5 percent for others.

Subsidies and SOEs: Unlike Canada, China has not notified the WTO on most of its state interventions such as subsidies and SOEs. Therefore the WTO must rely on other sources for its policy review regarding China. According to the WTO (2018):

- China's "implicit assistance to SOEs has increased over a number of years." "The authorities intend to continue" structural economic reform while "retaining the preponderance of public ownership."
- "China has continued to provide substantial support for, *inter alia*, intelligent manufacturing, advanced technologies, new energy vehicles, and fisheries. Outlays for these programmes are reported to be considerable."
- "China applies price controls, at both the central and provincial levels, on commodities and services deemed to have a direct impact on the national economy and people's livelihoods."
- China's "[s]tate involvement in the economy remains considerable." "The state retains a majority share in all but one of the 100 largest publicly listed companies."
- "The total value of government procurement accounted for 3.1% and 4.2% of GDP in 2015 and 2016 respectively. This relatively low ratio may reflect the fact that important infrastructure projects implemented by SOEs are not covered by Government Procurement Law."

In summary, the WTO trade policy review on Canada is brief and straightforward because Canada is fairly open and plays by the rules. In contrast, China has been playing all manner of tricks to bypass WTO rules and has largely ignored its obligation to the WTO to issue notifications on its trade interventions. Still, in all things measurable, China is indisputably the largest command economy on earth. Also, as concluded in the WEF's ETI report (2016), "In terms of market access, China remains one of the most closed markets" (98).

China model and IP infringement: An intrinsic linkage

Beyond the WTO trade policy review, many of China's systematic state interventions are immeasurable. Among these, the most damaging is infringement upon foreign intellectual property (IP), which has become an integral element of the so-called China model. It is heartening to review what some clear-minded Chinese scholars have said about the linkage between the China model and IP infringement.

First, the China model features government commanding power, a dominant SOE sector, and "smart" industry policy, as defined by Mr. Zhang Wei-ying (2018), an economics professor at Peking University.

China has been able to take shortcuts by "borrowing" advanced Western technologies.

Based on China's regional statistics, Prof. Zhang argues that like every other country's economic rise in modern history, China's explosive economic growth over the past 40 years has been the success of the "universal model" powered by market forces, entrepreneurial spirit, and advanced technology. But unlike other major rising economic powers in the past, China has been able to take shortcuts by "borrowing" advanced Western technologies accumulated through three industrial revolutions over the past 250 years. He believes such a "latecomer advantage" will disappear as the technology gap between China and advanced economies narrows and that sticking to the China model will ultimately reverse China's economic growth and lead to confrontation with the international order over fair trade and peaceful coexistence. He has therefore courageously called on the Chinese government and public to switch to the universal growth model.

Secondly, the latecomer advantage theory has been a guiding principle for China's trade policy and the justification for infringement upon foreign intellectual property rights, as observed by Mr. Cheng Tijie (2018), a professor of sociology (retired) at the University of Macau.

Mr. Cheng recalled a fierce academic debate at Qinghua University in the 1980s over the merits of the *latecomer advantage*. Promoting latecomer advantage was Prof. Justin Lin, who believed that China, as a latecomer, should not repeat the prolonged research and development routes of wealthy countries but instead copy their advanced technology by *all* possible means in order to save time and money and quickly overtake the world's leading economic powers. The prominent naysayer was the late economics professor Mr. Yang Xiaokai, who warned that by copying only advanced technology while rejecting advanced institutional settings, China would never be able to nurture its own innovation potential and hence would likely become a perpetual "latecomer."

Amid this debate, the Chinese government made its strategic choice: over the past 30-plus years, the latecomer advantage theory has been poured into all textbooks and dominated all classrooms in training government cadres. As such, forced technology transfers, copycatting, and brazen grabs of foreign commercial secrets have all appeared legitimate to Chinese officials and the Chinese business community in the name of "the national interest."[8]

Third, the focal point of China's pattern of unfair trade has been outright infringement upon foreign IP rights, as detailed by Mr. Cheng Xiaonong (Mingjing TV 2018), an independent scholar living in America.[9]

Since the early 1980s, this has assumed three overlapping tactics:

Forced technology transfer can be divided into two stages, with China's ascendance to the WTO in 2001 as the watershed moment.

Stage one featured "open grab" and officially began in 1984 with the mandatory "technology transfer for market access" requirement inked in the central government's documents. This stage enabled China to upgrade all of its manufacturing products to international standards before entering the WTO, which in turn helped China rapidly expand its global market share.

Stage two has been "disguised robbery" since 2001. Beijing, having complied with WTO rules only on its central government documents, has discreetly given subnational governments a free run on continuing its "forced tech transfer" from foreign investors.

Direct theft through espionage has been a parallel tactic all along.

Because companies under forced technology transfer constraints do not bring in their most advanced technology and eschew involvement in military secrets, China has since the early 2000s resorted to espionage to steal these secrets, including direct stealing by professionals with Chinese backgrounds,[10] indirect stealing by recruiting key personnel from foreign companies that possesses critical technologies,[11] and massive military Internet hacking (for example, by the Chinese People's Liberation Army Unit 61398).[12]

Disguised control through investment[13] has been Beijing's latest successful tactic. China has orchestrated state-backed waves of investment in foreign startups with promising innovations (O'Keeffe and Brown 2018) and funded massive joint research projects with foreign academics.[14]

These tactics have made systematic theft of technology a hallmark of the China model. According to an official US estimate,[15] this has led to billions of dollars of losses for China's foreign competitors. A single recent case involving a Chinese wind turbine firm stealing its US vendor's technology wiped out over US$1 billion and almost 700 jobs from the latter (Pham 2018), a case rightly summarized by an American attorney as "attempted corporate homicide" (Guardian 2013).

In summary, based on trade policy reviews by WTO and in-depth observations by several Chinese scholars, it is clear that China has not been an honourable player in the international trading community but instead a systematic rule-breaker that follows its own command economy model, which is in direct conflict with the principle of free trade.

CCFTA: Mismatched aims between two parties

A freer entry to the Chinese market is everyone's dream for our economic growth. This consensus became an easy selling point for the CCFTA proponents in Canada, who seem to have assumed that signing a CCFTA was the only means, and a privileged one, for this purpose.

But where is the role of the WTO in all of this? Shouldn't we gain free entry into China's potential market as an equal member of the WTO, just like China did to us? Isn't it China's persistent violations of WTO trade rules (USTR 2019) that have kept its potential market largely closed to Canada and the world? If our CCFTA ambition is to enter the Chinese market, isn't it logical to press China to fulfill its WTO commitments before proceeding with CCFTA negotiations (Ip 2018)? More importantly, do we know what China truly wants from an FTA with Canada, which is the price we need to pay for attaining a "bigger" share of China's vast market? If so, are we ready to pay this price?

In this section, I will pinpoint "what China wants from a CCFTA" and investigate the pattern in our trade relationship with China before initiating a cost-benefit debate around the much talked-about CCFTA.

What does China want from CCFTA?

As clearly stated by the Chinese ambassador to Ottawa, "Beijing's focus on the negotiations is to remove the Harper-era barriers that limited takeovers of oil-sands companies by state-owned enterprises, specifically from China, and to expand Chinese investment throughout the Canadian economy" (Fife and Chase 2017). So it is all about gaining an "unfettered entry" to our Canadian economy for Chinese SOEs. (Are we Canadians happy with that adamant demand from China? Let us take this question to heart and debate it carefully before arriving at an answer.)

In fact, as noted later in this paper, all China wants in any FTA with any country is free entry for its SOEs into that country. Simply put, China's ambition of globalizing its SOE-dominance is alien to all of the other 163 WTO member countries. It is only natural for all market economies, including Canada, to restrict the entry of Chinese SOEs in order to guard their free-market systems. It is precisely this restriction that China wants torn apart through its efforts at signing FTAs with countries around the world.

After having succeeded in signing an FTA with several countries, including Australia and New Zealand, China sees Canada as the next attractive and easy target. Canada is "attractive" because of our wealth in natural resources and quality of human capital and "easy" because of its perception of Canada's historical naïveté towards China[16] and our feeling of insecurity towards America.[17]

Thanks to unwavering alarms sounded by the US government and its policy circles over China's persistent violations of WTO rules,[18] and thanks to China's incessant bullying of Canadians as a people, our national discourse is finally turning towards getting to the bottom of China's attempt to make any deals (Bercuson 2019). And we have finally discerned the need for an honest assessment of the degree of China's state intervention in trade as compared with ours (Solomon 2019).

Canada's troubling trade relationship with China

Amid all the rhetoric on attaining a large share of China's vast market through CCFTA, we need to look at the recent pattern of our bilateral trade and FDI with China. That is, we need to understand the existing pitfalls in this bilateral trade and FDI relationship in order to hammer out what to put on the table if we want to negotiate an FTA with China.

Trade

Merchandise trade with China, both import and export, has indeed increased rapidly over the past decades. However, China has been Canada's second largest export destination only since 2012 when it surpassed the UK, whose population is less than 5 percent of China's.

Interestingly, China has been the largest contributor to our trade deficit since at least 2010, the earliest year for which official validated data are available. While our exports to China are largely limited to agricultural and forestry products, our imports from China are mainly manufactured goods such as telecommunications and data processing equipment and automobile parts (Chinese Ministry of Commerce 2018).

Table 1 provides a general picture of our merchandise trade with China for 2010–2017 as compared with that of the US.

TABLE 1: CANADA'S BILATERAL TRADE IN MERCHANDISE WITH CHINA AND US, 2010-2017 AS SHARE (%) IN OVERALL TRADE

	with China			with US		
Share (%) in overall trade	Exports	Imports	Exp./Imp.	Exports	Imports	Exp./Imp.
2010	3.4	11.0	0.29	74.6	49.9	1.42
2011	3.9	10.8	0.35	72.9	49.1	1.41
2012	4.5	11.0	0.38	73.8	50.0	1.38
2013	4.6	11.1	0.39	75.3	51.3	1.39
2014	3.8	11.5	0.32	76.1	53.8	1.38
2015	4.1	12.3	0.31	75.7	52.7	1.33
2016	4.3	12.0	0.33	75.2	51.7	1.33
2017	4.6	12.6	0.33	74.7	51.0	1.35

Sources: Statistics Canada 2019c and d.

As our major trade partners, the US takes on average 75 percent of our exports, while China takes in 4 percent. This means that despite rapid growth during the period 2010–2017, our exports to China reached only 6 percent of the exports that we sent to the US. Additionally, imports from China were close to 25 percent of what they are from the US. Table 2 breaks down the numbers further.

TABLE 2: CANADA'S BILATERAL TRADE IN MERCHANDISE WITH CHINA AND US, 2010-2017 IN $ BILLION

	with China			with US		
in $ billion	Exports	Imports	Balance	Exports	Imports	Balance
2010	12.3	41.9	(29.6)	268.4	189.6	78.8
2011	15.7	45.3	(29.6)	291.7	206.6	85.1
2012	18.2	47.8	(29.6)	300.8	217.7	83.1
2013	19.4	49.8	(30.5)	318.9	229.8	89.1
2014	17.8	55.4	(37.7)	356.9	258.8	98.1
2015	18.9	61.8	(42.9)	351.9	264.6	87.3
2016	19.5	59.8	(40.3)	341.3	256.9	84.4
2017	22.0	66.3	(44.3)	361.4	268.2	93.2

Sources: Statistics Canada 2019c and d.

It shows that Canada's annual trade deficit with China in 2017 exceeded $44 billion, which is more than our overall merchandise trade deficit of $42 billion.[19] In contrast, our merchandise trade surplus with the US increased to $93 billion, which more than doubly offset our overall merchandise trade deficit.

More importantly, as table 3 shows, within our dismal exports to China, less than 9 percent were machinery and equipment – the Canadian champion products that accounted for almost 29 percent of our total exports.

TABLE 3: CANADA'S EXPORTS BY PRODUCT TO CHINA VS. US (IN % OF TOTAL EXPORTS), 2017

Top exporting products	To all countries	to US	to China
Machinery and equipment	28.8	31.9	8.7
Mineral products	23.7	26.5	12.0
Agricultural and fishing products	7.3	3.7	34.3
Wood and paper products	7.1	6.4	24.5
Base metal	6.2	7.1	5.2
Pearls, precious stones or metals, coins and jewellery	4.7	1.6	1.6
Chemical product	3.6	4.9	6.3
Plastic product	3.1	3.8	1.0
TOTAL*	**85.8**	**85.9**	**93.5**

Sources: Based on Innovation, Science and Economic Development Canada, Trade Data Online.
* The total may not add up due to rounding.

Again in contrast, within our hundreds of billions of dollars of exports to the US, machinery and equipment accounted for 32 percent. A broader data search also shows that machinery and equipment accounted for 35 percent of our total exports to Germany, the global high-end manufacturing power house.[20]

So what's the problem with our exports to China, a country with a population of over 1.3 billion and a growing middle class? It is China's punishing import duties[21] used by the government to block foreign manufacturing goods for the purpose of protecting its domestic manufacturing industry.[22] The typical case is how China's hefty tariffs along with other levies have doubled the price of imported cars (Bradsher 2017). This tariff wall, in combination with other industry policies (such as restricting foreign entry and forced tech transfer), has enabled China to propel its car-manufacturing industry from infancy to the status of top global car producer within two decades (Lei 2018). For other consumer goods, a recent article published by the BC Chamber of Commerce (2017) tells it all. No wonder we so often see Chinese tourists more interested in shopping abroad than in sightseeing: for anything of a given foreign brand (even if it is made in China), it is believed to be much cheaper for Chinese to buy abroad than at home.

Investment

Canada has been a net contributor to global foreign direct investment in recent years, with an accumulated overseas investment stock of over $300 billion. This demonstrates that Canadian investors are avid and able profit seekers. But based on both Canadian (Statistics Canada 2019b) and Chinese[23] statistics agencies,[24] Canada has been a consistent net taker of FDI from China over the last decade. This is mainly due to China's excessively tight restriction on foreign investment into its numerous "strategically critical" industries and its outpouring of global investment backed by the government and largely through its SOEs, both of which are integral components of China's national strategy.

To demonstrate this linkage between China's outward foreign direct investment (OFDI) and its national strategy, I will focus on investigating trends and characteristics in China's OFDI to Canada from 2005 to 2017, the latest year for which detailed data are available.[25]

Chart 1 shows China's total global or worldwide OFDI between 2005 and 2017.

China's total OFDI grew steadily since 2005, when the government started its coordinated promotion of OFDI, until 2017, when the government tightened its controls on foreign exchange reserves. (Note that a quarter of China's OFDI in 2017 was due to its $43 billion takeover of Syngenta. Without this deal, China's total OFDI in 2017 would have dropped by over 40 percent, rather than only 19 percent.)

In contrast, China's OFDI in Canada, as measured by the Canadian share in China's OFDI (see chart 2), has been on a roller coaster, ranging from 0.3 percent in 2006 to over 36 percent in 2005, with the latest peak at 19 percent in 2013 when the CNOOC-Nexen deal was closed.

It is obvious that Canada's share in China's OFDI went almost hand in hand with China's appetite for Canada's resources, including "energy" and "metal and materials," which accounted for over 90 percent of annual flows for many years until 2014 (see chart 3), when China's OFDI started diversifying into a broad range of service sectors.

CHART 1: CHINA'S OUTWARD FDI – THE GLOBAL TREND (IN US$ BILLION): 2005-2017

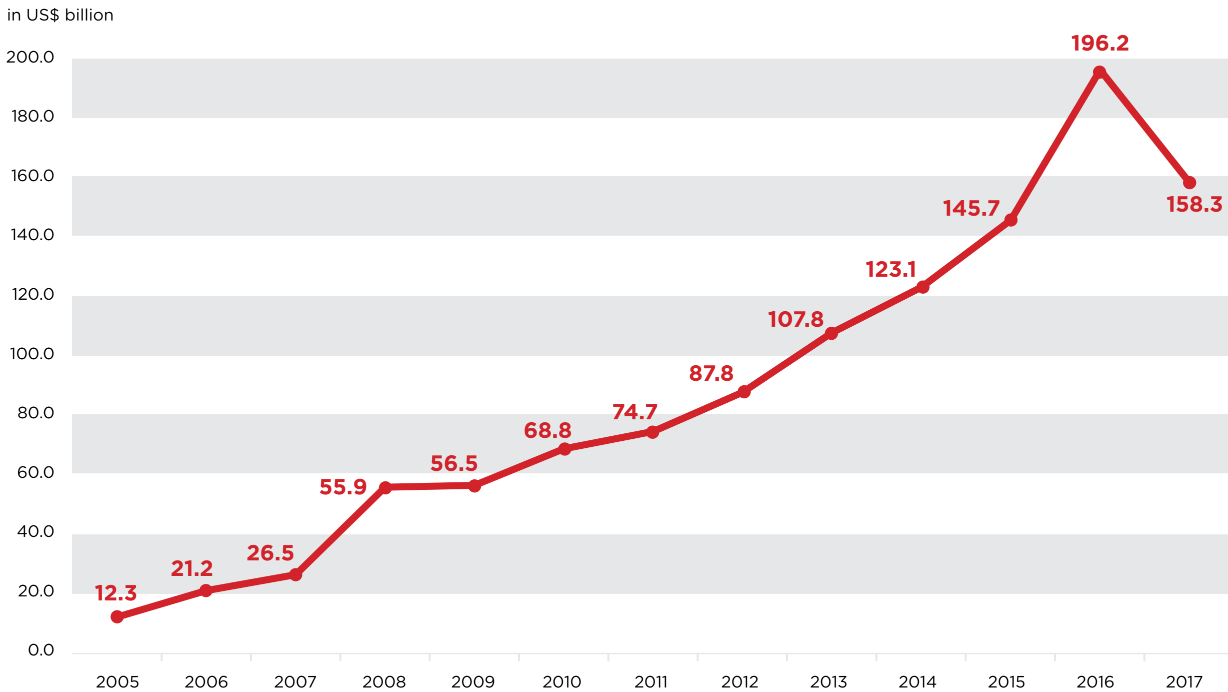


CHART 2: CHINA'S OUTWARD FDI – THE CANADIAN SHARE (IN %): 2005-2017

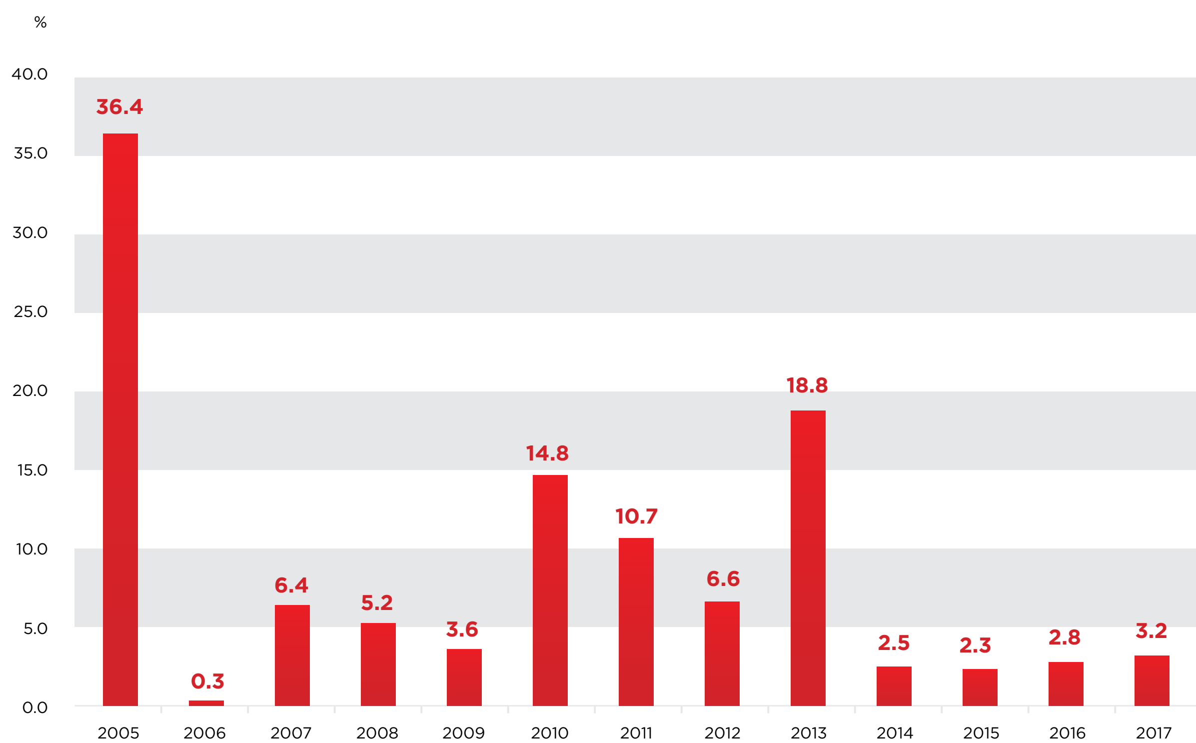
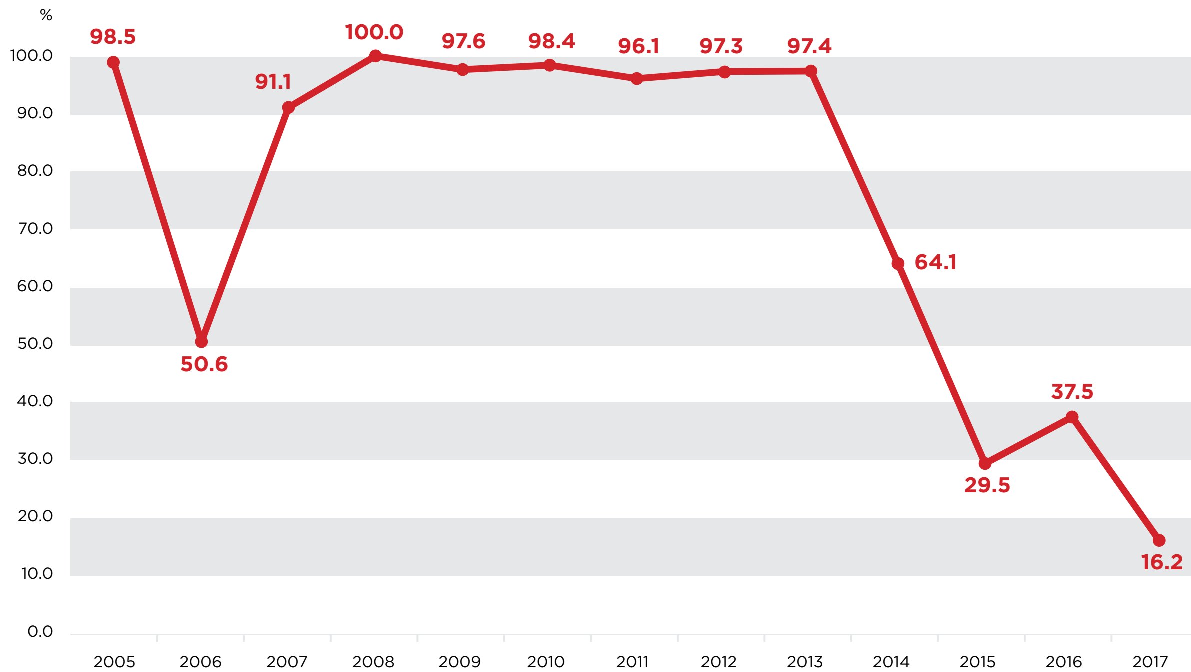


CHART 3: CHINA'S OUTWARD FDI IN CANADA – THE RESOURCE SHARE (IN %): 2005-2017



Sources for charts 1, 2 and 3: Based on Ministry of Commerce, People's Republic of China; National Bureau of Statistics, People's Republic of China; and China-Canada Investment Tracker, China Institute, University of Alberta.

Chart 4 shows that the industrial composition of China's worldwide OFDI has steadily tilted away from the historical highpoint for natural resources in 2013 and towards the manufacturing industry and a broad range of services, which in 2017 included mainly leasing and business services, real estate, data transmission, and IT services (Ministry of Commerce of the People's Republic of China 2017, table 6).

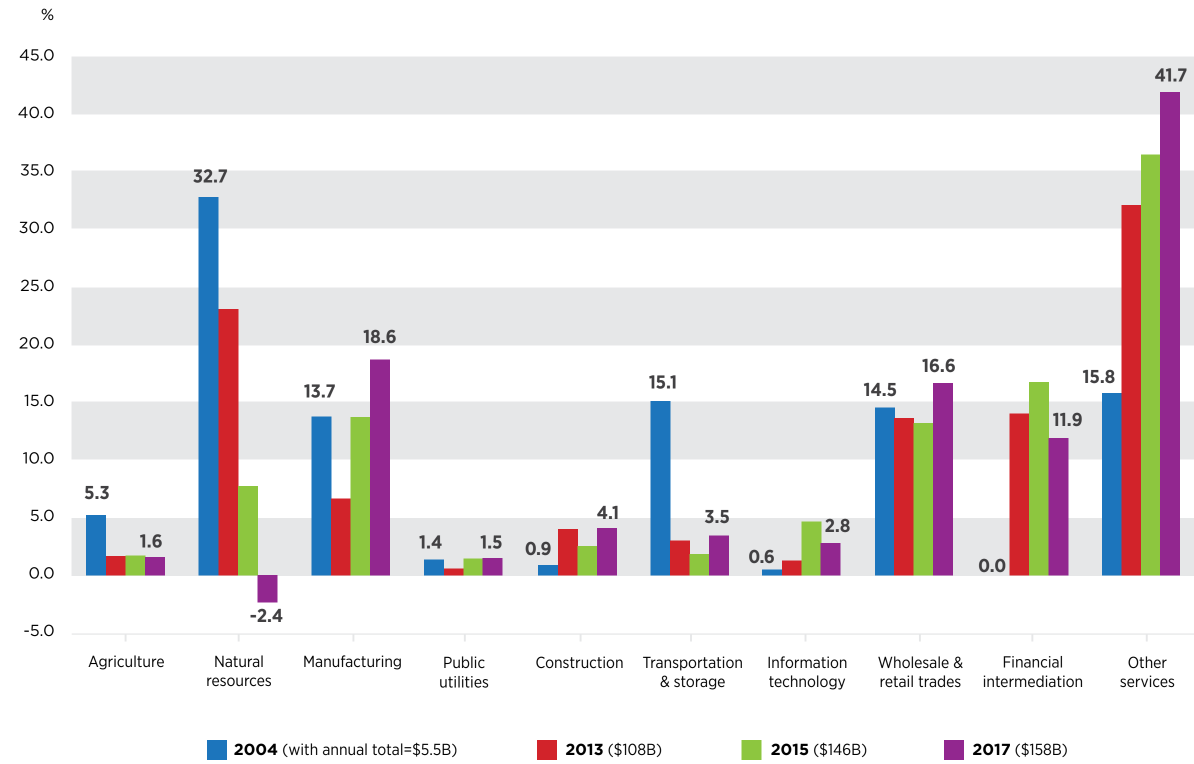
It is interesting to note the negative share for natural resources in 2017, which was a result of China's divesting itself of its failed resource investment projects abroad.

Similarly, China's OFDI in Canada has been diversifying since 2014, with its share in "natural resources" dropping steadily and reaching a new low of 16 percent in 2017 (see chart 3). In contrast, its share in "entertainment and real estate" rose steadily from below 1 percent in 2013 to over 42 percent in 2016. Still, the total share of resource sectors accounted for almost 90 percent of the accumulated Chinese FDI in Canada.[26]

This shift in industrial distribution is a combined result of the Chinese government's change of heart and its cautious loosening up on OFDI, which made it possible for any Chinese company with the financial capacity to pursue market share and better returns abroad in the years up to 2017, when the government tightened its foreign-exchange controls and saw its overall OFDI dwindle (see chart 1).

Charts 5a and 5b show that for the pre-2014 period, SOEs dominated China's OFDI in Canada except for its lean years prior to 2005. The non-SOE share of China's OFDI in Canada

CHART 4: CHINA'S OFDI BY INDUSTRIAL DISTRIBUTION (IN %): 2004 AND 2013-2017



Source: National Bureau of Statistics, People's Republic of China.

* Including hotels and catering services; real estate; leasing and business services; R&D; management of water conservancy and public environmental facilities; services to households and other services; education; health, social security, and social welfare; culture; sports and entertainment; public management; and social organizations.

finally overtook the SOE share in 2014 and has been growing steadily since then. This is the combined result of China's loosening up on its non-SOE's overseas investments and foreign governments increasing their scrutiny of China's SOEs.

But despite their diminished share in recent years, SOEs still account for 73 percent of China's OFDI stock in Canada. Interestingly, the Chinese government reported a bigger share of "state controlled" investors (51.3 percent) in China's 2017 global OFDI as compared with the "non-state controlled" investors (48.7 percent) (Ministry of Commerce of the People's Republic of China 2017, figure 11), which include non-controlling shares of SOEs. Given that by the official Chinese definition, SOEs do not include any "limited liability companies" solely or partially owned by the Chinese government, we should not equate China's "private" investors with nil SOE shares.

In summary, as witnessed over the past two decades, any trend in China's FDI in Canada is part of China's global trend in its OFDI, which has followed, and will always follow, China's national strategy for its global economic positioning. It is therefore fair to state that lifting our restrictions on the entry of China's SOEs to our economy would be akin to letting in China's national strategy to disrupt our free market system.

CHART 5A: CHINA'S ODFI TO CANADA BY INVESTORS' OWNERSHIP (IN %): 1993-2017

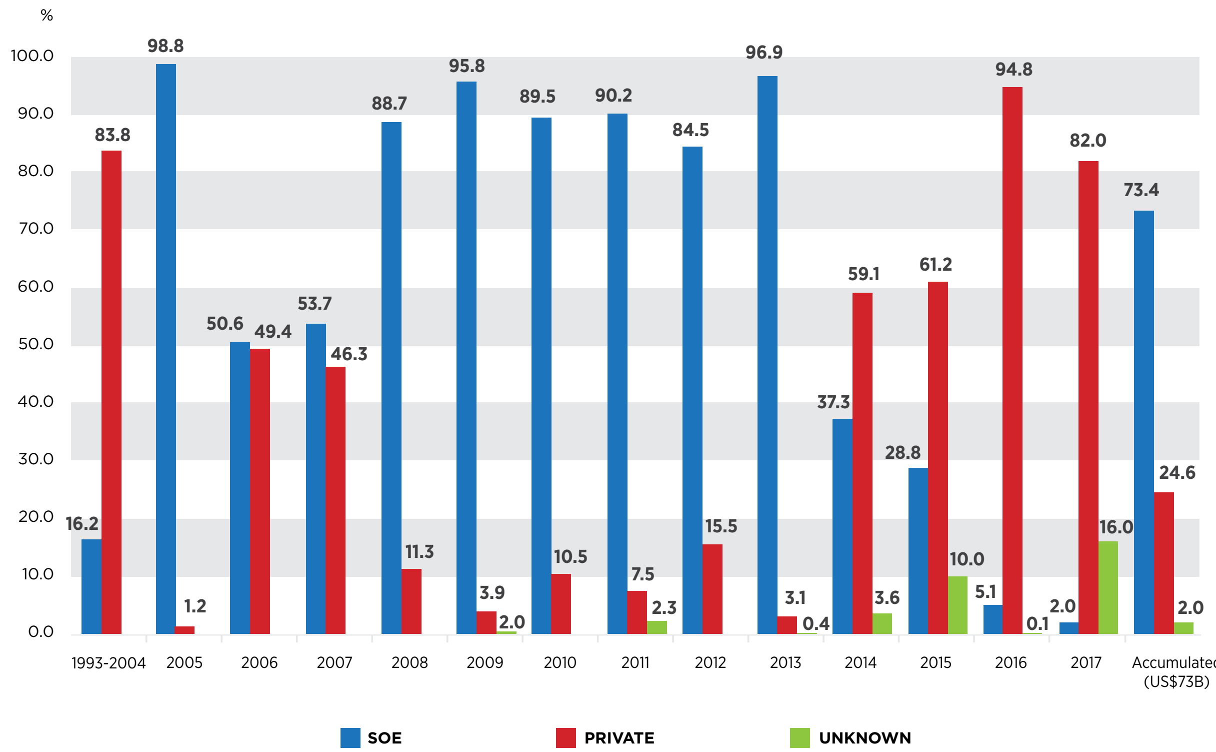
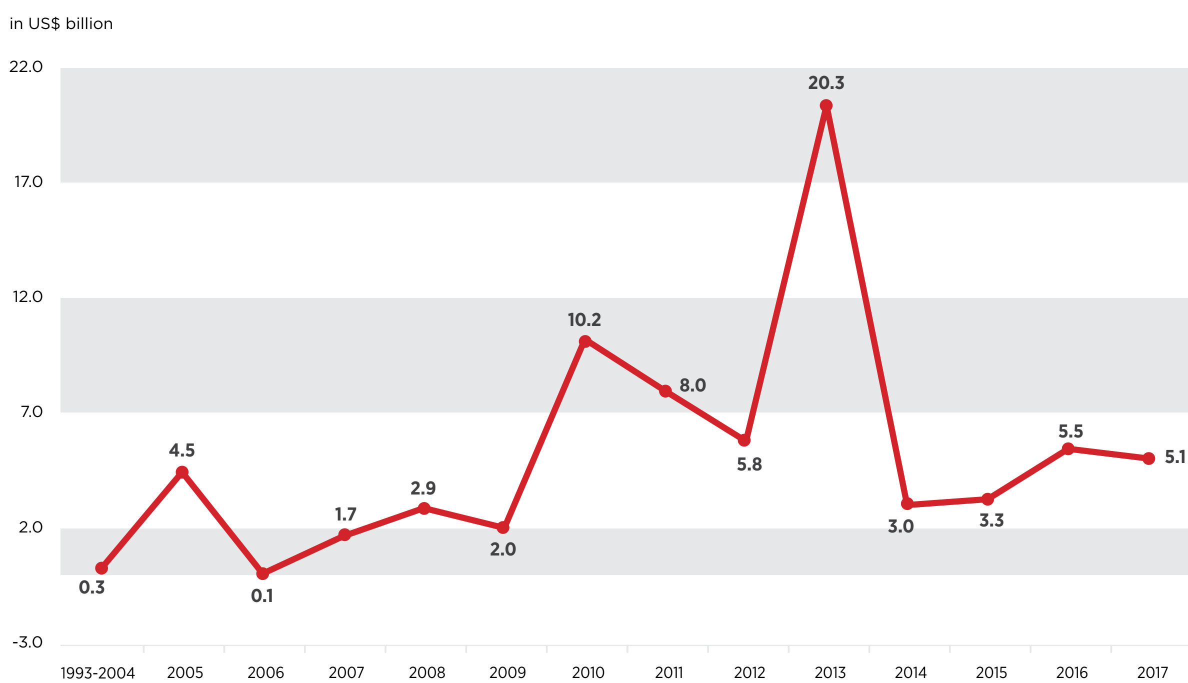


CHART 5B: CHINA'S ODFI TO CANADA – ANNUAL AMOUNT (IN US$ BILLION): 1993-2017



Sources for charts 5a and 5b: Based on China-Canada Investment Tracker, China Institute, University of Alberta.

CCFTA: A cost-benefit debate for Canada

Three observations can be drawn from the above analysis:

First, Canada and China are two contrasting economies following two different sets of trade policies. Canada, being a market economy, has played by the WTO rules diligently, with minimal tariffs and state intervention in trade. On the other hand, China is a command economy that has intentionally violated WTO rules with a full spectrum of state interventions ranging from conventional punitive import tariffs to unconventional tricks to infringe upon foreign technologies. Therefore, striking a level playing field with China would be the first step to develop a mutually beneficial trade relationship with China.

Second, due to China's mercantalist policy towards international trade, Canada has not benefited from China's growth "miracle" in proportion to China's population and economic size. Canada's trade with other free-market economies, particularly the US, provides contrasting outcomes.

And third, China's clear focus on cracking open our door for its SOE investment and Canada's basic desire for fair trade with China are two asymmetrical aims for FTA negotiations. That is, China wants to impose its SOEs, the dominant element of its command economy, on our small open economy, while we only want a fair trade relationship based on price signals given by free market operations.

It is therefore clear that Canada and China are two worlds apart in terms of their economic systems and value systems. Allowing China's SOEs free entry into our economy would damage the fabric of our free market system, and it is a price we should refuse to pay. There is no need to look very far; even without CCFTA, China has already infiltrated our economy and society to the point that its ambassador has dared to threaten us with reprisals if our government bans Huawei from our 5G networks (Fife, Chase, and Curry 2019). Given that Huawei is not yet officially a government agent, do we need any more evidence than this to wake up to China's threat to our national security?

The issues with China as an FTA partner

The sense of urgency in Canada for a CCFTA has been impelled in part by a slew of FTAs that China has signed with other countries over the past decade or so, the most notable of which is the fairly recent one with Australia.

China's earliest bilateral FTA partners are Chile and Pakistan (2006), followed by New Zealand (2008), Singapore (2009), ASEAN (2010), Peru (2010), Costa Rica (2011), Iceland (2014), Switzerland (2014), South Korea (2015), Australia (2015), and Georgia (2018).[27] The earlier FTAs were mostly negotiated through three stages, with each stage for a single-category agreement. The first was for trade in goods, the second for trade in services, and the third for investment. This was the case with ASEAN, Chile, Costa Rica, Singapore, and Pakistan (for Pakistan the first and third stages were combined). For all other countries, negotiations were comprehensive, covering both trade (in goods and services) and investment.[28]

My review of existing FTAs with China reveals a troubling pattern of benefiting China more than its partners. I also found China has been a much shrewder negotiator in getting what it wants from its partners, all of whom have regarded China's non-market system as harmless and therefore "casually" gave China what it wanted at the negotiation table, only to regret it when the harm had already been done – though several have moved to take steps to prevent further damage.

In this section I will first review the common features of China's FTAs[29] and then consider some warning cases. Based on these reviews I will point out the common traps that China's FTAs present to its free-market partners.

The common features of China's FTAs

The common feature of most existing FTAs with China is the pattern of asymmetry in measures taken by China and other parties respectively. Such asymmetric treatments can be found in both tariff reduction for trade in goods and non-measurable treatment of trade in services and investment.

Trade in goods: Unequal tariff commitments

In the majority of its FTAs, China gradually reduces its own import tariffs over a prolonged period of time in exchange for the other party's immediate abolishment of most, if not all, of its non-zero tariff lines.

For example, in China's 2014 FTA with Switzerland, "while Switzerland will dismantle import duties on almost all (99.7%) products originating from China from day one of the entry into force of the FTA, with only very few reservations for agricultural products where tariffs will remain, Chinese import-taxes on most (96.5%) Swiss products will (merely) be reduced gradually within rather long transition periods ranging from 5 up to 15 years." China's justification for these long transition periods was "the generally higher Chinese customs duty on average (medial of 8.7%, compared to 2.4% in Switzerland)" (Brunschweiler and Troller 2014).

It is apparent that China uses its generally higher customs duties as bargaining chips in negotiating its FTA with all developed economies in exchange for their immediate abolishment of the majority of their existing non-zero tariff lines. However, China denies its economically less fortunate partner Pakistan the use of such bargaining chips. In its FTA with Pakistan (Government of Pakistan 2018), a five-year commitment to tariff elimination is applied to both parties despite the fact that Pakistan's average tariff is much higher than China's (for example, an average MFN tariff of 14.3 percent in 2014/15 [WTO 2015b]).

Trade in services: Unequal degrees of openness

For trade in services, most of China's FTAs have followed the WTO's General Agreement on Trade in Services (GATS) in adopting a "positive list" approach, by which FTA parties provide a list of selected services sectors that allow foreign entry. FTA parties also use this "positive list" to specify their restrictions, sector by sector, in four different modes of supply of services, among which only "commercial presence" and "presence of natural persons" are involved in the physical entry of the foreign suppliers of services.

My review shows that China is generally less open as compared with its partners in terms of the number of sectors selected to allow foreign entry and the degree of restrictions on the supply modes of services.

For example, in China's FTA with Iceland (2014), a country among the warmest towards China, Beijing's "positive list" contains fewer sectors for entry than those of Iceland, and its restrictions on "commercial presence" and "presence of natural persons" for Icelanders are tighter than those of Iceland for Chinese. The main issue seems to be that, while Iceland imposes no restrictions on "commercial presence" of Chinese service suppliers in the majority of sectors on Iceland's "positive list," China allows Iceland's commercial presence only in the form of joint ventures with Chinese firms. There are also various restrictions on the percentage of shares Icelandic suppliers may possess in such joint ventures.[30]

More striking still are the asymmetric approaches adopted respectively by China and Australia in their FTA on trade in services. Despite China's "positive list" approach, Australia adopted the more open "negative list" approach, which specifies a limited number of service sectors that disallow China's entry.

Investment: Unequal restrictions on entry

China diligently seeks ensured free entry for its SOEs abroad while keeping its restrictions on foreign entry to its own markets. China pursues such a double standard using both explicit and implicit measures.

China's FTA with Australia provides an example of explicit asymmetrical treatment: while Australia applies national treatment obligations to China on both *market access* and post-establishment investment stages, China does so only to Australia's *established* investments. That is, while Australia treats Chinese investors as its own in all stages of investment, China does not allow Australians equal market entry provided to Chinese investors.

In its FTA with New Zealand, China played a different trick to secure free entry for its SOEs:[31] The "enterprise," as an investor defined in the FTA, "means any entity constituted or otherwise organized under applicable law, whether or not for profit, and whether privately owned or governmentally owned or controlled." This definition is hardly relevant to New Zealand, given that it doesn't have an SOE sector with aims of global expansion. Not to mention that China does not provide New Zealanders a free entry to China, given its numerous regulatory barriers to foreign investors that do not exist in New Zealand (such as China's black list of sectors that bar foreign entry).

Other hidden issues

The unequal value base for levying tariff: Unlike many countries (including Canada) that levy import tariffs using FOB (free-on-board) value, China uses CIF (cost, insurance, and freight) value to levy its import tariffs. China's approach is not unusual but does increase both its tariff revenue and the statistics on the value of its imports. (This latter effect might have contributed to the statistical discrepancy between China and its trading partners regarding their respective trade balances.[32])

State ownership of land: All of China's FTA partners protect private ownership of assets, including land. Yet, in China, land is exclusively state-owned. This fundamental discrepancy in land ownership implicitly motivates Chinese investors to grab land abroad but deters their counterparts from doing the same in China, which must renew their rights for land use within mandated periods of time (40 years for commercial purposes and 50 years for industrial purposes).

There are other opaque measures that may frustrate China's FTA partners such as regulatory measures ranging from safety codes to exchange controls, all subject to the will and whim of Chinese authorities.

Cautionary cases

All FTAs with China are flaunted in China to showcase its global conquests. They are also celebrated by all of China's FTA partner countries for supposedly gaining a better foothold in trade with China than other countries. But the unexpected consequences of these FTAs warrant close examination.

Pakistan: An ever-increasing trade deficit

The Pakistan-China relationship is unique in that both countries see each other as "best friends," a situation that led to Pakistan becoming one of China's earliest FTA partners. But in conjunction with this FTA, Pakistan's trade deficit with China has increased more rapidly in recent years (Iqbal 2018).

According to a 2017 column[33] on *Huanqiu* (an official Chinese media outlet), the second round of negotiations of the China-Pakistan FTA, which was supposed to have been concluded by 2013, was delayed for many years mainly because Pakistan's resentment over this FTA having benefited China more than Pakistan under the "equal" preferential clauses. In particular, given Pakistan's much less developed economy, this FTA caused many labour-intensive industries in Pakistan to shrink due to the influx of cheap, low-end Chinese manufactured goods. By following this FTA, Pakistan's tariff reduction for China reached US$220 million, but China did not reciprocate with similar tariff reductions for Pakistan. As a result of this FTA, Pakistan had run an ever-increasing trade deficit with China, which by 2017 reached an export-to-import ratio of 1:3. (Note that this is the same ratio at which Canada has run a prolonged annual trade deficit with China, as shown earlier.)

New Zealand: China's land grab

In signing its FTA with China in 2008, the government of New Zealand unwittingly allowed free entry for any Chinese firms, SOEs or not. It was also oblivious to the differences in land ownership between the two countries until Chinese land grabs began alarming the government. As early as 2010, many farmers in New Zealand had begun realizing that Chinese purchases of their arable land were unfair because foreign firms were forbidden from doing the same in China (Watts et al. 2010). Five years later the government of New Zealand had to end China's land grabs by blocking the 30th acquisition of farmland in New Zealand by a Chinese SOE. As some opposition politicians at the time had warned, New Zealanders were at risk of becoming "tenants in their own land" (Naidu-Ghelani 2015).

Australia: The loss of national strategic assets

In its FTA with China, Australia granted "national treatment" to Chinese investors at every stage of investment without demanding China to reciprocate. This one-sided open-door policy caused numerous Australian losses of critical infrastructure assets to China. Among these losses the most alarming were the Chinese acquisition of a 99-year lease on Darwin port, which is near a US submarine base (Nicholson 2015), and a significant Chinese share (including some controlling acquisitions) in Australia's power grid (Uhlmann 2016). As pointed out by Professor Clive Hamilton, the penetration of Chinese companies into Australia's energy infrastructure has led to a worrisome consequence: given that half of those who sit on the board of Energy Networks Australia represent two Beijing-controlled or Beijing–linked corporations, "There is nothing about Australia's energy networks and how they will evolve in the future that is not known in Beijing" (Hamilton 2018, 123).

Facing such alarming losses, Australia in 2017 tightened up its scrutiny of foreign investment in its critical infrastructure assets (Smythe 2017). To facilitate such scrutiny, the government established the Critical Infrastructure Centre, which was drawn from various agencies including the Australian Security Intelligence Organisation (ASIO) and the Treasury, and created a register of sensitive assets.[34]

South Korea: Economic coercion

Barely two years after its signing of an FTA with China in 2015, South Korea's decision to install an anti-missile battery (the THAAD system) stirred up large-scale, state-directed coercion from China.

China shrewdly focused its coercion on sectors where it could impose costs on Korean businesses without doing collateral damage to its own. First, China curbed tourism to South Korea, mainly by manipulating group tour packages, which caused a 48 percent annual decline in Chinese tourism to South Korea. Second, China hit the Lotte Group especially hard because the company had provided the land for the THAAD installation. In the wake of this, the Lotte Group was forced to close 87 of its 109 department stores in China for alleged fire code violations (Kim and Jourdan 2017) and had trouble selling the rest of its stores in order to exit the Chinese market. Third, China promoted popular boycotts against Korean exports such as Kia and Hyundai. Fourth and finally, China used other forms of regulatory harassment, including filing trade-related complaints against Korean companies on the flimsiest of pretexts. Overall, Beijing's coercion campaign shaved 0.4 percentage points off South Korea's 2017 economic growth, according to the Bank of Korea (Harrell, Rosenberg, and Saravelle 2018, 46–47).

Lessons to be learned

It is clear that signing an FTA with China does not guarantee many perceived benefits and instead can bring about unexpectedly harmful consequences. The common pitfall for any current or prospective parties in concluding FTAs with China is seeing China as a benign regime that is law-abiding and hence trustworthy. This has led, and can still lead to, unequal deals that benefit China more than its FTA partners.

That such a trap actually works is due in part to China's current and prospective FTA partners being either naïve, or greedy, or both. The naïveté is the unwillingness to understand the authoritarian nature of the Chinese government: a regime not governed by law domestically cannot be trusted to follow laws and rules internationally. The greed is the inability to bear the thought of being left behind from the "gold rush" into China's vast market. As a result, many parties eager to sign an FTA with China are also willing to apply a double standard in dealing with China.

First, they have long believed in zero government intervention in their own business operations but do not mind Chinese SOEs taking over their properties.

Second, they demand absolute transparency in their own government, even when national security is in stake, but are oblivious about the opaque dealings between Chinese firms and their own government.

And finally, they want their markets to be unconditionally open to all Chinese investors driven by China's national strategy, but they do not care how tightly China guards its own market.

Haste and credulity define the manner in which many FTAs with China have been conducted, and through these FTAs some of the freest economies in the world have been trapped and tricked into benefitting China more than themselves.

Conclusion

Free trade is not about empty rhetoric for show but a simple concept – zero state intervention in trade – that can be measured by deed. A free trade agreement is a contract between trading partners that sets rules for fair play and mutual benefits. Given the Chinese government's command power over its economy, which means all state interventions are regarded as legitimate, and also given its persistent violations of the WTO rules and underhanded actions against the interest of its existing FTA partners, we here in Canada should not rush headlong into FTA negotiations with China.

Instead, our government should conduct a rigorous cost-benefit analysis that is based neither superficially on our need for economic growth, which is inherently critical, nor on the Chinese market potential, which is plainly obvious for all to see. Instead, such a cost-benefit study should focus on the feasibility of the larger share we desire in, and freer entry into, the Chinese market *within a bilateral context: Is it possible, and if so what is the price we would have to pay?*

If our government does conduct a cost-benefit-feasibility study, it needs to answer some important questions. For example, what does the term *reciprocity* mean when China does not share our belief in the free market economy? Questions abound around the first and foremost pillar of our free market system: private property rights. Should we allow Chinese SOEs to enter our market while we have nothing reciprocal to request from them? Should we allow Chinese investors to buy our land when both they and we are not allowed to own land in China? Would the Chinese government protect our business properties in their country the way we do theirs, particularly when our government's future actions in defending our beliefs or safeguarding our national security could "hurt their feelings"? And so on.

In any proposed CCFTA, let us dispense with empty rhetoric and get serious about practical consequences. If in the name of its national interest China can blatantly violate WTO rules with an all-out industry policy including outright theft of foreign IP, we should then be able to slow down this entire CCFTA matter for the sake of our national security. If negotiating an FTA with Xi Jinping's China becomes so pressing and irresistible to our government, the best response would be to take one very careful at a time. How about starting off with negotiations on merchandise trade only, in order to bring down China's formidable tariff wall first and pre-empt its economic coercive tactics?

About the Author

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Endnotes

1 For a full set of arguments in favour of trade diversification centred on China, refer to the Public Policy Forum's 2018 report, *Diversification Not Dependence: A Made-in-Canada China Strategy,* a product of 18 months of labour that started in early 2017.

2 *The MIT Dictionary of Modern Economics*, Fourth Edition, s.v. "free trade".

3 This term is borrowed from Daniel J. Ikenson, Simon Lester, and Daniel Hannan, 2018, *The Ideal U.S.-U.K. Free Trade Agreement: A Free Trader's Perspective*.

4 The most important of these chapters cover competition policy (chapter 17), SOEs (chapter 17), intellectual property (chapter 18), labour (chapter 19), environment (chapter 20), competitiveness (chapter 22), regulatory coherence (chapter 25), transparency and anti-corruption (chapter 26), administrative and institutional provisions (chapter 27), and dispute resolution (chapter 28).

5 Note that China's ranking would be much lower if WEF's ETI did not include "infrastructure" facilitating the flow of goods, whereas China scored higher than Canada, particularly in "available airline seat kilometers" and the "online shipping connectivity index," both of which are irrelevant to my discussion of free trade and FTAs.

6 According to Statistics Canada (2019a), Canada has consistently run an FDI surplus since 1997.

7 According to the Canadian Trade Commissioner Service (2018), China's average tariff was 9.3 percent in 2017.

8 For example, according to the *Wall Street Journal*, "New vehicles currently need to get government approval before being mass-produced and undergo a mandatory technology audit that usually lasts several days. . . . An audit last year convinced an employee at one foreign auto maker that there was 'clear evidence of collusion' between the audit team and Chinese companies . . . When the audit began, the person said, inspectors asked for the blueprints of the electric-vehicle components that the foreign company was trying to protect from its Chinese JV partner" (Mauldin and Cameron 2019).

9 For a cross-check, refer to Office of the United States Trade Representative, 2018, "Update Concerning China's Acts, Policies and Practices Related to Technology Transfer, Intellectual Property, and Innovation."

10 For the latest case, see the news release by the US Department of Justice, 21 December 2018, "Chinese National Charged with Committing Theft of Trade Secrets."

11 For the latest case, see the news release by the US Department of Justice, 1 November 2018, "PRC State-Owned Company, Taiwan Company, and Three Individuals Charged with Economic Espionage."

12 For the latest charge against Chinese military hackers by the US Department of Justice, refer to the DOJ news release dated 20 December 2018: "Two Chinese Hackers Associated With the Ministry of State Security Charged with Global Computer Intrusion Campaigns Targeting Intellectual Property and Confidential Business Information."

13 For the most telling story, refer to Liana B. Baker, 2017, "Trump Bars Chinese-backed Firm from Buying U.S. Chipmaker Lattice," *Reuters*, September 13.

14 On Chinese telecom giant Huawei's funding of Canadian universities, see Sean Silcoff et al., 2018, "How Canadian Money and Research Are Helping China Become a Global Telecom Superpower," *Globe and Mail*.

15 For reports providing such estimates, refer to the Commission on the Theft of American Intellectual Property, 2019, *IP Commission 2019 Review*.

16 It was shocking to hear the Chinese ambassador Lu Shaye characterize Canada's decision to detain Huawei's CFO at the request of the US government as "backstabbing," meaning that Canada in his eye should be a better friend of China's than America's (Fife, Chase, and Curry 2019).

17 For a full display of such sentiment, refer again to the Public Policy Forum's 2018 report, *Diversification Not Dependence: A Made-in-Canada China Strategy.* (See footnote 2.)

18 Along with the many think tanks in America, the two US government bodies that lead this trade policy discourse are the US-China Economic and Security Commission created by Congress and the Office of the United States Trade Representative.

19 Those interested in the discrepancy between Chinese and Canadian official statistics on trade may refer to the China-Canada Joint Working Group on Trade Statistics Reconciliation, 2018, "Latest Developments in the Canadian Economic Accounts Comparing Canada's and China's Bilateral Trade Data."

20 Author's estimate based on Trade Data Online, www.ic.gc.ca

21 For example, China's import duty for foreign-made automobiles had been over 25 percent before being cutting down to 15 percent for all except those imported from America, in retaliation for Trump's trade war with China.

22 Moreover, there is also a hidden cost for exports to China. According to The Canadian Trade Commissioner Service (2018), Chinese tariffs "are assessed on the transaction value of the goods, including packing charges, freight, insurance premiums and other service charges incurred prior to the unloading of the goods at the place of destination." That is, Chinese tariffs are based on CIF (cost, insurance, and freight). In contrast, our Canadian tariffs are based on "free on board" (FOB) prices that exclude transportation and insurance costs incurred by the loading (exporting) port in China to the unloading (importing) port in Canada (Customs Act (R.S.C., 1985, c. 1)).

23 For Chinese FDI to Canada, refer to Ministry of Commerce of the People's Republic of China, 2017, *China's Outward Foreign Investment Report.* For Canadian investment in China, refer to Ministry of Commerce of the People's Republic of China, 2018, *Report on Foreign Investment in China*.

24 There is such a wide gap in bilateral FDI statistics between Chinese and Canadian official sources that I do not rely with confidence on either for my analysis in this paper. Aside from the methodological discrepancy, this problem seems at least partly associated with a grey area in identifying "foreign" sources and destinations concerning China's FDI statistics. For example, Hong Kong was both China's largest investor (73 percent in 2017, followed by Singapore with 4 percent) and recipient (58 percent, followed by the British Virgin Islands with 12 percent), which

indicates that a lot of "foreign" funds recycling through Hong Kong are hard to disentangle by any official standards.

25 As noted below each of my charts in this section, one of my main data sources is the "China-Canada Investment Tracker" produced by the China Institute (2019) at the University of Alberta. As stated on its website, this China-Canada Investment Tracker "provides a bottom-up perspective on investment flows from China to Canada, as an alternative to the survey-based official statistics in both China and Canada." More valuable to my analysis is that this dataset "tracks investment transactions back to the ultimate Chinese parent companies, which made the investments, rather than counting only the investment flow directly from China. Therefore, it "better captures those investments that originate in China but which are routed through Hong Kong, Europe, and other regions before flowing into Canada."

26 These estimates are based on the China-Canada Investment Tracker (China Institute 2019).

27 To avoid being sidetracked, I will ignore any Chinese FTAs with Hong Kong (2003), Macau (2003), and Taiwan (2010).

28 Refer to China One-Stop Business Service Platform, 2016, "An Overview of China's current FTA: Signed and under negotiation." On the China-Georgia FTA, see Thea Morrison, 2018, "Georgia-China Free Trade Deal Comes into Effect," *Georgia Today*, January 8.

29 All official documents in both English and Chinese can be found on the website of China's Ministry of Commerce: http://fta.mofcom.gov.cn/pakistan/pakistan_agreementText.shtml.

30 See the Annex VII referred to in Paragraph 3 of Article 84 in the Free Trade Agreement between the Government of the People's Republic of China and the Government of Iceland.

31 Refer to Chapter 11, "Investment" in the Free Trade Agreement between the Government of the People's Republic of China and the Government of New Zealand.

32 For example, both China and Switzerland seemed to have run a trade deficit with each other in 2017 based on their respective customs data, as shown by the Sino-Swiss Competence Centre (2018, 13–14).

33 This article can be found at the following hyperlink as of March 2019: http://opinion.huanqiu.com/opinion_world/2017-08/11138645.html.

34 These sensitive assets include airports, ports, telecommunications infrastructure, nuclear facilities, infrastructure for public transport, electricity, gas, water, and sewage systems, as well as certain roads, railways, and inter-modal transfer facilities.

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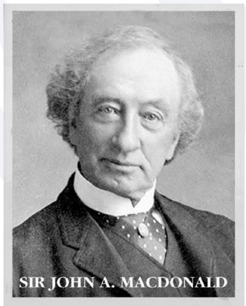

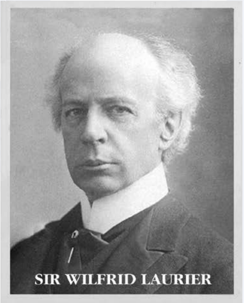

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The Macdonald-Laurier Institute is an important source of fact and opinion for so many, including me. Everything they tackle is accomplished in great depth and furthers the public policy debate in Canada. Happy Anniversary, this is but the beginning.

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In its mere five years of existence, the Macdonald-Laurier Institute, under the erudite Brian Lee Crowley's vibrant leadership, has, through its various publications and public events, forged a reputation for brilliance and originality in areas of vital concern to Canadians: from all aspects of the economy to health care reform, aboriginal affairs, justice, and national security.

BARBARA KAY, NATIONAL POST COLUMNIST

Intelligent and informed debate contributes to a stronger, healthier and more competitive Canadian society. In five short years the Macdonald-Laurier Institute has emerged as a significant and respected voice in the shaping of public policy. On a wide range of issues important to our country's future, Brian Lee Crowley and his team are making a difference.

JOHN MANLEY, CEO COUNCIL