

COUNTERING CHINA'S ECONOMIC COERCION

**No fear but resolve,
no illusion but
diversification**



Duanjie Chen

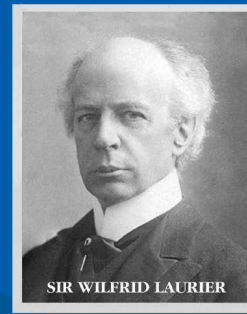
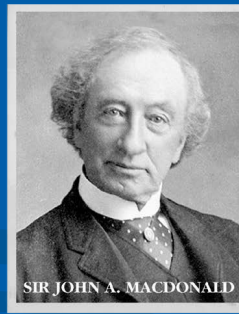
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Table of contents

Executive Summary	4
Sommaire	6
Introduction	9
China’s Economic Coercion around the Globe	11
The Bottom-Line Cost of China's Economic Coercion	16
Options for Countering China’s Coercion	22
Conclusion	25
About the Author.....	26
References.....	27
Endnotes.....	33

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Executive Summary

China recently moved to ban key Canadian agriproducts, including canola, soybeans, and pork. These moves against Canadian agriproducts are closely tied to the growing tensions between the two countries that began in December 2018 when Canadian authorities arrested Huawei executive Meng Wanzhou in Vancouver, following an extradition request from the United States.

Canadians need to reject the view that the arrest of Meng caused a historical turn in Canada's otherwise highly positive relationship with China. To the contrary, Canada's bilateral relationship has long operated under the shadow of Chinese bullying. Meng's detention drew much-needed attention to the abnormality of our existing relationship with China. Were Canada

to heed calls from retired politicians who have recommended returning Meng as a means to de-escalate the situation with Beijing, such action would represent a wholesale capitulation to China.

Canadians must also reject the view that China has all the economic power and Canada has none.

Canadians must also reject the view that China has all the economic power and Canada has none. Some Canadian observers have been quick to point out the disparity in power between Canada and China, commenting that “we need China – and China doesn't need us” or that we were only “a flea sitting on China's shoulder.” The suggestion is that there's little the Canadian government can or should do in response to Chinese economic coercion.

This paper demonstrates that nothing is further from the truth. Canada has some significant advantages and China is taking some serious risks.

It is important to remember that the majority of our exports to China are commodities for which the supply is constrained by natural resources that are either scarce or rapidly depleting in China. Meanwhile, all our imports from China are manufactured goods that are easily replaceable from suppliers in other markets, despite possibly higher prices. Indeed, cultivating more reliable suppliers for such goods will benefit Canada economically in the long run.

In its dealings with China, the Canadian government has much to learn from other governments. The Philippines, Mongolia, France, Norway, South Korea, Japan and Taiwan have all suffered from Chinese economic coercion. Each has dealt with the threat differently.

The Philippines and Mongolia have capitulated while France and Norway have modified their behaviour to appease China. South Korea largely refused to appease China, and at least one of its large investors is seeking to leave China entirely (with others possibly following suit). Japan also took the important step of diversifying its rare earth supplies following a Chinese ban in 2010. Among all the coerced, Taiwan is the most vulnerable due to both its international isolation and its close economic ties with China. Even so, Taiwan has shown remarkable resilience

and made conscious efforts to boost trade and investment with other countries to reduce its economic dependence on the mainland.

The long-term prospects for our farmers facing China's ban on our agriproducts do not seem as dire. For example, even with the ban on canola, Canadian canola area planted is expected to climb, canola seed exports will be still higher than in the past, and canola oil production will increase over the longer term. However, as detailed in the recommendations, they deserve support from the government in the near term due to political disruptions beyond their control.

The canola story reflects general global trends for other commodities dependent upon natural resources, particularly edible ones – specifically, that global markets for our agriproducts and other natural resources have been generally stable. China's bans of Canadian agriproducts will not change the *global* demand for those products, but only cause a disruptive shuffle between buyers and sellers. Indeed, China's disruptive play will only cause growing distrust among its trading partners, which in turn will adversely affect China's long-term security in food supply.

A Chinese ban on all our agriproducts would total about \$10 billion for the coming year – and that potential loss would increase to \$16.4 billion if China ever decides to bar its tourists from Canada and recall its students studying in Canada. That is not a likely outcome, but it does show the limits of China's ability to apply economic coercion against Canada.

Finally, the Chinese economic juggernaut is showing signs of wear, at least in part due to its use of industrial policies in an attempt to remold the international order to its liking, and also its willingness to undermine private wealth in order to pursue speedy GDP growth. It is suffering from severe shortages of arable land, persistent income disparity, an aging population and a growing popular desire for the benefits of foreign competition. Importantly for Canada, its need for agriproducts imports will only continue to grow.

So, Canada is not in such a weak position as we had believed. We have options in countering China's economic coercion. What can we do?:

- Ban Huawei from any involvement in Canada's 5G wireless network, given that it poses a direct threat to our national security.
- Expand existing insurance programs to help Canadian farmers cope with China's economic coercion, with some of the funds potentially coming from the diversion of our capital share in the China-led Asian Infrastructure Investment Bank (AIIB).
- Register and scrutinize all the R&D funding sources from China and sever the ones that aim to steal our intellectual property.
- Withdraw Canada's membership from the AIIB, which serves as an important institutional representation of China's global power.

With its growing economic size, China believes it can act at will against any country. Yielding to China's coercion, economic or otherwise, will only embolden it. It is time for Canada to learn from the like-minded jurisdictions that have been standing up to China's economic coercion.

This is not to suggest that Canada take a blindly confrontational approach towards China, but rather, to act upon our conviction that we do not want any country to behave the way China currently does towards Canada. What we want from China is for it to behave like an equal member of the international community, which is how we see ourselves and how we treat the United States. The world will be a better place when China sees itself as an equal member of the international community and respects international norms.

Sommaire

La Chine a récemment décidé de cesser toutes ses principales importations de produits agroalimentaires canadiens, notamment le canola, le soja et le porc. Cette mesure est étroitement liée aux tensions croissantes entre les deux pays résultant de l'arrestation à Vancouver, en décembre 2018, de la dirigeante de la société Huawei, Meng Wanzhou, à la suite d'une demande d'extradition adressée aux autorités canadiennes par les États-Unis.

Les Canadiens doivent écarter l'idée que l'arrestation de Meng représente un précédent historique dans les relations jusque-là harmonieuses du Canada avec la Chine. Au contraire, les relations bilatérales entre les deux pays souffrent depuis longtemps de l'intimidation chinoise, et la détention de Meng a enfin attiré l'attention sur cette situation anormale. Les appels de

certaines politiciens à la retraite en faveur de la libération de Meng pour désamorcer la situation à Beijing auraient représenté, s'ils avaient été exaucés, une capitulation sans condition pour le Canada.

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Les Canadiens doivent également écarter l'idée que la puissance économique mondiale est concentrée entre les mains de la Chine et que le Canada en est exclu. Certains observateurs canadiens se sont empressés de souligner l'inégalité des pouvoirs entre le Canada et la Chine, arguant que le Canada « a besoin de la Chine » et que la Chine n'a pas besoin du Canada » ou que le Canada est assis « sur l'épaule d'un géant ». Cela laissait supposer que le gouvernement canadien avait bien peu de poids ou ne pesait rien du tout face à la coercition économique chinoise.

Cet article démontre que rien n'est plus éloigné de la vérité. Le Canada présente de sérieux avantages, ce qui fait que la Chine risque beaucoup.

Il est important de rappeler que les importations de la Chine en provenance du Canada se composent surtout de produits dont l'offre est limitée en raison de la rareté ou de l'épuisement rapide des ressources naturelles chinoises. En revanche, toutes les exportations chinoises sont constituées de produits manufacturés pouvant être facilement approvisionnés sur d'autres marchés, même si ces derniers commanderont probablement des prix plus élevés. Ce qui est certain, c'est que, pour le Canada, le recours à de nouveaux fournisseurs offrira des sources d'approvisionnement plus fiables, donc économiquement bénéfiques à long terme.

Dans ses relations avec la Chine, le gouvernement canadien a beaucoup à apprendre des autres gouvernements. Les Philippines, la Mongolie, la France, la Norvège, la Corée du Sud, le

Japon et Taïwan ont tous souffert de la coercition économique chinoise. Chacun a affronté l'intimidation différemment.

Les Philippines et la Mongolie ont capitulé, tandis que la France et la Norvège ont adapté leur conduite de manière à apaiser la Chine. En revanche, la Corée du Sud lui a tenu tête et au moins un de ses grands investisseurs cherche à quitter tout à fait le territoire chinois (d'autres pourraient éventuellement emboîter le pas). Le Japon a également pris ses distances en diversifiant ses approvisionnements en terres rares à la suite d'une interdiction chinoise en 2010. Parmi tous les pays contraints par la Chine, Taïwan demeure le plus vulnérable en raison de son isolement international et de ses liens économiques étroits avec ce pays. Malgré tout, Taïwan a fait preuve d'une résilience remarquable et a consenti des efforts délibérés pour stimuler le commerce et les investissements avec d'autres pays afin de réduire sa dépendance économique à l'égard du continent.

Les perspectives concernant l'avenir à long terme des agriculteurs canadiens exposés à l'interdiction semblent moins graves. Par exemple, malgré le boycott chinois de canola, la superficieensemencée devrait augmenter au pays, les exportations de semences continueront d'être plus élevées que dans le passé et la production d'huile de canola s'accroîtra à long terme. Toutefois, comme l'indique la recommandation, les agriculteurs doivent obtenir l'aide à court terme du gouvernement en raison de perturbations politiques indépendantes de leur volonté.

L'évolution du canola traduit les tendances générales mondiales pour d'autres produits qui dépendent des ressources naturelles, en particulier les produits comestibles – les marchés mondiaux pour les produits agroalimentaires et d'autres ressources naturelles du Canada, notamment, ont généralement été stables. Les interdictions imposées par la Chine à l'encontre des produits agroalimentaires canadiens ne modifieront pas la demande *mondiale* pour ces produits, mais perturberont les interconnexions entre acheteurs et vendeurs. En effet, le jeu déstabilisant de la Chine ne fera que créer une méfiance croissante parmi ses partenaires commerciaux, méfiance qui aura à son tour des incidences sur la sécurité à long terme de la Chine en matière d'approvisionnement alimentaire.

Une interdiction chinoise sur tous les produits agroalimentaires canadiens signifierait environ 10 milliards de dollars en moins dans les coffres au cours de l'année à venir – et cette perte potentielle augmenterait à 16,4 milliards de dollars si la Chine décidait d'interdire à ses touristes de visiter le Canada et à ses ressortissants d'étudier au pays. Ce scénario est plutôt improbable, mais il montre les limites de la capacité chinoise à imposer des sanctions sur l'économie du Canada.

Enfin, l'irrépressible croissance économique de la Chine a commencé à se fissurer, du moins en partie parce qu'elle adopte des politiques industrielles qui visent à modeler l'ordre international selon ses propres désirs, mais aussi en raison de sa volonté de brider la richesse privée pour assurer la croissance rapide de son PIB. Ainsi, la Chine est frappée par de graves pénuries de terres arables, génère des inégalités de revenus persistantes, voit sa population vieillir rapidement et fait face à la montée du désir collectif de mieux tirer parti des avantages de la concurrence étrangère. Fait intéressant pour le Canada, ses besoins en importations de produits agricoles ne pourront que croître.

Le Canada n'est donc pas dans une position aussi faible qu'il y paraît. Il dispose des moyens lui permettant de contrer la coercition économique de la Chine. Que peut-il faire?

- Interdire à la société Huawei l'accès au réseau sans fil 5G du Canada, dans la mesure où elle constitue une menace directe pour la sécurité nationale du Canada.
- Élargir les programmes d'assurance existants pour aider les agriculteurs canadiens à faire face à la coercition économique chinoise, entre autres à partir des fonds canadiens investis dans la Banque asiatique d'investissement dans les infrastructures (BAII), qui est dirigée par la Chine.
- Revoir toutes les sources de financement en R et D de la Chine et écarter celles qui visent à s'emparer impunément de la propriété intellectuelle canadienne.
- Retirer l'adhésion du Canada à la BAII, symbole important de la puissance mondiale chinoise.

En raison de sa taille économique croissante, la Chine pense pouvoir agir à sa guise à l'égard de n'importe quel pays. Céder à la contrainte chinoise, qu'elle soit économique ou autre, ne fera que l'encourager. Il est temps que le Canada tire les leçons des pays aux vues similaires qui ont su résister à l'agression économique chinoise.

Cela ne veut pas dire que le Canada doit adopter une approche de confrontation; il devrait plutôt intervenir en affichant sa conviction qu'aucun pays ne doit se comporter comme le fait la Chine envers le Canada. Ce que le Canada attend de la Chine, c'est qu'elle se comporte comme un membre à part entière de la communauté internationale, tel que nous nous percevons nous-mêmes et tel que nous traitons les États-Unis. Le monde sera meilleur lorsque la Chine se considérera comme un partenaire de la communauté internationale et respectera les normes de cette communauté.

Introduction

China recently moved to ban key Canadian agriproducts, including canola, soybeans, and pork. This amounts to a form of economic coercion. The intent is to inflict pain on Canadian farmers; it is not just a financial loss for this important economic sector, but also damages the sector's reputation and capacity for future planning. Canada's federal government has faced a steep learning curve in dealing with this issue. Initially, Ottawa believed it could deal with China's "health concerns" over our products through ordinary bureaucratic channels. When that strategy clearly did not work, the government began helping our farmers financially and broadening our export horizons beyond China.

China's moves against Canadian agriproducts are not an isolated occurrence. Indeed, they are closely tied to the growing tensions between the two countries that began in December 2018 when Canadian authorities arrested Huawei executive Meng Wanzhou in Vancouver, following an extradition request from the United States. Beijing's response to that action has been particularly aggressive, ranging from the arbitrary and unlawful arrests of Canadians Michael Kovrig and Michael Spavor to the resentencing of alleged Canadian drug smuggler Robert Schellenberg from prison to execution (Burton 2019). With its ban on Canadian agriproducts, China is increasing its economic coercion to pressure Canada into releasing Meng Wanzhou.

China's moves against Canadian agriproducts are not an isolated occurrence.

Clearly, Ottawa should focus its diplomatic efforts on raising global awareness of Beijing's "hostage diplomacy"¹ and call upon its allies to help secure the release of both Spavor and Kovrig. What has befallen these two Canadians today can happen to the citizens of any other country if their governments' law-abiding actions unexpectedly agitate China. As a result, Canada should expose China's unlawful actions against these Canadians as much as possible.

Closer to home, Canada needs to better understand the current Sino-Canadian dispute and overcome an unwarranted fear of China's ban on our agriproducts.

On the first point, Canadians need to reject the view that the arrest of Huawei's Meng Wenzhou caused a historical turn in Canada's otherwise highly positive relationship with China. This assertion is utterly out of step with reality. Canada's bilateral relationship has long operated under the shadow of Chinese bullying as evidenced by the thuggish style of the former Chinese ambassador Lu Shaye during his two-year tenure in Canada (Elmer 2019). Further, China has co-opted a number of people from a wide range of disciplines in Canada, as meticulously documented by Jonathan Manthorpe (2019). Simply put, Meng's detention drew much-needed attention to the abnormality of our existing bilateral relationship with China. Recent reports² that retired Canadian politicians have recommended returning Meng as a means to de-escalate the situation with Beijing are a wake-up call—such an action would represent a wholesale capitulation to China.

We also must contend with the unwarranted fear that we have no leverage with China because of the latter's economic size. China's ban on our canola was a shock and initially caused some panic particularly among farmers. Some Canadian commentators were quick to point out that "We need China – and China doesn't need us" (Pitman 2019) or that we were only "a flea sitting on China's shoulder" (Hutchins 2019). While perhaps well intentioned, those commentators were wrong to look only at the disparity in the size of the GDP of the two countries. What is at issue here is not economic size, but China's use of economic coercion. A good counter-example is our relationship with the United States. Canada has often spoken up in frustration – and even anger – over trade disputes with Washington, despite the fact that America's economic size is still larger than China's and we rely heavily on the US as our closest trading partner.

This paper aims to accomplish three things: take lessons from the recent history of China's use of economic coercion against other jurisdictions, estimate the ultimate financial cost of China's economic coercion against Canada, and examine the options Canada has at its disposal, taking into consideration our convictions and willingness to take action. We must better understand

We must better understand the risks of pursuing further trade ties with China.

the risks of pursuing further trade ties with China, stop fearing further Chinese retaliation (which is beyond our control anyway), and recognize that the fungibility in our agriproduct exports gives us significant leeway in finding other markets around the globe. Indeed, Canada should be taking every measure available to diversify our trade beyond China. Taiwan has been vigilantly doing so for years, and Canadians should take note of its efforts to achieve greater resilience against China's economic coercion (Fontaine 2017). Such trade diversification should be part of Canada's long-term strategy in the Indo-Pacific region.

In addition to pursuing trade diversification with partners who are more reliable and trustworthy than China, Canada should also be pursuing other measures, including banning Huawei from building our 5G network for the sake of our national security,

expanding existing agricultural insurance programs to cover the unpredictable political risks that China poses, registering foreign funding sources for Canadian R&D activities in order to root out those that intend to steal our government-funded research successes, and withdrawing our membership in the China-led Asian Infrastructure Investment Bank (AIIB) – or at least divert our AIIB capital to a better use (e.g., help our farmers). Doing nothing but waiting for Xi Jinping's mercy is not an option; rather, it is a failure that has invited, and would keep inviting, more trouble for our country. It is high time we placed our national interests above those of any interest groups, regardless of their social status or lobbying power.

China's Economic Coercion around the Globe: Triggers, Patterns, and Outcomes

China has applied economic coercion against a number of countries,³ none of which had ever done anything beyond standing by their own values and defending their national security. Canada and the rest of the world often treat such episodes as passing news due to the ubiquitous desire among Western countries to gain a bigger share of the Chinese market. But the Canadian chapter in this playbook has revealed the extent to which international norms have been repeatedly violated by China's coercive tactics. Oddly enough, democracies seem to be particularly vulnerable to Chinese coercion, partly because the constituencies hit hardest by China's calculated coercion can be the loudest and most insistent on "forcing" their own governments to yield to China's demands.⁴

China's economic coercion: The triggers and an illustrative list

According to Jeffrey Dundon (2014), China's use of economic coercion is triggered by a number of factors that pertain to China's territorial integrity and sovereignty (e.g., disputes over the South China Sea and East China Sea), regime legitimacy (e.g., official respect for Tibet's spiritual leader the Dalai Lama and state dealings with Taiwan), and "the status quo," which I reworded as "Chinese norms."⁵ Among these three categorized triggers, "Chinese norms" are the least clear-cut and hence the most challenging to the international community due to their unpredictable deviation from international norms centred on the rule of law.

Below is an illustrative list of recent episodes of Chinese economic coercion, categorized according to the aforementioned three triggers.

Trigger 1: Territorial integrity and sovereignty

2010: Tensions over the Japanese-controlled Senkaku Islands (also claimed by China and referred to as the Diaoyu) triggered an "administrative halt" on exports to Japan of a rare earth element (REE) crucial to the manufacture of high-value products such as hybrid cars, wind turbines, and guided missiles. Of note, China's action was not a formal ban, which would be readily challengeable at the World Trade Organization (WTO). Despite not having received any notice from China regarding the suspension, the Japanese government had to ask China repeatedly not to restrict its REE exports, citing the severe consequences such a move would have on global production and trade (Bradsher 2010).

2012: The Scarborough Shoal dispute with the Philippines triggered a letter from China's General Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ) stating that it had found 104 types of "harmful organisms" in bananas and other fruit sent from the Philippines. The letter resulted in a sudden ban on Filipino bananas and threatened the livelihoods of 200,000 people in the banana-producing Mindanao Island region (Higgins 2012). Beijing also issued a travel advisory that led to a rash of abrupt cancellations of Philippines-destined vacation bookings from China (Higgins 2012, Almendral 2014).

Trigger 2: Regime legitimacy

1992: When France sealed a US\$3.8 billion deal to sell Mirage 2000-5 jet fighters to Taiwan, China ordered France to close its consulate in the southern city of Guangzhou, excluded French companies from bidding on a US\$1 billion subway project in the city, banned its wheat exports to China, and froze a French project to build a nuclear power plant in China (Zhang 2019 and Cohen 1994).

2016: One week after the Mongolian government permitted the Dalai Lama to visit in November at the invitation of Mongolian Buddhists, Beijing imposed new fees on Mongolian commodity exports to China, piled on new cross-border transaction costs, and cancelled talks on both a major infrastructure investment and a US\$4.2 billion loan (Harrell, Rosenberg, and Saravalle 2018, 47).

Incidentally, the impact of the Dalai Lama's foreign visits became such a phenomenon that two German academics ran calculations on international trade data and found solid statistical evidence that "the Dalai Lama meetings decreased exports to China by 12.5% on average" for about two years after a country's official met with the spiritual leader (Fuchs and Klann 2010).

Trigger 3: Chinese norms

2010: When the Norwegian Nobel Committee decided to honour jailed Chinese dissident Liu Xiaobo with a Nobel Peace Prize, Beijing was furious and used its AQSIQ – the same agency that later banned the Philippines's bananas – to issue a stringent new food-safety regulation that mysteriously targeted only Norwegian salmon, causing its direct salmon exports to China to fall by 59 percent in 2011, while imports of the fish from elsewhere soared.⁶ China also terminated trade negotiations with Norway. In this case, China was unable or unwilling to admit the factual independence of the Norwegian Nobel Committee and its decisions from Norway's national government.

2015: South Korea's decision to install an American anti-missile battery (the THAAD system) on land provided by the Lotte Group triggered a large-scale Chinese campaign of economic coercion against South Korea. Within a single year, China reduced its tourism to South Korea by 48 percent, hit the Lotte Group directly with allegations of fire code violations (which led to the closure of 80 percent of its stores in China), promoted popular boycotts against Korean exports, and used regulatory harassment, including the filing of flimsy complaints at the WTO against Korean companies (Chen 2019). In this case, China took South Korea's measures of self-defence as a military threat to its own security.

2016: Taiwan's DPP leader Tsai Ing-wen won the presidential election and subsequently resisted Beijing's demand to endorse the "1992 Consensus,"⁷ a trickier version of the "one country, two systems" diktat promised for Hong Kong. China quickly ceased communications with Taiwan's Mainland Affairs Council and cut the number of Chinese tourists to the island by nearly 60 percent in 2017, which strained the Taiwanese tourism sector (with a revenue loss of US\$1.9 billion (Yang 2018)) and elicited worker protests (Fontaine 2017). In this case, China could not accept the democratically-elected Taiwanese president whose party did not share Beijing's political views.

These three cases help explain Chinese norms: China is a party-state that does not allow any independent voices internally; it is self-interested enough to boycott foreign countries that act in their own national interests within their own territories, and it sees Taiwan as its territory and the democracy within Taiwan as a threat. Of course, Chinese norms are broader than those outlined in these cases, but in general they go against international norms that are based on the rule of law.

China's economic coercion: The patterns⁸

The list above reveals three patterns in which China uses its economic coercion to hit back at its trading partners: some are discreet and thereby evade WTO disputes and legitimate retaliation, some are calculated to inflict maximum damage on the target country, and some are tailored to sow division among Western allies.

Discreet to evade WTO disputes

China's AQSIQ agency initiated the bans on Norwegian salmon and Filipino bananas. China issued no formal import restrictions; rather, it conducted prolonged inspections in the name of "health" or "safety" concerns, which effectively forced Chinese importers to cease importing the sanctioned products from the named countries. Similarly, China's restrictions on rare earth element exports to Japan were never officially made, which avoided any paper trail for a WTO complaint.

Canada is no stranger to China's use of "health and safety concerns," especially now that our farmers are facing bans on almost all of their major agriproducts, despite the earlier high demand for them in China. Canola was "contaminated" (Associated Press 2019); soybeans contained "ants" (Thomas Reuters 2019); pork showed "residue from a restricted feed additive" (Vieira 2019). Canadian farmers need to be prepared for more Chinese bans and should expect that they might be completely cut off from the Chinese market for the near future. The Canadian government should not waste time attempting to resolve disputes with China but instead focus on finding new, more trustworthy buyers.

Calculated for maximum impact

Bananas are the Philippines' second biggest agricultural export. Over the three years before China's sudden ban in 2012, some small growers rerouted their selling destinations to bet solely on China's growing appetite for their crop. China's imports of Philippines bananas increased by 27 percent and accounted for a quarter of the country's banana exports in 2011. It was expected that China's imports of Philippines' bananas would increase another 40 percent in 2012. Instead, China's sudden ban in 2012 devastated 200,000 Philippine banana workers.

Similarly, canola is Canada's largest single export to China, the value of which doubled in a decade to exceed \$4.3 billion in 2018 (Canada, Innovation, Science, and Economic Development 2019). China's sudden ban on the crop earlier this year was announced by its customs agency on the pretext of finding "harmful organisms" (Bodeen 2019), which was similar to the 104 "organisms" claimed to have been found in the Filipino bananas.

Tailored to split western allies

In 1992 China excluded France from bidding on the Guangzhou subway project and granted the entire project to Germany in order to punish France for its arms sales to Taiwan. Then, in 2007, after Chancellor Angela Merkel decided to meet with the Dalai Lama in September, China quickly cancelled several bilateral meetings for "technical reasons" and withdrew its invitation to the German finance minister to visit China. While Germany was busy debating its policy on China, French president Sarkozy brought home from his China trip lucrative contracts worth €20 billion (Buck 2007).

Similarly, China has been playing its "farm-belt" card to alternate wins and losses between Canadian and American farmers. Canadian farmers are not as big growers of soybeans as their

American counterparts, but they still saw their soybean exports to China increase by 230 percent in 2018 (USDA, Foreign Agricultural Service 2019a). This took place because China reduced its purchase of American soybeans by more than two-thirds. The good fortune of Canadian farmers has quickly reversed this year: they are now helplessly watching their Chinese market share disappear and go to others, possibly including American farmers should China fulfill its promises to President Trump to buy more American crops.

China's economic coercion: The outcomes

China sees its use of economic coercion as being largely successful in shaping the behaviours of the coerced countries. This “success” has so far only emboldened China to use coercive tactics, as Canada quickly discovered following the arrest of Meng Wanzhou. But China has also failed repeatedly, particularly in its claimed territory: Taiwan. The Canadian government has much to learn and follow from the Taiwan case. More fundamentally, China has exposed itself as an international bully through its economic coercion and started losing reliable trading partners (see below for the South Korean case). Below are some outcomes of China's economic coercion, which showed that leverage with China lies in firm resolve and strategic diversification.

The shaken: The Philippines and Mongolia

Beijing's most obvious success appeared to be its 2012 ban on Filipino bananas (Agence France-Presse 2019). To China's benefit, the subsequent 2016 Philippines election propelled the current president Duterte from Davao City, the banana-exporting port. Notably, Duterte went so far as to set aside a ruling from the Permanent Court of Arbitration in the Hague – one that favoured the Philippines's territorial claim against China – in exchange for Beijing's promise of billions of dollars in investment. Among such investment projects is a joint venture with China Telecom, a wholesaler of Huawei equipment (Mandhana 2019).

Mongolia also represents another example of capitulation. Several weeks after the Dalai Lama's visit, the government offered a public apology to Beijing and promised not to host the Buddhist leader in the future (Harrell, Rosenberg, and Saravalle 2018, 47). China's foreign minister Wang Yi drove home the point by emphasizing Beijing's hope that Mongolia had “taken this lesson to heart” (Reuters 2017).

The caved-in: France and Norway

After being strong-armed over its 1992 arms sales to Taiwan, it took France a year or so to get back on an equal footing with its other Western peers in their pursuit of market share in China. It took Norway six years to normalize its relationship with China after the independent Nobel committee offended China's sensibilities when it awarded Chinese dissident Liu Xiaobo the Nobel Peace Prize in 2010.

In both cases, the coerced countries yielded to China's political demands to minimize their commercial losses: France promised to make no future arms sales to Taiwan, and Norway promised to “do its best to avoid any future damage to the bilateral relations” (Chan 2016).

The awakened: South Korea and Japan

China's all-out economic coercion of South Korea following Seoul's decision to install the American anti-missile battery THAAD caused the country to lose 0.4-percentage-point of GDP growth

in 2017. But life did move on for South Korea: the government installed the THAAD system (although it did assure China that there would be no expansion of the system), and the Lotte Group received Beijing's approval to resume its US\$2.6 billion real estate project in northeast China after a hiatus of almost two years (Reuters 2019).

Regardless, the damage was done: South Korea's past blind enthusiasm for China is gone. The Lotte Group is seeking to leave China completely (Korea Herald 2019), after having learned that "growth in scale does not necessarily guarantee sustainable growth" (White, Jung-a, and Buseong 2019.) Other South Korean companies are shifting their businesses out of China too. There is a sentiment among South Korean companies that their early encounters with China and all the problems from them "might be a blessing in disguise" (South China Morning Post 2019).

Japan responded decisively to China's ban of rare earth elements. At the time, Japan was still largely reliant on China for its rare earth element (REE) exports. Yet, following several years of concerted effort, Japan succeeded in diversifying REE supplies away from China, thereby foreclosing future attempts at coercion using such a ban (Nikkei Asian Review 2019a).

The resilient: Taiwan⁹

Among all the coerced, Taiwan is the most vulnerable due to both its international isolation (caused by China's unwavering pressure on the international community) and its close economic ties with China (developed since China's opening up in the late 1970s).¹⁰ In 2018, Taiwan's trade with China exceeded US\$150 billion, about 24 percent of its overall trade value, with 29 percent of its exports going to China and 19 percent of its imports coming from there.

Even so, Taiwan provides a model for resilience in countering China's economic coercion through diversification. Successive Taiwanese presidents from the two political parties have made conscious efforts to avoid outright economic dependence on China. A KMT government (preferred by Beijing) under Ma Ying-jeou regarded its Economic Cooperation Framework Agreement signed with China in 2010 as China's acceptance of Taiwan signing trade deals with other countries, and it went on to sign free trade agreements with New Zealand and Singapore in 2013. The current DPP government under Tsai Ing-wen has responded to China's economic coercion with a new "Southbound Policy" for boosting trade and investment with Southeast Asia and India and reducing economic dependence on China. The results are encouraging: excluding its trade with China, Taiwan's 2018 total exports increased by 16 percent from 2016 and its imports by 25 percent.

What are the quick lessons that Canada can learn from these cases? First, it needs to remember that resolve trumps fear. Second, there should be no illusions about any diplomatic solutions until the dust settles on the Chinese side. And third, the ultimate safeguard against any future economic coercion by China is diversification beyond China that will come from Canada broadening its circle of friends and trading partners (Iverson 2019).

Taiwan provides a model for resilience in countering China's economic coercion through diversification.

The Bottom-Line Cost of China's Economic Coercion

For Canada to overcome its fears of China's economic coercion, it is helpful to calculate the ultimate cost of the maximum economic damage China could possibly inflict on Canada. I will start by analysing global markets for our agriproducts that have been banned by China. The reassuring fact is that global markets for these products have been generally stable because they are closely related to the global population and the global economy, both of which have been growing. That is, China's bans of Canadian agriproducts will not change the *global* demand for those products, but only cause a disruptive shuffle between buyers and sellers. Such disruption will take time to resolve and will require costly adjustments, but our farmers and our economy will ultimately emerge from the fray still producing those products, and still finding markets in which to sell them.

I will then compare the structure of our exports to and imports from China, explain the general elasticity of the supply of these goods in relation to their demand, and demonstrate that our trading power is greater than China's in the long term despite our overall smaller economic size. I will also take into account non-merchandise trade, such as tourism and Chinese students, to estimate the possible higher tangible cost of China's all-out economic coercion.

Finally, I will explain how China's economic coercion will reach a dead end. China's ruthless pursuit of GDP size – the very psychological underpinnings for its use of economic coercion – has been heading towards a stone wall in recent years despite its artificially maintained GDP growth rate of over six percent. As its growth potential diminishes, China is losing its seemingly effective coercive power too. China will soon realize that it needs the world more than the other way around.

The global market for canola and beyond: The globe is round and commodities flow

Canola was our first commodity to be banned in China in 2019, followed by soybeans, peas, and pork (Wilkins 2019). What will be next? The best guess comes from the statistics. Based on the international harmonized system at its most desegregated level (i.e., the 6-digit coding level), there are nine agriproducts (including lobster) within the list of our top 25 exports to China.

It is no mystery that the three canola products combined (seeds, oil, and meal) are our number one export to China, accounting for over 16 percent of our total exports in 2018. Canada's number two agriproduct export to China is soybeans (accounting for 6.5 percent of our overall exports there in 2018), followed by peas (2.7 percent), meslin (a wheat/rye mix) and wheat (2.2 percent), barley (1.9 percent), pork (1.2 percent), and lobster (1 percent). Now that six of these nine agriproducts are banned in China, wheat and barley might follow (lobster exports appear to have been secured by the premier of Nova Scotia¹¹). On the other hand, wood pulp (number 2 on the top 25 list) and lumber (number 5) (Canada, Innovation, Science, and Economic Development 2019) might be deemed theoretically to contain poisonous ingredients.

However, if we are to look at global commodity markets for Canadian agriproducts exported to (or banned by) China, the long-term prospects for our farmers do not seem as dire.

First, consider canola. As with most commodity markets, the canola market is subject to wild price fluctuations. For example, over the past decade up to the marketing year (MY) 2017/18, the price of canola seed, which started from US\$393 per metric ton in MY 2008/09, peaked at US\$647/MT in MY 2010/11, and bottomed out at US\$409/MT in MY 2015/16 before climbing up slightly over the past two marketing years (USDA, Foreign Agricultural Service 2019b, Table 29). While the dollar value of Canadian canola exports to China had more than doubled within 10 years to over \$4.3 billion in 2018, this growth was not without big bumps – three sharp annual drops and three great leaps (Canada, Innovation, Science, and Economic Development 2019), which trend clearly interacted with the canola price. In other words, growing canola, like producing any other commodity using natural resources, has never been riskless.

The good news is that despite a volatile outlook associated with China's ban, industry sources indicate that the Canadian canola area planted is expected to climb by one percent in MY 2019/20 *on sustained profitability relative to alternative crops*, and total canola seed exports will be still higher than they were in MY 2017/18. In addition, Canadian canola oil production is expected to increase over the longer term, especially as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) trade agreement brings down tariff rates in key markets such as Japan and Vietnam. As for canola meal, US dairy operations had taken in almost all of Canada's canola meal production until MY 2016/17, when Chinese demand took off and swallowed 30 percent of Canada's otherwise relatively stable canola meal exports for MY 2017/18 (USDA, Foreign Agricultural Service 2019a). That is, Chinese imports of our canola meal did not enlarge our export market, but diverted a share of its exports previously bound for the United States.

The canola story reflects general global trends for other commodities dependent upon natural resources, particularly edible ones: sustainability and profitability rely on some fundamental conditions (e.g., global demand and supply) that cannot be dictated by any individual country's political will, including China's. On the demand side, the world's population is still growing and a certain percentage of it is still undernourished, and this includes almost 9 percent of the Chinese population (in 2016) (FAO 2018, 86). The quality of human life is continuing to improve, and along with it, so will the steady and increasing demand for agriproducts in general, and canola (seed, oil, and meal) in particular. For example, from 2005 to 2016, China's import of foods grew by more than 6-fold from \$16 billion to \$102 billion (FAO 2018, 86).

On the supply side, natural resources (e.g., arable land, renewable water resources, crop intensity ratio, etc.) are limited and their per-capita availability is highly constrained as both population and per-capita consumption of foods increase. It is important to note that market trends for agriproducts have favoured and will continue to favour sellers over buyers. China is a case in point: as its population and economy grew, its demand for agriproducts outstripped its supply to such an extent that from 1995 to 2016, its trade deficit more than doubled to US\$11.5

*The canola story reflects
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billion for “cereals and preparation,” and its trade deficit for dairy products grew more than 8-fold to US\$5.6 billion, while its meat trade turned from a small surplus to a US\$15-billion deficit (FAO 2018, 86).

The same can be said of market trends for all other Canadian agriproducts currently facing Chinese bans: growing Chinese demand has taken a larger share of the increasing global production of these products; China must find replacements for Canadian canola, soybeans, peas, and pork by courting other countries producing these things. Viewing each producer of such products individually, the replacement quantity might be small and easy to fill. But by taking the global market as a whole, which is constrained by natural resources, producers who will be filling in the Canadian share of the Chinese market (say 4.4 metric tons of canola) must vacate their existing non-Chinese markets for Canadian farmers to supply. Such reshuffling of suppliers of any given commodity will take time, but the market will find a new equilibrium, and China will pay the ultimate price for its politically-driven disruption of global markets.

Specifically, the globe is round and commodities flow and are fungible. China may ban Canadian canola and whatever else it wants to, but it is precisely because of its population and economic size (the fundamental causes of its burgeoning imports of and trade deficit in foods) that China cannot diminish the global market for canola and other agrifood products. Instead, China’s disruptive play in the global agriproduct market will only cause growing distrust among its trading partners, which in turn will adversely affect China’s long-term security in food supply.

The contrasting composition of Canada-China trade: We do have leverage

The existing structure of Canada-China trade is a typical outcome of Chinese mercantilist trade policy: China does not follow the principle of “comparative advantage,” but rather uses its industrial policy to expand its global market share at all costs (including subpar human living conditions and environmental damage) for whatever it can make, and also limit its imports to what it is absolutely unable to produce itself. As a result, China has been running unreasonable trade surpluses with many countries, including Canada.

To illustrate this point, table 1 itemizes at the most desegregated level the top 10 Canadian imports from China and the top ten Canadian exports to China as a share of their corresponding overall values for 2009 and 2018 respectively. It also presents our overall trade values with China (imports, exports, and balance) for the same years.

Three major observations can be drawn from table 1.

First, seven of our top 10 imports from China are telecommunications equipment and electronic gadgets, which used to be made in Canada by Nortel – our national pride less than two decades ago. The value of telecom equipment and electronic gadgets imported from China more than tripled from \$4.8 billion in 2009 to \$16 billion in 2018, and the share of total imports of electronic equipment from China increased from 12.1 percent to 21.2 percent in that period. Little wonder, then, that Huawei – China’s massive manufacturer of telecom equipment – has its defenders within some of our telecom companies.¹²

Second, Canada’s top 10 exports to China are highly concentrated in three categories: agriproducts including canola seed and canola oil (20.8 percent of our total exports to China in 2018); wood products (18.2 percent); and minerals (11.7 percent). These are all produced from natural resources, which have been rapidly depleted in China over the past four decades during the explosive growth of China’s GDP.

TABLE 1: CANADA'S TRADE WITH CHINA: TOP TEN ITEMS, OVERALL VALUE AND BALANCE, 2009 AND 2018*

Top ten imports from China (as % in total imports)	2009	2018
Telephones For Cellular/wireless Networks	1.9%	8.5%
Portable ADP** Machines	6.2%	6.6%
Machines for data transmission***	1.6%	2.9%
Toys	2.3%	1.9%
Video Game Consoles and Machines	0.0%	1.0%
Parts and Accessories of ADP Machines	1.0%	0.7%
Electric Static Converters	0.7%	0.8%
Television Receivers	0.8%	0.7%
Seats With Wooden Frames	0.9%	0.7%
Road Wheels For Motor Vehicles	0.4%	0.7%
Total share of the top 10 imports	15.7%	24.5%
Total value of the top 10 imports (\$B)	6.2	18.5
Overall imports from China (\$B)	39.7	75.6
Top ten exports to China (as % in total exports)	2009	2018
Rape or Colza Seeds	12.9%	10.2%
Chemical Wood pulp	6.2%	9.8%
Soya Beans: other than seeds for sowing	0.0%	6.5%
Rape (Canola) or Colza Oil	3.6%	4.1%
Lumber	0.0%	3.9%
Semi-Chemical Wood Pulp	3.7%	3.5%
Iron Ores and Concentrates	2.9%	3.3%
Ethylene Glycol (Ethanediol)	3.2%	2.8%
Copper Ores and Concentrates	2.7%	2.8%
Gold in Unwrought Form (Non-Monetary)	0.0%	2.8%
Total share of the top 10 exports	35.1%	49.7%
Total value of the top 10 exports (\$B)	3.8	13.3
Overall exports to China (\$B)	10.9	26.8
BALANCE (\$B)	-28.7	-48.8

Source: Canada, Innovation, Science and Economic Development Canada 2019.

* Based on the HS 6-digit code level. The names of several items have been altered to fit in table entry fields; numbers may not add up due to rounding

** ADP = Automatic Data Processing

*** Machines for reception/conversion/transmission/regeneration of voice/images/or data

Third, as our trade with China grew rapidly from relatively low levels, our trade deficit also grew alarmingly – from \$29 billion in 2009 to \$49 billion in 2018. Given China’s import barriers (both tariff and non-tariff) (Chen 2019) on our manufactured goods and its insatiable pursuit of global markets for its “national champions” such as Huawei, there does not seem to be any hope that Canada can export much beyond commodities to shrink our trade deficit with China.

In summary, table 1 indicates that the majority of our exports to China are commodities for which the supply is constrained by natural resources that are either scarce or rapidly depleting in China, and all our imports from China are manufactured goods that are easily replaceable from other suppliers in other countries, despite possibly higher prices. That is, we can easily replace Chinese imports if we are willing to forego the lower prices of Chinese products in the short term in order to secure safer long-term trading partners. By contrast, China cannot live without our contributions to global commodities markets (as analysed in the last section).

On the other hand, however, if we do nothing to divert our sources of imports away from China, a Chinese ban on all our agriproducts (which total about \$10 billion annually and account for over 37 percent of our total exports to China) would increase our 2019 trade deficit with China by the same amount, pushing it to \$59 billion.

In addition to merchandise trade, there is some anxiety about a possible downturn in Chinese tourism to Canada, and even in enrollment of Chinese students in our universities, the former yielding an annual revenue of \$2.1 billion¹³ and the latter \$4.3 billion.¹⁴

Adding all the above estimates of potential losses and assuming Canada takes no action and the market condition stays unchanged, our maximum financial loss for the coming year would be \$16.4 billion in the event that China bans all our agriproducts, bars its tourists from travelling to Canada, and recalls all of its students studying in Canada. I do not believe there is any possibility that such an extreme scenario will emerge.¹⁵ However, Canada does need to secure its long-term prosperity by focusing on other countries for both its export markets and sources of imports, to minimize the risk of incurring maximal tangible financial loss should China completely shut down its imports of Canada’s agriproducts and tourism and educational services.

The future of China’s economic coercion

China may want to keep coercing Canada and whoever else gets in its way, but the power of such coercion is waning fast and will end sooner than many expect. This is mainly because the so-called “China model,” in which the government undermines private wealth in order to pursue speedy GDP growth, has also destroyed China’s economic vigour and sustainability.

Here is why:

First, “GDP growth is not the same as economic growth” (Pettis 2017). China’s GDP is awash with wasteful and debt-ridden investments that have no economic substance, and its growth rate will plummet in the foreseeable future (Tan 2019). This is a consensus long held by economists, including those in China.¹⁶ More specifically, the Chinese economy has been fuelled by debt since 2008, its working age population (15 to 64) began to shrink in 2014 (Reuters 2018), its investments in fixed assets – the driving force of China’s artificial GDP growth – as a share of its GDP have also been falling since 2014 (World Bank Data 2019), and its income disparity has widened more rapidly over the last decade than in any other country (Jain-Chandra 2018). Beneath its prosperous appearance, China’s per-capita income was less than a quarter of the

average of OECD countries, with an estimated 373.1 million people (i.e., more than a quarter of its population) living below the “upper middle income” international poverty line of US\$5.50 a day (World Bank 2019a).

Second, China’s ruthless pursuit of GDP growth has in many ways destroyed its natural resources wealth to such an extent that it will have to rely on foreign natural resources for its ongoing economic development. Based on its official reports, China had lost about 3.6 million hectares of arable land over the six decades up to 2017.¹⁷ As a result, its arable land per person in 2016 was 0.09 hectares (vs. Canada’s 1.21 hectares), only 0.43 percent of the world average (World Bank 2019b). Unless China can recover its massive loss of farmland, it will be unable to feed its population without permanently importing foodstuffs. According to the UN Food and Agricultural Organization, from 2006 to 2016, China’s imports of foods (excluding fish) have tripled in quantity and more than quintupled in monetary terms (due to the almost 60 percent increase in food prices). China’s food imports will continue to increase until at least 2029, when its population is predicted to peak (Nikkei Asian Review 2019b). In other words, China cannot live without the global agricultural industry in which Canada is a major producer.

And finally, the Chinese people are yearning for the benefits of foreign competition as they see their welfare being rigged by government-groomed “national champions.” The most recent example of this is the uproar against Baidu, the Chinese search engine whose initial survival was secured by the government’s decision to drive out Google. For years Baidu has been enriching itself by “placing ads according to commission size” (竞价排名), which has misled its users for the benefit of profiteers and caused numerous accidents in the case of medical treatments, where the most aggressive commercials on Baidu were paid by the most notorious medical providers.

As an example of the pushback against the company, on July 3, when Baidu’s CEO Li Yanhong was speaking at the company’s AI conference, a young man rushed onto the podium and quickly poured a bottle of water over Li’s head, symbolically washing out the dirty tricks in Li’s brain. The story went viral online before being taken down. Surprisingly, almost all the feedback was against Baidu, some of which appealed for Google’s return to China in order to accrue the benefits of foreign competition (Radio Free Asia 2019). Such public sentiment goes against China’s use of economic coercion abroad, which has already started driving away foreign trading partners (e.g., South Korea) who brought in international norms – mainly the rule of law that safeguards business integrity that strives to provide high quality goods and services – for the benefit of Chinese consumers.

In summary, China does not have an economic substance to match its economic size, and its artificial growth rate is unsustainable.¹⁸ Its demand for foreign agriproducts will continue to grow, and the Chinese people want to see their markets full of foreign competition. Such realities mean that China has no enduring power of economic coercion over any rule-abiding countries, large or small. If Taiwan can survive China’s economic coercion, then every country with international legitimate sovereignty can as well, including Canada.

*The Chinese people
are yearning for the
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Options for Countering China's Coercion: Justification and Feasibility

The analysis so far has demonstrated that countering China's economic coercion requires resolve and strategic diversification. Fear based on the disparity between the relative sizes of our two economies is unwarranted, and illusions that China will play by the rules are unrealistic and unhelpful.

Below are some feasible measures that the federal government can use to counter China's coercion against Canada.

First, ban Huawei from any involvement in Canada's 5G wireless network

Despite repeated and clear warnings from our national security experts (Fife and Chase 2018) and investigations by Canadian journalists (Silcoff, Fife, Chase, and Dobby 2018), the federal government has been largely silent on whether it intends to ban Huawei from building Canada's 5G wireless network. Canada has opted to undertake a national security review on the implications of foreign involvement in our 5G networks, including Huawei's. It seems difficult to believe that Ottawa will decide in favour of Huawei, given the current tensions in the Canada-China relationship. Yet doubts continue to linger about the results of this review and when its findings will be released.

Huawei should be seen as a state tool for China's global expansion (Mauldin and Deng 2019). If China's all-out economic coercion against Canada and its detainment of our citizens as hostages for saving Huawei's CFO are still not enough to resolve the Huawei debate for Canada, then surely President Xi Jinping's demand that America end its supply ban to Huawei as a precondition for resuming trade talks should do the trick. We must ask ourselves: If Xi makes the entire trade deal with the US contingent upon Huawei's survival, how could Huawei refuse to spy on anyone who falls out with Xi Jinping? And we need to remember: a great many Canadians have already fallen out with Xi Jinping thanks to China's escalating economic coercion against Canada.

Aside from constituting a direct threat to our national security, Huawei's entry into Canada would represent a full-fledged infiltration by China's state capitalism into our free-market system. Here is a fresh case for our policy-makers to ponder: In addition to receiving its government's direct grants totalling US\$1.6 billion and obtaining heavily subsidized plots of land, Huawei has been equipped with a US\$30 billion state line of credit (Xinhua News Agency 2009) to help it sell its telecom gear overseas through low-cost financing to customers.¹⁹ Through this arrangement, a Brazilian telecom firm (Oi S.A.) and an Indian wireless provider (RCom), both of which filed for bankruptcy recently, had each obtained loans worth hundreds of millions dollars from the China Development Bank (CDB). While the CDB assumed the lending risks for Huawei, which secured Brazil's 5G business, Huawei's competitor Ericsson has been left battling in court for its receivables owed by the bankrupted Indian firm (McMorrow 2019). Similarly, in 2010, Huawei replaced Ericsson AB and Nokia Corp to become the sole supplier for Globe, a major Philippines telecom, because Huawei, with the backing of the Chinese government, "offered innovative products at prices most others couldn't match" (Mandhana 2019).

Who would be able to compete with Huawei in Canada? The answer is absolutely nobody, since no Western telecom companies have the type of government backing enjoyed by Huawei. Letting Huawei into Canada's 5G network would be helping China take over our telecom industry by killing any Canadian carriers that did not use Huawei gear.

It is fair to conclude that Huawei, despite its mysterious “non-State-Owned Enterprise” ownership,²⁰ is literally a branch of China's state capitalism. Banning Huawei from building Canada's 5G network will help protect the integrity and prosperity of our telecom industry as well as safeguard our national security. The long-term prosperity of every single business in Canada is dependent on our national security. Our business and political leaders must heed the advice of our national security agencies (Canada, Canadian Security Intelligence Service 2018).

Second, expand existing insurance programs to help Canadian farmers cope with China's economic coercion

China's economic coercion is a political hazard to Canadian farmers. Under the administration of Agriculture and Agri-Food Canada (AAFC), there are two existing insurance programs that need to be expanded in order to help Canadian farmers cope with China's economic sanctions. One is AgriInsurance, which gives producers cost-shared insurance for natural hazards, and the other is AgriMarketing, which “provides support to increase and diversify exports to international markets” (Canada, Agriculture and Agri-Food Canada 2019).

These two programs should be expanded to cover *political* hazards posed by China's bans on our agriproducts and simultaneously help our farmers diversify their global sales to avoid over reliance on the Chinese market. The federal government should provide initial funding for such expansion of risk coverage to prevent future panic; an initial funding source could be the diversion of our capital share in China's Asian Infrastructure Investment Bank (see below).

Third, register and scrutinize all the R&D funding sources from China and sever the ones that aim to steal our intellectual property

According to a *Globe and Mail* report in early 2018 (Silcoff, Fife, Chase, and Dobby 2018), over the past decade Huawei had:

- Committed about \$50 million to 13 leading Canadian universities, including the University of Waterloo, the University of Toronto, McGill University, and the University of British Columbia, which ultimately funds Huawei's intellectual property (IP) development.
- Worked with nearly 100 professors in Canada who have additionally obtained millions of dollars in government grants for their Huawei-related research but have given Huawei exclusive rights to their research products, including 40 patents and “co-authorships” in 350 peer-reviewed papers.
- Made Ottawa one of its four global 5G research institutes and set up many other research facilities in Canada, which have taken advantage of the direct R&D funding and generous R&D tax credit provided by our federal and provincial governments.
- Partnered with Canadian telecom carriers (e.g., Telus) to conduct field tests with its 5G technology developed by Canadian researchers.

In 2018 alone, Huawei had invested \$180 million in research and development in Canada, and this figure is expected to grow by 15 percent for the current year (Greiner 2019). However, as a Canadian patent lawyer Jim Hinton has pointed out, for Huawei, “Canada is an employee and consumer state – we work for pennies to harvest the land, then pay our foreign masters dollars to eat what we had harvested” (Silcoff, Fife, Chase, and Dobby 2018). Our federal government should step in to stop companies like Huawei from stealing Canadian innovative power and products. This can be done by establishing a registry of all R&D funding sources from China, scrutinizing their legality, verifying their fair share in final IP rights, and severing ties with those that fail the scrutiny.

Finally, withdraw Canada’s membership from China’s Asian Infrastructure Investment Bank

It was Conservative leader Andrew Scheer who justifiably demanded that Canada withdraw from the Asian Infrastructure Investment Bank in retaliation for China’s ban on our canola (Canadian Press 2019). But looking deeper, joining the AIIB was a mistake in the first place, and China’s ban on our agriproducts has afforded Canada the opportunity to correct this mistake. China never really needed our capital share, but our membership helped substantiate the AIIB’s legitimacy. It also further isolated the United States and Japan, which remain the only G7 countries who still hold enough conviction not to trust China.

A recent German-American academic study provides a clear and alarming picture of China’s darker side as a profiteer through lending (Horn, Reinhart, and Trebesch 2019).²¹ The study shows that:

- China has become the world’s bank with US\$6 trillion in overseas assets; it exports more capital to developing and emerging countries than all other industrialized countries put together.
- Almost all of China’s lending and investment abroad is government-directed rather than market driven.
- China does not report on its official lending and there are no comprehensive standardized data on Chinese overseas debt stocks and flows. As a result, about half of China’s loans to the developing world are hidden.
- China’s lending to lower-income developing economies is often at commercial rates, on shorter terms, and backed by collateral such as access to foodstuffs, oil, and profits from the recipient country’s state-owned enterprises. This new form of “development aid” has driven several developing countries into default, which has led to China’s seizure of their properties.
- Chinese loans often form a closed financial loop – issued by China’s state-owned banks and used by Chinese contractors to build airports, roads, ports, or dams without involving a single foreign player’s account.

To be fair, AIIB has played little role in this form of state lending by China. But it does serve as an important institutional representation of China’s global power and is an alternative to the US-led World Bank. By joining the AIIB, Canada is effectively helping pivot the “world economy away from the US to China” (Cross 2017) while providing a veneer of legitimacy to China’s approach to the global economy, despite its dirty lending tricks and consistent failure to abide by the World Trade Organization’s rules.²²

Canada was right to resist becoming a founding member of AIIB, but its late joining was still a win for China. Canada has a history of priding itself in often not siding with the United States, but in the current struggle to defend the international order and norms, we must rethink who we should side with: the US or China? After all, we can always fight against the US, in any diplomatic setting, as an equal member of the international community, but we can never expect to do that with Xi Jinping's China. Withdrawing our AIIB membership is the right step to take amid China's economic coercion of Canada. With this withdrawal, Canada's current capital share in AIIB (close to US\$1 billion) can be re-appropriated to better serve the country's national interest in ways that range from helping our farmers to offering direct aid to developing countries.

All of the measures discussed above are intended more to protect our national interests than retaliate for China's ban on our agriproducts; China's ban on these products only provided our government with an opportune time to act decisively.

Conclusion

China's ban on major Canadian agriproducts has opened a new chapter in its habitual deployment of economic coercion against countries whose lawful actions it finds offensive. In driving Canada into the camp of the coerced, China has also hastened its own loss in the world it cannot live without.

Among the coerced, Taiwan provides a resilient model for Canada to follow. Taiwan has long been consciously broadening its circle of trading partners beyond China while keeping its delicate trading and overall relationship with China as normal as possible. The same can be said for South Korea: despite its late awakening, South Korea has been successfully phasing out its business operations in China. In both cases, China has appeared to have the upper hand, but neither Taiwan nor South Korea has despaired; instead, they have countered China's coercion with a long-term strategy of resolve and diversification.

It is important to remember that China dictates most bilateral trading relationships using a mercantilist calculation and in the pursuit of global hegemony. With its growing economic size, China believes it can act at will against any country. As such, yielding to China's coercion, economic or otherwise, has only emboldened China, and will only keep emboldening it to further dismiss international order and norms. China's ruthless economic coercion of our farmers and its jailing of two innocent Canadians has forced Canada to learn this lesson. Our government's inaction is not acceptable to a clear majority of Canadians who no longer believe that China is a harmless trading partner.

It is time to learn from, and side with, the countries that have been standing up to China's economic coercion and other law-breaking behaviour, which range from stealing intellectual property to militarizing artificial islands in the South China Sea. These countries, led by the United States, are our indispensable allies. This is not to suggest that Canada take a blindly confrontational approach towards China, but rather, to act upon our conviction that we do not want any country to behave the way China currently does towards Canada. What we want from China is for it to behave like an equal member of the international community, which is how we see ourselves and how we treat the United States. The world will be a better place when China sees itself as an equal member of the international community and respects international norms.

About the Author

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Endnotes

- 1 For recent examples of China's hostage diplomacy, see Mozur, Stevenson, and Wong (2019) and Wen and Wong (2019).
- 2 See, for example, Galvin (2019).
- 3 Economic coercion is only one of many levers in the Chinese Communist Party's "toolbox" for shaping the behaviour of whichever country is in its way, according to Evan A. Feigenbaum (2017).
- 4 The flip side of this point is also true: the various interest groups that have benefited from their commercial ties with China can also force their democratically elected executive branches to proactively adopt policies that serve China's strategic goals.
- 5 My wording "Chinese norms" is more to the point than Dundon's "the status quo."
- 6 For a thorough investigation and data analysis of this episode, refer to Chen and Garcia (2015).
- 7 In an over-simplified manner, the so-called "1992 Consensus" can be seen as a version of the "One China, Two Systems" governance style that was promised to Hong Kong.
- 8 The discussion here is partially inspired by Zhang (2019).
- 9 Numbers presented here are the author's estimates based on Taiwan's National Statistics, available at <http://statdb.dgbas.gov.tw/pxweb/Dialog/statfile9L.asp>.
- 10 The earliest thorough study that documents these economic ties is Tanner (2006).
- 11 Our export of lobster to China appeared to be secured by the Nova Scotia premier, according to a disheartening news report (Smith 2019).
- 12 For example, both Bell and Telus are big purchasers of Huawei equipment (Paddon 2018).
- 13 Author's estimate based on Destination Canada (2019), which says that Chinese tourists totalled 737,000 in 2018 and spent an average of \$2,850 per trip.
- 14 Author's estimate based on Todd (2019), which says that Canada annually receives \$11.6 billion in foreign student fees from about 500,000 foreign students, of which 186,000 are Chinese.
- 15 For example, despite China's ban on Canadian pork, fast-spreading porcine disease in Asia has already pushed up retail pork prices by 9 percent over the year before. This demonstrates the minimal price impact of China's ban on global pork prices—the fundamental market gauge for Canadian farmers. See Maltais and Bunge (2019).
- 16 See Dickinson (2018), "The Top Ten Issues for China's Economy," particularly Point 5 about the dead end of China's GDP growth. The original Chinese article on these 10 issues was taken down shortly after its online publication. For its modified version, see <https://zhuanlan.zhihu.com/p/52948657>.
- 17 Author's estimate based on two official sources: 1) Xinhua News Agency (April 12, 2009) reported that China had lost, on average, 66,667 hectares of arable land annually over the previous 50 years ("我国近50年来因水土流失年均损失耕地约一百万亩") and 2) in May 2018, China's Ministry

of Natural Resources reported, in its *Chinese Land, Mineral and Ocean Resources Statistics Bulletin* (2017) that China lost another 266,668 hectares of arable land between 2013 and 2017 (pp. 1-2).

- 18 This author believes that, instead of betting on China's high growth rate being unending, the world must welcome an economic deceleration in China should its government be willing and able to rebalance an economy that is currently heavy on debt-ridden real estate construction and lacks basic welfare for its vast rural population that have been left behind despite the country's rapid growth.
- 19 Notably, since 2015, China has provided more funding each year to support its exports than have the OECD's 36 member-nations combined.
- 20 A recent academic study, drawing on publicly available sources such as media reports, corporate databases, and court cases, makes a compelling case that Huawei is, in fact, a stated-owned enterprise. See Balding and Clarke (2019).
- 21 For a summary of this paper, see Grill, Sauga and Zand (2019).
- 22 On the last point, see Chen (2019).

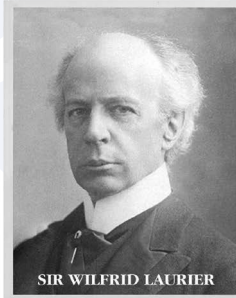
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- Aboriginal people and the management of our natural resources;
- Making Canada’s justice system more fair and efficient;
- Defending Canada’s innovators and creators;
- Controlling government debt at all levels;
- Advancing Canada’s interests abroad;
- Ottawa’s regulation of foreign investment; and
- How to fix Canadian health care.



True North in
Canadian public policy

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What people are saying about the Macdonald-Laurier Institute

In five short years, the institute has established itself as a steady source of high-quality research and thoughtful policy analysis here in our nation's capital. Inspired by Canada's deep-rooted intellectual tradition of ordered liberty – as exemplified by Macdonald and Laurier – the institute is making unique contributions to federal public policy and discourse. Please accept my best wishes for a memorable anniversary celebration and continued success.

THE RIGHT HONOURABLE STEPHEN HARPER

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.

THE RIGHT HONOURABLE PAUL MARTIN

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
