



Canada China Relations under Political Tensions:

A look through the lens of International Trade and Investment

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Major Research Paper
Graduate School of Public and International Affairs
University of Ottawa
Summer 2022

Abstract

China-Canada relations have a long history. 2020 represented the 50th anniversary of the establishment of diplomatic relations between China and Canada. Economic collaboration has been an important topic of bilateral exchange for decades. Yet, there has been no shortage of discussion of the deterioration of the relationship in recent years. The goal of this major research paper is to analyze the direction of the China-Canada relationship from a trade and investment perspective. The years 2018 and 2019 mark the lowest point in this relationship, but the seeds of the deeper causes were planted in the early years of diplomatic relations. The reason for this is the fundamental differences between the two countries in their understanding of the rule of law, human rights, and diplomatic approaches. These disagreements also had an impact on investment and trade, and these effects were undeniably passed on to the Canadian society itself. Analyzing these implications, this paper concludes that the future of the relationship, from a Canadian perspective, will focus on two areas: continued engagement with China to maintain collaboration on areas of common interest (e.g., climate change actions, two-way trade and investment cooperation) and active engagement with similarly minded Indo-Pacific partners to diversify trade and investments away from China.

Keywords: Canada-China relations, trade and investment, diplomatic relations

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Acknowledgements

I would like to express my sincere gratitude to my research paper supervisor, Professor Patrick Leblond, for his expertise and recommendations on this paper, his timely guidance, his helpful suggestions for improvement, and his dedication and energy.

I also want to give a special thanks to my parents for their constant unconditional support and love. Without their support along the way, I would not have been able to complete this journey. And to my friends who have always given me encouragement. And finally, my partner, Jiaxu, who was there for me in all my weak moments and gave me unlimited care and support.

Chapter 1: Introduction

The world has changed dramatically in the last few decades, as western countries have become increasingly aware of the global influence of the Indo-Pacific region. With China's involvement and impact on the world stage having grown significantly, the discussion around Chinese foreign politics has become more contentious. Fifty-two years of the Canada-China relationship established in 1970 has seen its ups and downs - from China becoming Canada's second largest trading partner to the failed free trade agreement negotiations and Meng Wanzhou's arrest. Prime Minister Justin Trudeau publicly condemned China's "coercive diplomacy" in response to the arrest of two Canadian citizens only days after Meng's arrest, during a daily media briefing (Sevunts, 2021):

"China needs to understand that it is not just about two Canadians. It is about the respect for the rule of law and relationships with a broad range of Western countries that is at play with the arbitrary detention and the coercive diplomacy they have engaged in."

The statement summarized well how Canada also perceived a series of incidents that happened in China, such as Hong Kong and Xinjiang, as hostile and coercive. These incidents are adding up to multiple violations of labour rights, human rights, freedom and liberties, and the rule of law (Blanchfield, 2020; Zimonjic and Ling, 2021). China, on the other hand, has perceived Canada's call for respecting these values and rules as a trespass on China's sovereignty in domestic affairs, as well as western countries' intention to contain China's economic and political rise. In recent years, scholars have noticed that the diplomatic doctrine of "hide your capabilities and bid your time" is gradually being abandoned (Ong, 2020). Under Xi Jinping's leadership, China's diplomacy has stepped in the direction of "wolf-warrior" diplomacy (Ong, 2020). As US-China relations have deteriorated, because of the trade war and

the extradition request to detain Meng, Canada has found itself caught in between this great power rivalry.

In these frictions, China's economic prosperity continues to grow. Canada cannot deny that economic ties with China are important, as China is Canada's second largest trading partner and a robust destination for Canada's trade diversification plan away from the US. However, the incompatible political history and cultural backgrounds are increasingly making both sides go against the original intention of mutually beneficial cooperation. Collaboration with China is nevertheless unavoidable to address global concerns such as climate change, post-pandemic recovery, and supply chain shortages. Dealing with China in a way that respects both Canadian core values and national interests is difficult for Canadian policymakers.

1.1 Purpose, Research Question

The purpose of this paper is to analyze the impact of political tensions between Canada and China on their bilateral trade and investment. It does so by revisiting the major events that have caused the deterioration of Canada-China relations based on sentiments expressed in media, government publications and academic articles. From the trends observed in trade and investment, this paper also gains insights into the future directions of the Canada-China relationship. Thus, the research questions are: 1) How have tense political relations between Canada and China in recent years affected trade and investment between the two countries? 2) What can we expect regarding the Canada-China relationship in the coming years?

Research suggests that trade is often affected by shocks to political relations; however, relations themselves are subjected to lesser influences due to changes in trade (Whitten et al., 2020). Additionally, Kastner's (2007) study concluded that economic relations can flourish even in extreme hostile relations. This paper argues that Canada-China political frictions has a more

pronounced impact on investment, especially Chinese investment in Canada, than on trade. Canada-China investment, although much smaller in terms of flow and amount than bilateral trade, corresponds to greater volatility at the point when relations between the two countries begin to fall to a freezing point. Moreover, after considering the impact of trade and investment on Canadian society, our analysis suggests that Canada-China relations, while not necessarily improving significantly, must focus in the future on maintaining economic engagement with China, diversifying in the Indo-Pacific region, and cautiously managing relations with the US.

1.2 Structure

Chapter 1 is the introduction of the paper. Chapter 2 starts with an overview of the China-Canada relationship between 1970 and 2016 to help put the years 2017-2022 in a broader context.

Chapter 3 focuses on explaining when and why the political tensions began by identifying the contradictions and contrasts between the two countries that shaped those tensions. Chapter 4 analyzes data from Statistics Canada and China Institute University of Alberta (CIUA)'s existing data analysis reports to evaluate Canada's trade and investment activity before and since the current political tensions began in 2017. Chapter 5 illustrates how trade and investment's impact Canada's economy. Chapter 6 uses the analysis in chapters 4 and 5 to examine the likely future of the Canada-China relationship.

Chapter 2: The Evolution of the China-Canada relationship between 1970-2016

2022 marks the 52nd anniversary of Canada-China diplomatic relations (Canada, 2020). There have been "warmth and coolness" since Canada and China established diplomatic connections, such as during the Tiananmen Square incident in the late 1980s and the early years of the governments led by Stephen Harper, who was prime minister between 2006 and 2015 (Houlden, 2020). This chapter provides an overview of the Canada-China relationship's evolution since the

1970s from three perspectives: diplomacy, economic developments and people-to-people linkages.

2.1 From 1970 to 2006

Pierre Trudeau, the then Canadian prime minister, was one of the first western leaders to recognize the People's Republic of China (PRC) in 1970 by officially establishing a diplomatic relationship with the PRC (Lovrics, 2021). Before 1970, Taiwan nationalists were regarded as the actual leaders of China, occupying the permanent place on the United Nations' Security Council (Burton, 2011). Back then, China considered diplomatic relations with Canada to help it break out of its isolation, which was largely self-imposed but bolstered by US sanctions and China's split with the Soviet Union (Houlden, 2020). With Trudeau's formalization of the Canada-China relationship, China increased its involvement with the international community by joining the United Nations. These involvements also paved the way for an eased US-China relations two years later when the then US President, Richard Nixon, visited China (X. Li, 2021). Nixon's visit marked a significant development in international politics and his first visit to China was even described as a "week that changed the world" (Kraus, 2021). This visit helped break decades of animosity between the US and China.

The easing of US-China relations opened up the possibility of more cooperation between Canadian and Chinese governments. This is evident from Trudeau's friendly diplomatic posture toward China throughout his tenure. For example, during Trudeau's visit to China in 1973, an aid program dedicated to Chinese development and a family reunion plan for Chinese in Canada managed by the Canadian International Development Agency (CIDA) was introduced (Lovrics, 2021). However, Trudeau's plan to strengthen the relationship with China were hampered by the Chairman Mao-era Cultural Revolution as well as a series of reconstructions following Mao's

death, which caused great internal instabilities within China (Burton, 2011; Lovrics, 2021). Nevertheless, the two succeeding prime ministers, Brian Mulroney and Jean Chrétien, had a more tangible impact on the relationship.

After the Conservatives secured their first majority in Parliament in 1984, the Mulroney government set its sights on advancing Canadian trade in the Asia-Pacific region. Although the main target of this trade initiative was Japan, the Conservative government continued the Trudeau government's approach to China to deepen this relationship (Frolic, 2011). During Mulroney's visit to China in March 1986, he announced an expansion of the concessional financing to promote trade of \$350 million and a plan to build a bulk-fertilizer plant to promote Canadian potash sales worth \$300 million (Frolic, 2011). In return, China assured Mulroney that Canada would remain China's major wheat supplier. Furthermore, the Chinese government expressed its dedication to the open-door policy and respect for international trade regimes, human rights, and intellectual property. At this time, Mulroney presented the *China Strategy*, which reaffirmed Canada's commitment to the relationship and trade between the two countries (Frolic, 2011; Lovrics, 2021).

Aside from trade cooperation, it is worth noting that Canada's human rights condemnation and sanctions towards China under Mulroney were put second behind trade activities with China. Canada's response to the Tiananmen Square incident, where student protests for greater political freedom were brutally suppressed and arrested by government forces, resulting in many deaths (BBC, 2021), was symbolic: although Canada could not accept "business as usual", it still valued its friendship with China, would not become anti-China, and would avoid measures that isolate China (Gecelovsky, 2011). In short, Mulroney's government

had chosen a similar strategy toward China as Trudeau's. Trade expanded and human rights issues took a back seat.

By the time Jean Chrétien took office, the Tiananmen Square incident would no longer be brought up. Canada's disregard for China's human rights abuses along with its aggressive trade development caused resentment among social groups, and there was no shortage of headlines filled with "Chrétien Must Challenge China On Human Rights" and "Canada Resolutely Builds Trade Ties with China" at the time (Clayton, 1994; Direct Database Rights & Democracy, 2001). But there is also no denying that trade cooperation between China and Canada continued to flourish during his time in office. Economic ties, as reaffirmed by the then-Chinese Ambassador to Canada, evolved from "small, simple-item commodity trade into an all-dimensional cooperation covering trade in commodity and services, capital flows and personnel exchanges" (Lu, 2005). While Deng Xiaoping called for more reforms in 1992, seeing that the Chinese state's future depended on economic growth and international normalisation, Jiang Zemin, President of China from 1993 to 2003, was able to attain economic stability as a result of the effectiveness of this reform agenda. This domestic stability gradually reflected on the international stage. The years 1993-2003 were the most robust in China's economic development as well as the most productive in its relations with Canada.

Immigration played another essential external factor during this expansion; according to Statistics Canada (2007), immigration from China to Canada rose by 19% from 1996 to 2001, while the total growth of the Canadian population was only 4%. At the time, there were approximately 250,000 Canadians in Mainland China and Hong Kong, more than a medium-sized Canadian city like Saskatoon (Zhang, 2011). These people-to-people linkages created a "human platform" for stronger relations that went beyond upgrading the economic performances

to making greater contributions and influences domestically (Zhang, 2011). For many, this connection is one of the fundamental elements to consider for a more robust future relationship between the two countries.

The Canada-China relation from 1970 to 2006 followed a consistent direction despite differences in political parties. Trudeau, Mulroney and Chrétien were not harsh on human rights, focusing instead on economic developments through trade and financial commitments. China underwent a great transformation during this period. Under the leadership of Deng, China achieved important reforms to open up its economy, strengthen partnerships with international markets, and maintain internal stability. Also, the thaw in relations between China and the United States and the two-way flow of people between China and Canada are indispensable factors that pushed the relationship forward.

2.2 From 2006 to 2016

When Harper's Conservative government came to power in 2006, many people began to expect that the friendly relations between Canada and China would continue and grow; instead, his government adopted a hardline approach toward China, addressing human rights issues as a priority (Ong, 2020).

In his first year in office, Harper stepped on the bottom line of Chinese diplomatic doctrine regarding foreign intervention in China's internal affairs by welcoming the Dalai Lama, a political leader who was originally a spiritual leader from Tibet (Ditchburn, 2007). This provoked strong condemnation from China. In a statement by the Embassy of the PRC in Canada (Embassy of the People's Republic of China in Canada, 2007), China urged Canada to "stop supporting and conniving at the separatist activities of the Tibet independence forces, stop interfering with China's internal affairs and take concrete steps to safeguard the China-Canada

relationship.” Canada’s initial refusal to extradite Lai Changxing and the public fear of China waging spies in Canada also contributed to souring relations between Canada and China a series (Lo, 2011; Wee, 2011). Later, Harper’s absence at the Beijing Olympics Ceremony in 2008 among many world leaders was perceived by the Chinese government as disrespectful (CTV News, 2008; Lo, 2011). Yet, Harper visited China in 2009 to promote bilateral cooperation and trade, where Wen Jiabao, the Premier, publicly criticized Harper’s overdue visit to China (Schiller, 2009). Harper’s two further visits to China after 2009 were also partly driven by the dissatisfactions from the business community. The awkward bilateral relationship between Canada and China has upset many Canadian companies because it has lost them big opportunities and competitiveness in the international marketplace. A number of companies have called for Canada to make more efforts to promote the economic partnership between China and Canada (Hopkins, 2014).

Although both Canada and China managed the damage from the 2008 Global Financial Crisis, the crisis was still one of the factors that led this relationship closer despite China having little motivation to engage with a “hostile” Canada on human rights (Lovrics, 2021). China’s annual GDP growth rate reached the highest level at 14% in 2007 while the trade was flourishing within the World Trade Organization (WTO), which China joined in 2001, and free trade agreements (FTAs) that China signed with several countries (*China GDP Growth Rate 1961-2022*, 2022; Lovrics, 2021). Canada, at the time, also sought a way to diversify its trade relations away from the US amid economic uncertainties. From China’s perspective, dissatisfaction with the Harper administration did not outweigh the economic benefits of trade cooperation with Canada. Consequently, during Harper’s visit to China, the two sides agreed on cooperation. China lifted the ban on Canadian pork and granted Canada approved destination status, meaning

the number of Chinese tourists visiting Canada would generate \$100 million in tourism revenues annually (Schiller, 2009). In 2014, Canada ratified the Canada-China Foreign Investment Promotion and Protection Agreement (FIPA), an investment protection agreement that aims to ensure both Canadian and Chinese investors are treated equally as other foreign investors or domestic investors in each other's country, regardless of controversies raised over risks such as transparency in investor-state arbitration, environmental concerns for First Nations' rights. In terms of people-to-people linkages, by 2016, almost 1.8 million people in Canada were from the Chinese community scattered across provinces offering contributions to the Canadian economy (Statistics Canada, 2017).

During the Harper governments' years in office, the struggle between upholding human rights and trade cooperation went hand in hand. Indeed, Canadians believe strongly in the country's human rights policies. Still, it is also true that Canada must seek cooperation to solve global problems that affect Canada's security and prosperity. Therefore, a value-based foreign policy towards China alone is unrealistic, as it is unlikely to materialize. Brean (2015) describes this shift in attitude toward China as "more pragmatic than principled" - portraying China as a great power that tolerates criticism and is willing to contribute to creating a new international order in which its influence is comparable to that of the US.

Overall, Sino-Canadian relations from the formal establishment of diplomatic ties in 1970 to the election of a Liberal government under Justin Trudeau at the end of 2015 can be broadly divided into two phases: 1970-2006 and 2006-2016. During the first phase, the two sides continued to deepen their economic cooperation despite frictions over human rights issues during China's significant systematic reform. As China's internal situation stabilized, human rights issues were major in fracturing the China-Canada relationship after 2006, with the arrival of the

Harper government in Ottawa. Although trade and trade cooperation could still strive, different strategies and perceptions of human rights issues became a hidden problem in Canada-China relations.

Chapter 3: 2016-Today

Former Chinese Ambassador Lu (2005) mentioned in a public speech that smooth diplomatic relations between China and Canada are possible because the two countries do not have fundamental conflicts of interest. His example included that both sides aspire to peaceful development and respect national and territorial sovereignty. These commonalities seem incomplete today, as the human rights issues left over from the last chapter appear to have been the catalyst for the deterioration of this relationship after 2016. This section examines the factors and events that have defined the relationship since 2016 and will continue to govern in the future.

3.1 From “Golden Era” to “Crossroads”

As Justin Trudeau’s government took office at the end of 2015, it adopted a trade-friendly engagement policy to build the foundation for a stronger, more stable Canada-China relationship, as expressed during Trudeau’s first visit to China. In This trip, new initiatives were announced in areas of trade and investment, legal and judicial cooperation, and people-to-people ties and exchanges (Prime Minister of Canada, 2016). Premier Li Keqiang, later in 2016, also paid an official visit to Canada, reaffirming the cooperation ahead with Canada, describing the coming years as the “golden decade” to double bilateral trade volume by 2025 and agreed to launch the discussions on a free trade agreement (Wang, 2016). However, Canada had requests for China before entering into the negotiations for the FTA, which were raised during Li’s visit: the removal of the import resections for Canadian agricultural products and the release of Canadian

residents Julia and Kevin Garratt. The Garratts were arrested by the Chinese government in 2014, charged with engaging in military spying. When Kevin Garratt finally came back to Canada, he warned Canada to approach trade deals with China with an “abundance of caution” (Zimonjic and Cullen, 2017).

Ultimately, the two countries could not agree on the ground rules regarding labour, gender and environmental rights and protection for the FTA negotiations. The government of Canada held public consultations with over 600 stakeholders for this possible FTA with China and receiving 130 submissions (Government of Canada, 2017b). The result was that Canadians saw both difficulties and opportunities with an FTA with China. Canadians were concerned that some issues cannot be resolved through regular FTA provisions, such as China’s state-run economy, human and labour rights, instability of the rule of law, and intellectual property (Government of Canada, 2017b). Houlden (2018) had similar concerns over product safety, digital security and intellectual property, and a fast-shifting China can barely be seen as stable. China undeniably offers great opportunity, but its complexities in its system, and economic structure are hard to bridge with Canadian society’s values and norms, such as human rights, labor rights and the rule of law. This discussion again drew attention to the underlying problems in this relationship, even if they had not caused serious conflict in previous collaborations. Ultimately, pushes to launch the FTA was failed marked by a cancelled press conference on the FTA during Trudeau’s 2017 visit to China, as Chinese Primers Li Keqiang explained that it is only natural that both sides “don’t see eye-to-eye” on some issues given the different national circumstances (Bloomberg News, 2017). In 2020, Foreign Affairs Minister Francoise-Phillippe Champagne said that the trade agreement with Beijing is no longer worth pursuing, resulting

from a series of disastrous interactions after the exploratory talks that brought the relationship to a historical low (Vanderklippe, 2020).

If the inability to bridge the gap between China and Canada over core values was not fully revealed in 2017, then 2018 was the year that left the conflict completely exposed. The extradition request from the US Department of Justice to Canadian authorities led to Meng Wanzhou's arrest when changing flights at Vancouver airport. Meng, who was (and still is) Huawei's Chief Financial Officer, was accused of using Huawei's subsidiary, Skycom, to engage in business with Iran, thereby violating US economic sanctions against Iran (Proctor et al., 2021). Immediately after Meng's arrest, China's foreign ministry urged the Canadian Ambassador in Beijing to release her or otherwise face "consequences"; Chinese officials expressed that Meng's arrest was "extremely nasty" and violated her human rights (Reuters, 2018). Though Trudeau reiterated that the Canadian government had no involvement in the decision-making of this case, China authorities went on to detain two Canadian citizens, Michael Spavor and Michael Kovrig, on espionage charges nine days after Meng's arrest in Canada. Their arrest was perceived as retaliation on the Chinese government's part (Proctor et al., 2021). In 2019, as Meng's case was still not settled, China not only detained another Canadian Robert Schellenberg, accused of drug trafficking, but also put a stop to Canadian agricultural goods imports such as canola. The ban was only fully lifted in 2022, causing a great loss to Canada's canola industry (Edmiston, 2022). As for Meng Wanzhou, Michael Kovrig and Michael Spavor, their cases were resolved in late September 2021 after Meng reached an agreement with US prosecutors (Corera, 2021).

Ong (2020) observed that China had adopted a new strategy of using punishments on small foreign countries to "extract compliance." In addition of Canada, this strategy has been used against Norway, Sweden, and Australia. For instance, China applied wide restrictions on

In terms of mitigating factors, some see the outbreak of COVID-19 as both a threat and an opportunity for Canada and China to temporarily ease up on each other amid the global crisis, with the US attempts to restrict exports of medical and preventive equipment when the virus hit Canada (Stephens, 2020). Perhaps both countries see this possibility to warm up the relationship as well as the emergency to address the pandemic with global effort. Canada sent 16 tonnes of personal protective equipment (PPE) to China in February 2020 to help China fight the outbreak even as the public criticized the government for not being proactive in preparing for an outbreak at home (Chase, 2020). In return, China donated PPE to Canada a month later. Due to continuous shortages of PPE worldwide, Health Canada had ordered 1.8 million worth of PPE from different manufacturers in China (Geoff, 2020). Unfortunately, the “opportunity” was short-lived. The Angus Reid Institute’s (2020) survey found that 53% of Canadians strongly disagreed that the Chinese government has been transparent and honest about the COVID-19 situation in China, even though Trudeau, when the survey was conducted, did not issue any public condemnation toward China regarding the government’s handling of the pandemic.

On topics of trade, economic consequences versus human rights and the rule of law, Figure 2 depicts that 58% of Canadians are not worried about the economic consequences if it is impossible to “cut trade ties with the country without a high cost to Canada’s economy” (Angus Reid Institute, 2022). In the same report (Figure 3), the survey on “what should be more important to Canada, trade and investment opportunities or human rights and the rule of law” shows that the difference between the two options has increased significantly over the years. By November 2021, 77% of the people surveyed chose human rights and the rule of law, whereas only 23% chose trade and investment.

Public polls and media reports from past events and statements by leaders have confirmed that the deterioration in Canada-China relations occurred between 2017 and 2018. The reason for this is ostensibly because of Meng's arrest and China's retaliatory detention of Canadian citizens. More fundamentally, it is the different interpretations of values between the two societies, which has been a source of tensions, explicit or implicit, between the two countries since as far back as the Tiananmen Square incident.

**Agreement - I'm worried about the economic consequences of standing up to China
(All respondents, n=2,005)**

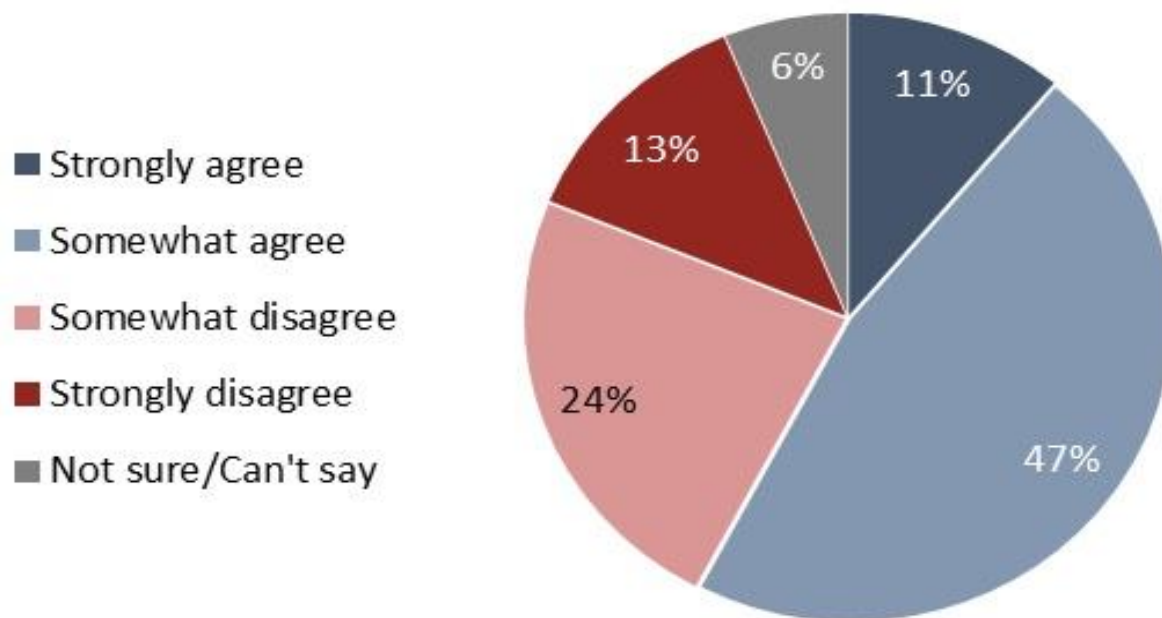


Figure 2: Canadians' views on consequences of standing up to China

Source: Angus Reid Institute (2022)

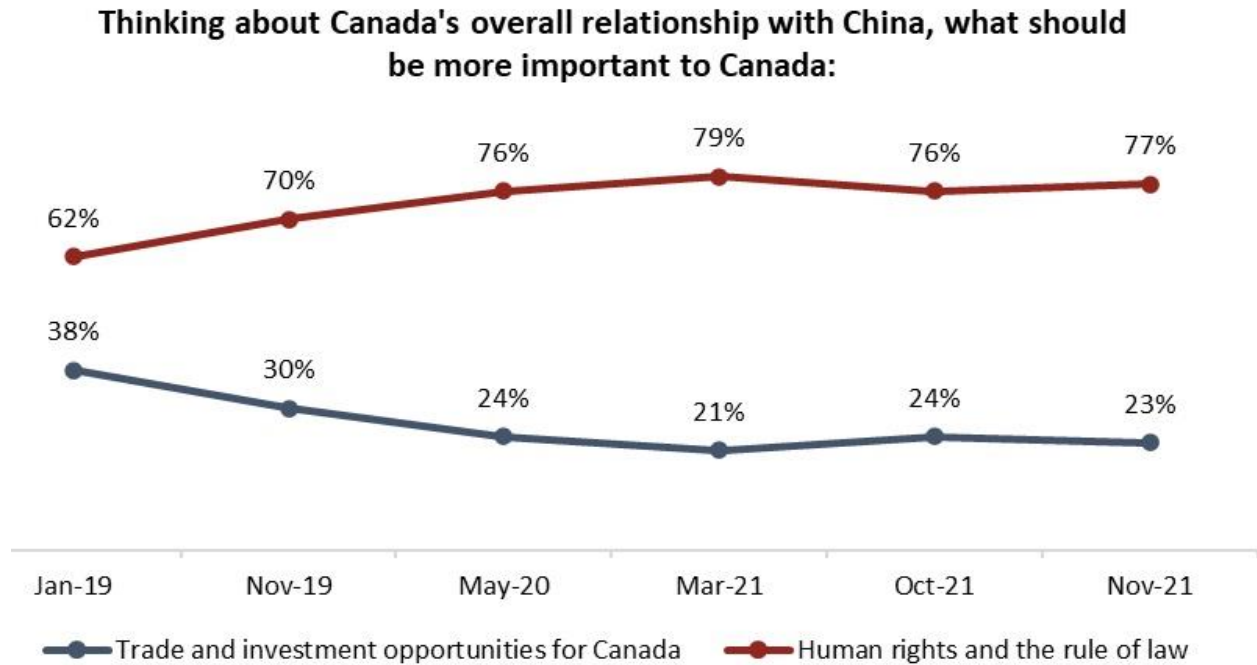


Figure 3: Canadians' view on approaches that Canada should adopt when dealing with China

Source: Angus Reid Institute (2022)

3.2 The US Factor

The Canada-China relationship must also be assessed from a geopolitical standpoint, especially America's accusation of imports as a national threat and putting tariffs and/or quotas on imports, as well as Canada and China's response to America's trade restrictions. This subsection examines how the US played a role in escalating tensions between China and Canada.

The US and China relationship is primarily characterized by strategic competition, and the US trade deficit with China, which was a major concern during the 2016 presidential campaign. US President Donald Trump promised to reduce the deficit and claimed that it was increasingly caused by unfair competition from China: intellectual property theft, forced technology transfers, limited access to China's markets for US firms, and unfair funding to favored Chinese enterprises (Ong, 2020; SCMP Reporters, 2020). In 2018, the US imposed a 25% tariff on US\$34 billion in Chinese imports. This was the first set of tariffs imposed in 2018

and 2019 (Bown and Kolb, 2022). Later, it escalated to a period where both the US and China imposed various tariffs on a range of products until December 2019, when an agreement was reached. The Economic and Trade Agreement Between the United States of America and the People's Republic of China: Phase One went into effect in 2020. According to the agreement, China promised to increase its purchases of specific US goods and services by \$200 billion over the course of two years, starting on January 1, 2020, and ending on December 31, 2021 (Bown, 2022). However, US official said China and US are under discussions since China has failed to meet Phase 1 commitments. US trade representative expressed that the negotiations had been "very difficult" therefore Phase 2 of the agreement has been stalled (Cartwright and Delaney, 2022; Lawder and Shalal, 2022).

Meanwhile, China not only perceived the tariffs as the US' way of securing domestic jobs and the economy but also saw it as the US using economic leverage to keep China from becoming a great power that challenges the US's dominant position. At the heart of these concerns was Huawei, one of the largest technology companies in the world. The US was suspicious about Huawei's close relationship with the Communist Party in China, in spite of Huawei's claim of being privately owned and, thus, independent of Chinese government influence (Ong, 2020). In addition, there has been long expressed concern over Huawei's "snooping and sabotage," leading to worries that relying on Huawei's 5G technology would put national security at risk (The Economist, 2020). Huawei was ultimately targeted in the US-China trade war.

On the other hand, Canada had a lot to adjust due to the fast-changing US-China relations and the global order. The geopolitical realities and antagonism of China and Canada have forced Canada to rethink and handle the situation with great caution. The fact that the United States is

Canada's largest trading partner and China is its second partner makes it even more difficult for Canada to control the situation. Canada had grappled with the US's protectionist approach under Trump's presidency and after. The deep concern had to go with both Meng's arrest and the renegotiation of the North American Free Trade Agreement (NAFTA) (Gardner and Panetta, 2019). Despite the long-standing relationship between Canada and the US, Trump's decision to put tariffs on Canadian steel and aluminum left Canada feeling betrayed. Later, the call for an end to NAFTA to the new US-Mexico-Canada Agreement (USMCA), following the arrest of Meng, again forced Canada to choose which country Canada would stand with. Specifically, the US pushed for section 32.10 and required partner countries to notify the other two before entering FTA negotiation with any non-market economy¹ (Mu, 2021). The clause is essentially directed at China, which further defeats the discussion of an FTA between Canada and China. (Wingrove, 2018).

On the other hand, China was furious about Meng's arrest upon a US extradition request, urging Canada multiple times to release Meng. China viewed Canada as a proxy for the US. Canada consequently suffered trade punishments from China on a range of products. The US-China rivalry has caught Canada in the crossfire. As Massot (2019) recognized, a key challenge for Canadian foreign policy is finding ways to carve out room for manoeuvre in this triangular relationship.

In the previous subsection, we observed that the number of people in Canada who are not in favor of China has been increasing over the years. Similarly, Canadians' opinion toward the US reached a low according to an Angus Reid Institute poll (Angus Reid Institute, 2020). The

¹ Any agreement can be reviewed by the other countries before being signed, and once a new agreement has been reached between a USMCA member and a non-market economy, the other two parties can end the trilateral North American accord and reach a bilateral one. In addition, USMCA country must give the other two members three months' notice before beginning free trade negotiations with a non-market economy (Wingrove, 2018).

downward trend has been attributed to Trump's administration. Only 38% of Canadians favored the US in 2020, compared to 62% in 2016. However, when asked which country Canada should try to develop closer trade ties with, 37% of respondents indicated the US whereas only 11% pointed toward China in a May 2020 poll (see Figure 4). China is the only country among the

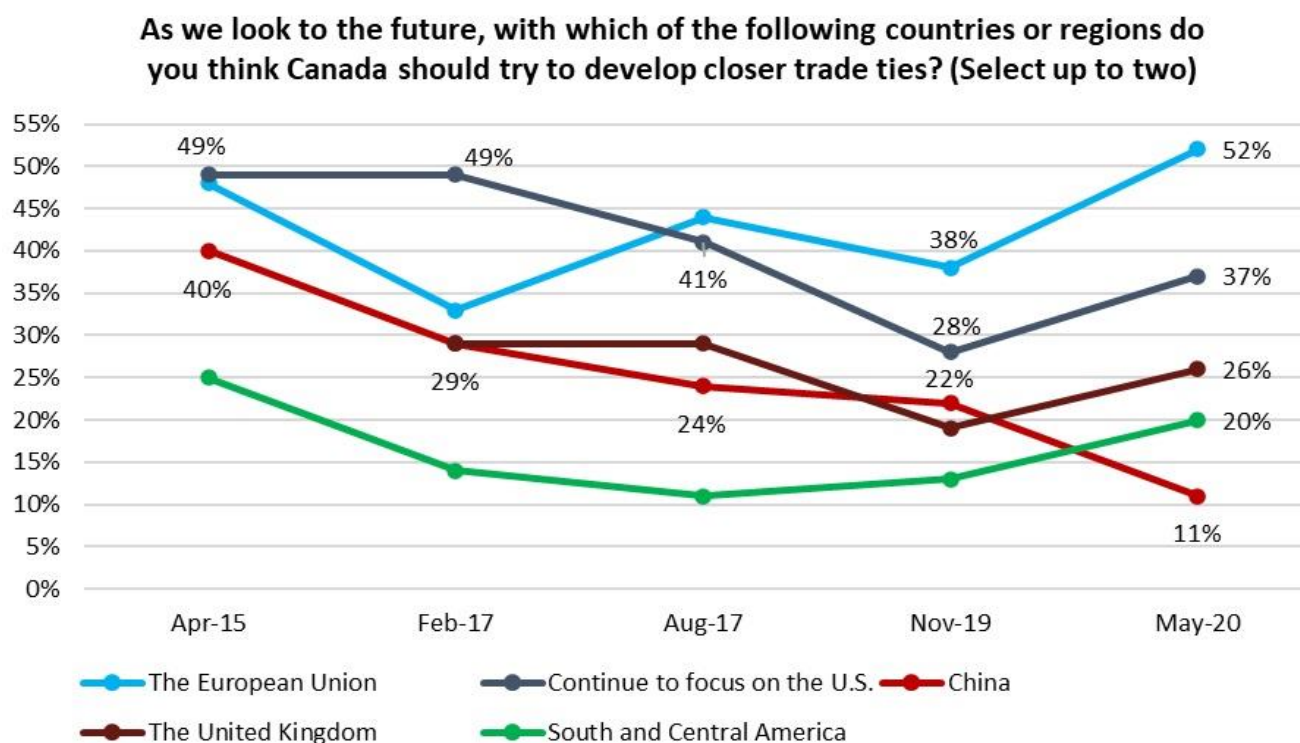


Figure 4: Countries or regions with which Canada should develop closer trade ties Source: Angus Reid Institute (2020)

regions and countries mentioned to experience a decrease in support between November 2019 and May 2020 (see Figure 4). In April 2015, 40% of surveyed Canadians thought that Canada should develop closer trade ties with China, compared to slightly less than 50% thinking that trade ties with the European Union and the US should be privileged (see Figure 4).

To sum up, the tensions in China-Canada relations started in 2017 and ultimately exploded in 2018 because of Meng's arrest. It was also the year that Canada shifted its attitude toward China to distrust. The bilateral relationship between the US and China was arguably the catalyst for a more frozen relationship between China and Canada in this period. But what is

more deeply at stake is the discord in foreign policy approaches caused by incompatible values and legal and social systems between Canada and China. Other western countries, including the US, struggle with similar concerns when cooperating with China economically. Houlden (2018) pointed out that more substantive interaction means greater conflict; Canada's attempt to negotiate an FTA with China makes for an appropriate example. As the great power competition continues between China and the US, the Canada-China relationship becomes more challenging.

Chapter 4: Canada-China Trade and Investment Before and After the Political Tensions

Canada and China have a solid history of economic connection. As its economy grew robustly over the last three decades, China became one of Canada's most important economic partners together with the US and the European Union (EU). The deterioration of bilateral relations in recent years raises concerns about whether trade and investment will decrease. This section compares the trade and investment situations between China and Canada before and after the political tensions that began in 2018.

4.1 Bilateral Trade

Trade is critical to Canada's prosperity as it accounts for nearly two-thirds of the national economy and 3.3 million jobs before the pandemic (Global Affairs Canada, 2020). Since China is Canada's largest single trading partner behind the US and the EU, most discussions around Canada - China economic ties cannot be separated from bilateral trade activities. The analysis of the trade component is divided into two main parts: trade in goods and trade in services.

From 2011 to 2020, as shown in Figure 5, the total Canadian imports and exports with China show an overall upward trend (Statistics Canada, 2021, 2022a). The following subsections

closely examine whether the up and downs match incidents identified in Chapter 3, which is Meng's arrest and the US-China trade war that started in late 2018.

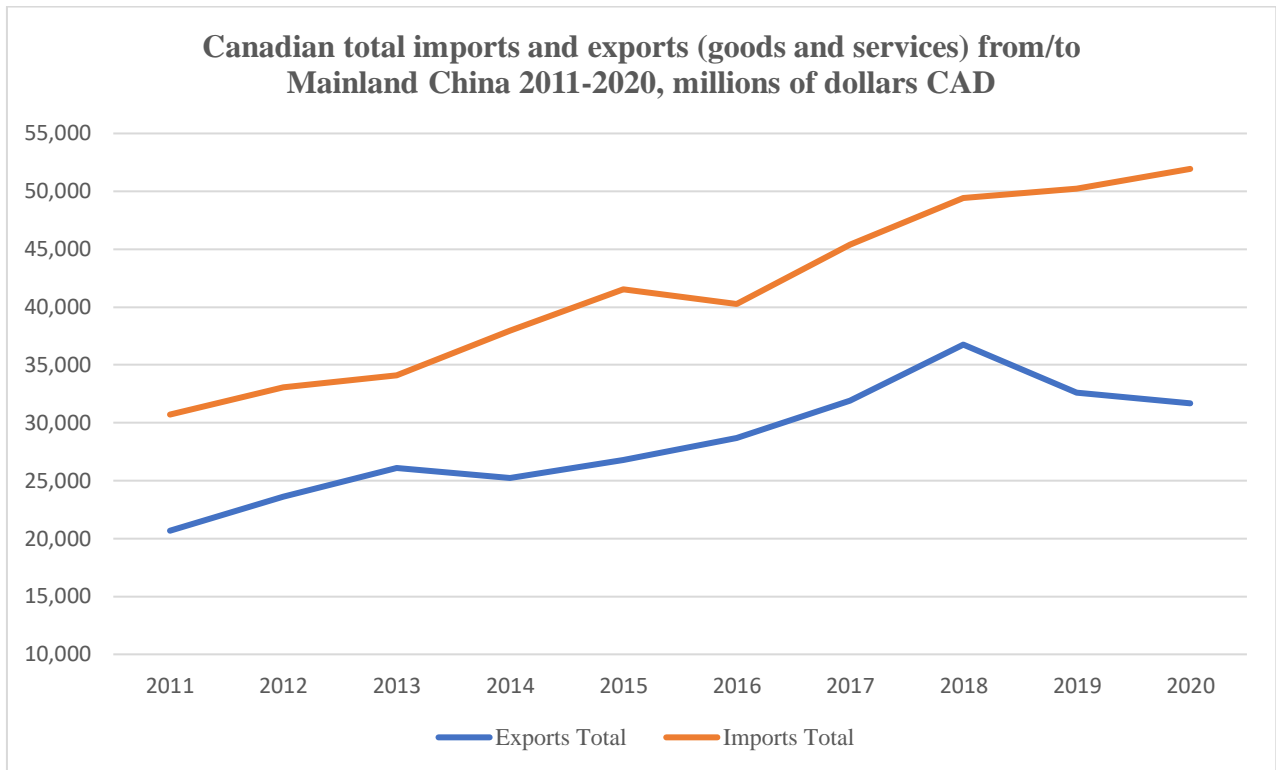


Figure 5 Total Canadian imports and exports to China, 2011 to 2020

Source: Statistics Canada

4.1.1 Trade in Goods

Figure 5 (above) shows that exports and imports for both goods and services between Canada and China were growing relatively steadily until 2018. In comparison, Canadian exports to China dropped by significantly in 2019. Figure 6, obtained using the same set of data as used to construct Figure 5, calculates the year-over-year (YoY) percentage changes that reveals more visually the changes from year to year. It indicates that exports of goods from Canada to China declined by 19% in 2019 compared to the previous year, after experiencing four years of growth, while imports increased by only 2% when they had grown by 11% and 8% in 2017 and

2018, respectively.

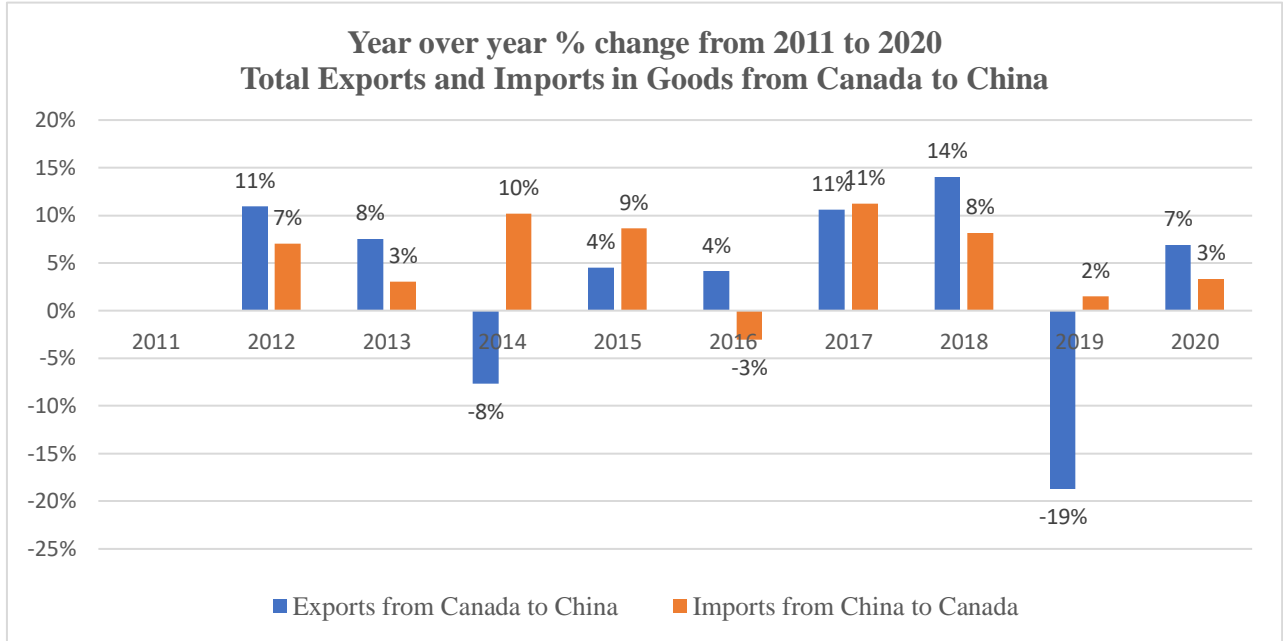


Figure 6: Year-over-Year % change from 2011 to 2020, for total goods imports and exports

Source: Statistics Canada

By looking at the timing of these data fluctuations, we find that they correspond to Meng's arrest and the US-China trade war between 2018 and 2019. Presumably, China chose to restrict imports of Canadian goods, such as canola, soybeans and pork, in order to force Canada to release Meng, with officials explaining the broad restrictions due to concerns about harmful organisms in the shipments (Gardner and Panetta, 2019). The restrictions led both sides to suspect that the deterioration in political relations was the primary reason for the decline in Canadian exports. In contrast to the public impression that many would struggle in dealing with widespread trade barriers, some provinces and industries still managed to make profits regardless of several trade restrictions imposed by China. According to Alton's (2020) analysis, the value of beef and pork exports from Canada to China were able to increase even after months of standstill. Other analysis and news concluded a similar finding that trade overall is in good shape despite the ongoing political factor, with a 7% increase in goods exports from Canada to China

in 2020 (see Figure 6), shortly after the decline in 2019 (Choi, 2022; Hertzburg, 2020). Even though the increase in 2020 seems not enough to cover the lost in 2019, at least an increase was observed without the trade restriction being lifted. In addition, China was among only a few countries where Canadian exports increased in 2020 (Chiang, 2021). A University of Alberta analysis on Canada-China trade explained that Canada's export to China grew 14% year-on-year in 2021, the largest growth since 2018 (Choi, 2022).

In 2020, Canola seed and oil ranked third and fifth of the top 10 Canadian exports to China, respectively (CCBC, 2021). And China is one of the world's largest consumers of vegetable oil. Canola products exported to China were 3.1 billion, only 0.6 billion behind the exports to the US (Alton, 2021). Canadian canola exports to China have grown significantly since the 1990s. Over the past few decades, the largest disruption in this industry's exports to China was in 2019 when China revoked the canola seed export licenses of two large producers: Richardson and Viterra. The official reason was a concern regarding the quality because hazardous organisms were detected in the shipment. Observers have linked the arrest of Meng with this ban. Headlines such as "Farmers' group hopes end of Meng case will lead to resolution of canola dispute with China" illustrate the public perception of the relationship between the arrest and the trade restriction (Seskus, 2021). On the other hand, Sun's (2020) article concluded that politics was not the single driver of the ban, with China undergoing changes in its agricultural trade direction and working to obtain more diversification in developing trade relations with Belt Road Initiative countries where China has more control over the purchase of products with less political concerns. Regardless, we see that political reasons play a role in the canola trade dispute. According to the Canola Council of Canada, canola seed exports experienced a sharp drop from \$2.8 billion in 2018 to \$800 million in 2019, 1.4 billion in 2020

and \$1.8 billion in 2021. Expert analysis says this trade dispute caused a loss of between \$1.45 billion and \$ 2.35 billion for the industry (Canola Council of Canada, n.d.). Despite this, Canada is not likely to abandon China as an attractive market. Canada China Business Council's (CCBC) (2021) analysis illustrates that although canola exports have temporarily encountered restrictions, they do not affect the upward trend in exports. Coupled with the recent complete removal of restrictions, the canola industry can again see a bright future (Global Affairs Canada, 2022a). Opinions differ on the direct link between Meng's arrest and the canola oil market being restricted from importing into China, but what is undeniable is the supporting role that political factors played. Even as China-Canada trade in goods continues to trend upward, the canola oil market gives us an example of how politics caused trade to stagnate and led to economic losses.

In terms of imports in goods, Canada and China are two highly complementary economies, they both produce goods that each other needs. China tends to deliver products with good quality and low prices such as cell phones, toys, textiles, and clothing, while it is a large importer of Canada's canola, pork, coal, etc. Imports from China made up 14% of total Canadian imports in 2020, an increase of 2% from 2019, largely because of the demand in PPE (CCBC, 2021). Canada was very dependent on PPE imports from China at the beginning of the pandemic; 40% of PPE was still bought from China in 2022 (Fraser et al., 2022). A Global Affairs Canada report (2020) on the Canada-China supply chain attested that the "welfare of Canadians is enhanced by" importing consumer goods from China because these imports are inputs to many Canadian productions in the forms of capital and intermediate goods. Similar to exports in goods, some industries are more reliant on Chinese imports than others. For instance, Canadian electrical equipment, small electrical appliances and computer manufacturers are prone to trade disruptions of Chinese components; almost 40% of these components are from Chinese

imports (CCBC, 2021). Even during the low point of diplomatic relations in 2018-2019 due to Meng's arrest and the start of the US-China trade war, Canadian imports from China were not that much affected compared to Canadian goods exports to China as described in both Figures 5 and 6. Considering Canada's highest value imports from China were largely technology-related, computers, toys, phones, and communication equipment, Canada rarely imposes trade sanctions for political purposes partly because Chinese imports are in great demand for the Canadian market. So, it made it difficult for the Canadian government to retaliate against China's restrictions on Canadian agricultural products. Moreover, it was likely that the Canadian government did not want to make the political situation with China more difficult, which could lead to an escalation of trade sanctions, as happened between China and the US, and make the release of the two Michaels even more challenging.

The pandemic that began spreading across China at the end of 2019 led to disruptions in the global supply chain, including Canada. Regardless of the difficulties in determining how much the political factors affected imports between 2019 and 2021 in middle of the pandemic; Choi's (2022) analysis found that the 2021 year-over-year growth for imports from China was 11.96%, the highest growth since 2010 regardless of series of political frictions over the past three years. While Meng has been allowed to return to China in 2021; Canada's public condemnation of human rights abuses and forced labor issues in Hong Kong and Xinjiang, as well as the Minister's letters to eliminate forced labour, human rights abuses away from supply chains, have all added uncertainty to the future of the relationship (Chase, 2021; Trudeau, 2021). In the end, taking both the political and pandemic factors into account, we found that political downturns in 2018 and 2019 have impacted both goods imports and exports. It is also noted that the flow of Chinese goods imports to Canada has been less impacted by the worsened bilateral

relationship than Canadian goods exports to China. Canadian goods exports to China are more prone to Chinese trade restrictions.

4.1.2 Trade in Services

While trade in services is smaller in quantity than in goods, services trade with China grew significantly over the past decade. A Global Affairs Canada report (2020a) explained that the growth in services trade is primarily driven by exports rather than imports. Canadian services exports to China were growing at an average rate of 11% in the past ten years until the pandemic hit both services exports and imports. As described in Figure 7, a significant change was in 2020, with a 50% year-on-year decrease in exports and a 40% year-on-year decrease in imports.

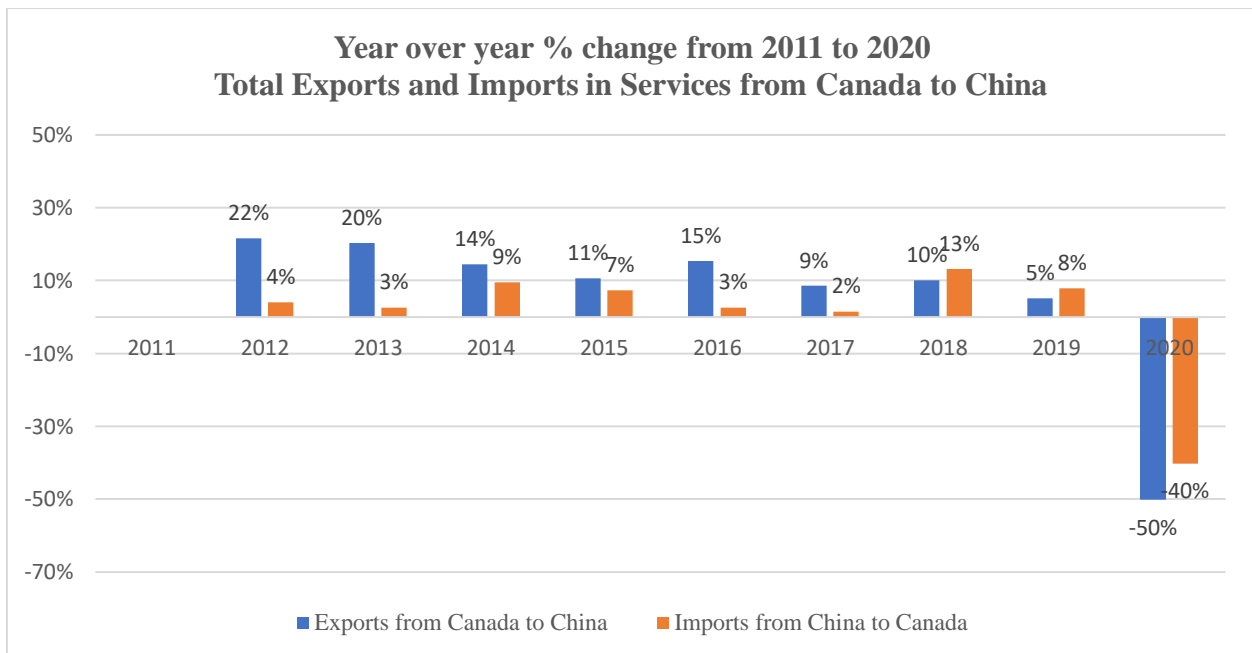


Figure 7: Year over Year % change from 2011 to 2020, for total services imports and exports Source: Statistics Canada

In recent years, travel exports, including tourism and education, have become increasingly popular. They became the largest and fastest-growing category of Canadian services exported to China (i.e., Chinese tourists and students coming to Canada). Within travel exports, education accounts for two-thirds of the total while tourism accounts for the remaining one-third

adding up to \$6.7 billion in 2020 (CCBC, 2021). From Figure 7, we see a weak growth in services export in 2019 following a sharp 50% decline in 2020, the downturn in tourism and education were the main reasons for the drop in exports since the other main categories - commercial services, transportation, and government services - only made around 1.7 billion of exports. According to an international education strategy report released by the Government of Canada (2019), more than 50% of the international students in Canada come from India and China; Chinese international students alone made up a quarter of the total international student population in Canada. The number of Chinese students obtaining study permits declined by 44%, compared to 2019, in the first four months of 2020 because of travel restrictions and diplomatic tensions (Todd, 2020). China warned Chinese citizens that they should be extra careful when coming to Canada because of the “frequent violent actions” by Canadian law enforcement (Reuters, 2020). Canada has also issued a travel advisory to citizens visiting China to practice caution (Xu, 2019). Since then, the number of Chinese students in Canada has plummeted, which corresponds to our observations of the decline in trade data. Therefore, it is reasonable to consider the decline was affected by both the pandemic and political factors. On the other hand, bilateral tensions may also have led the tourism industry to suffer losses. In 2019, Canadian travel agents said the arrest of Meng and heightened tensions between China and Canada had stalled their business. Government tours from China for training, study, or business purposes have declined more compared to individual travel, especially after the travel warnings given by both countries (Xu, 2019). In terms of numbers, Chinese tourists to Canada fell from 682,000 in 2018 to 571,000 in 2019, then 100,000 in 2020 (CCBC, 2021). While the diplomatic tensions may not be fully blamed for the drop, they are most likely a contributing factor.

On services trade imports, China ranked third for the import of services by Canada.

Barriers to trade in services in Canada and around the world are also an important constraint to the development of services trade. As the Shenzhen Institute of Standard and Technology identifies (Izk, 2020), Canada is an early developer of services trade, but still has restrictions on market access in services such as telecommunications, finance, and culture. In addition to retaining the 46.7% ownership requirement for telecommunications service providers, Canada requires that essential telecommunications facilities be controlled by Canadians, and therefore requires that at least 80% of the board of directors of telecommunications companies have Canadian citizenship. These restrictions have prevented global telecom service providers, including those from China, from establishing and operating their own telecom transmission facilities in Canada (Izk, 2020). Telecom services may be a topic of wide interest in China and Canada these days, with Trudeau announcing an official ban on Huawei and ZTE from providing 5G and 4G network services in Canada in May 2022, becoming the last of the Five Eyes countries to join the camp of banning the two companies (Zimonjic, 2022). However, the chatter about the ban had been going on since Meng's arrest, which created hesitancy of this demand in services. The reason is that Canada believes both companies have such close ties with the Chinese government that they threaten Canadian national security. Both Chinese and local Canadian companies have expressed their displeasure. Chinese Ambassador Cong Peiwu said late last year that if Canada banned Huawei, it would pay the price (Boynton, 2022). In addition, small local telecom companies are also facing financial losses for this policy change, as there are already companies that have invested in building the infrastructure purchased from Huawei. According to Boutillier and Connolly (2021), Canadian telecom companies have spent more than \$700 million on Huawei facilities. While waiting to see how this restriction will affect bilateral relations and trade in the coming years, we find that overall services trade does not show a

negative growth until 2020. The sharp decline in services trade data in 2020 can be analyzed as a combination of the pandemic's disruption on supply chain and the barriers that arose from stalemated political relations.

In summary, the analysis shows an overall upward trend in import and export flows in goods and services between Canada and China. Canadian exports and imports of goods are more directly affected by political factors considering the trade ban put in place right after the arrest of Meng. In contrast, services imports and exports seem to have experienced more impacts due to the pandemic. But there is no denying the negative role played by ongoing political tensions, as demonstrated by Canada's decision to ban Huawei and ZTE's 4G and 5G services. But, overall, politics has not had a detrimental impact on bilateral trade. This confirms what scholars have said, that politics can impact trade relations but does not rule out the possibility that bilateral trade can still prosper while experiencing hindrances in the face of poor political relations (Kastner, 2007; Whitten et al., 2020). Li et al.'s (2021) study on China's trade activities further suggests political conflicts lowers Chinese imports from democracies than from non-democracies countries, inferring that distinct political ideologies between China and the exporting country can affect trade decisions.

4.2 Investment

Two-way investment between China and Canada is small compared to bilateral trade; nevertheless, it is still an important component of bilateral economic ties. Investment is a way that brings benefits to both countries regardless of destination or source. This section discusses both Canadian investment in China and Chinese investment in Canada, with a focus on foreign direct investment (FDI). This section also aims to assess whether the impact of the political rift triggered between the two countries in 2018 corresponds to investment fluctuations.

4.2.1 Chinese Investment in Canada

All Chinese outward foreign direct investment (OFDI) was strictly controlled by the state until China's accession to the WTO. Since then, Chinese companies have aggressively invested abroad to improve global competitiveness and access technological growth. China was ranked the second-largest OFDI source country in 2016 following the US (Dobson, 2019). The same year, Canada was ranked the 10th-highest recipient of Chinese OFDI stock globally.

CHINESE INVESTMENT IN CANADA OVERVIEW

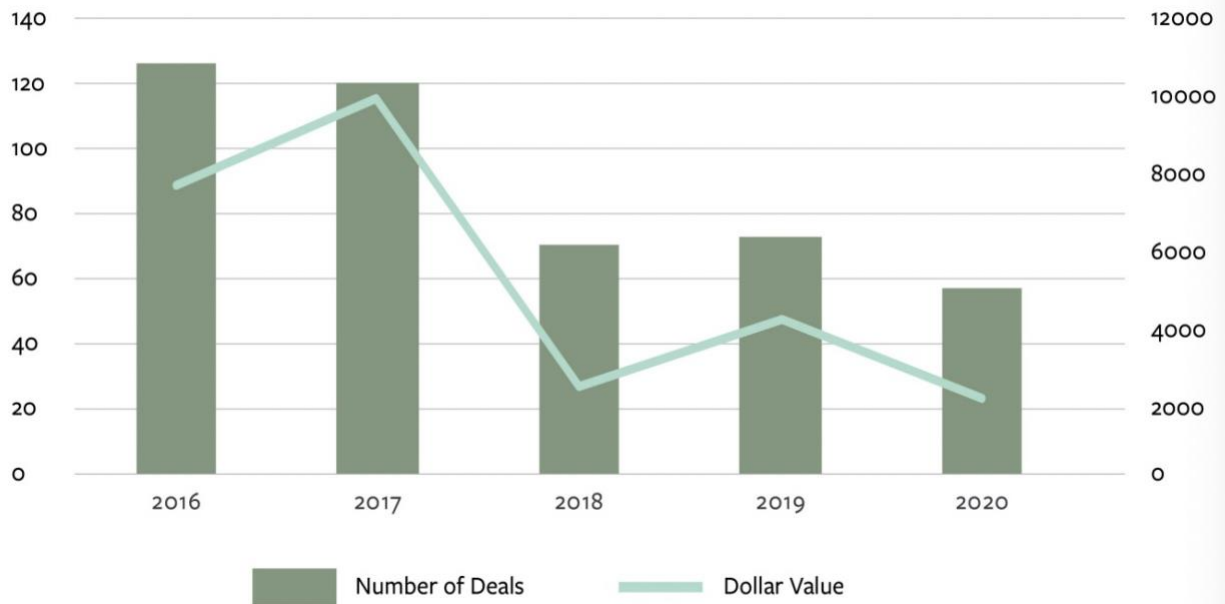


Figure 8: Chinese Investment Flows in Canada 2016- 2020 Source: Canada -China Investment Tracker, CIUA & CCBC ²

Total Chinese FDI dropped by 40% in 2018, part of this reduction could be attributed to the Chinese government's capital outflow controls established in 2016 and 2017. This has been worsened by rising trade uncertainties between the US and China, as well as the increased

² The China Institute at the University of Alberta's China-Canada (CIUA) Investment Tracker was created for the absence good, accessible data on Chinese investment deals in Canada (Alton & Oddleifson, 2020). Tracker is one of the most comprehensive and up-to-date database tracking Chinese investment to Canada since 1993(CIUA, 2022). It is widely used by many studies on Chinese investment in Canada.

scrutiny of Chinese investment by Western countries. Western governments' scrutiny of Chinese investment may have deterred potential Chinese investment (CIUA, 2019). A similar decline was observed in Chinese FDI to Canada: a 47% decline in investment flow took place, from \$8.35 billion in 2017 to \$4.43 billion in 2018 (CIUA, 2019). Accordingly, the number of deals, as well as the investment values of Chinese investment in Canada, also declined in 2018, as revealed in Figure 8 (CCBC, 2021). Data were drawn from the China-Canada investment tracker produced by the China Institute at the University of Alberta (CIUA), visualized by the Canada-China Business Council (CCBC). While the slump in 2018 corresponds to the timeline of Meng's arrest and the start of the US-China trade war, there are many aspects beyond these that have contributed to this downward trend.

A surge of Asian investment in 2013 altered the character of the Canadian oil and gas business and reignited concerns over foreign investment regulation. Discussions on investment by state-owned enterprises (SOEs) took place, partly due to public skepticism about Chinese investment. SOEs have been the major source of Chinese capital flows to Canada. In particular, the \$15.1 billion acquisition of Calgary-based oil and gas company Nexen by state-owned China National Offshore Oil Corporation (CNOOC) raised concerns about the relationship between the Chinese SOEs and the Chinese government. Woo's (2014) summary of the policy debate gave a comprehensive account of Canadian hesitancy to take on Chinese SOEs. Views that are against SOEs in the Canadian market are based on the grounds of Chinese state intervention and unfair competition since the SOEs are subsidized. A popular view is that China will use investment in Canada as a "bargaining chip" in bilateral relations (Woo, 2014). On the other hand, supporters of this deal argued for the benefits that foreign investment could bring to Canada because the high acquisition price offered by CNOOC was good for stockholders and taxpayers. From here,

we see that the original concerns over China's investment in Canada were on SOEs' ownership and their affiliation with the Chinese government, which pose the risk of harming Canadian interests. Subsequently, an amendment to the Investment Canada Act (ICA) was enacted in 2013, adding scrutiny to ensure that SOEs are operating under commercial purposes, including identifying the factors to assess whether an SOE investment meets the net-benefit-for-Canada approval test (Campbell, 2013; Government of Canada, 2017a). The test considers, among other things, the extent of foreign government control over SOEs that may affect Canadian businesses. Even though Canada made clear that this amendment did not mean closing the door to foreign investment by SOEs, these requirements created uncertainties for SOEs investing in Canada, especially Chinese ones (Campbell, 2013; Walker, 2013).

While this test has been used less frequently in recent years, as China has been expanding its operations in the high-tech, energy and natural resources sectors, the focus of Canada's reviews for foreign investments gradually shifted from the net-benefit test to national security reviews (Dentons, 2022). The ICA 2021-21 annual report published by Innovation, Science and Economic Development Canada (2022) expressed that national-security reviews under ICA, in contrast to net-benefit reviews, reached a high in 2020-21, with 23 notices sent to non-Canadians informing of a potential national-security review. Within the 23 notices, 11 cases were subjected to formal reviews and three involved sanctions that prohibited the investors from proceeding with the investment. Furthermore, the report also mentioned that 7 of the 11 Chinese investments were sent for formal national-security review, and Chinese investments made up most of the reviews in the last past years (Hollenberg et al., 2022; Innovation, Science and Economic Development Canada, 2022). Though these reviews do not mean Canada is willing to ban Chinese investments, a court filing regarding China Mobile's prohibition wrote that China is "a

foreign entity posing a strategic threat to Canada and carrying out activities detrimental to the national security and economic prosperity of Canada” (Hollenberg et al., 2022). This statement sent signals that Canada perceives investment from China as high risk. Dobson (2017) criticized the ambiguous net-benefit test and the national-security review process under ICA, that it is liable to politicization by putting the onus of proof on investors rather than the review minister. She explained that the regime was flawed in different ways, including a lack of clear factors named under review and SOEs’ performance expectations. The OECD held similar views that Canada’s FDI screening system under the ICA is opaque (Dobson, 2019, p. 90). Moreover, these changes under the ICA were also influenced by US actions toward China, as US-China trade tensions around 2018 reflected an increasingly rival diplomatic relationship between the two countries. In order to stop the unfair acquisition of US technologies with forced technology transfers and intellectual property concerns, President Trump placed tighter controls on technology transfers to foreign firms (Dobson, 2019). Changes in US policy regarding the review and approval of FDI transactions have made other like-minded countries, such as Canada, more cautious. As initial suspicions regarding Chinese investment and national security issues were already embedded from the CNOOC-Nexen deal in 2013, the negative US stance on China and Meng Wanzhou’s arrest can be seen as ancillary to the implementation of stricter national security policy changes in Canada, which in part led to a significant decline in Chinese investment in Canada in 2018. In addition to Canada, European and US governments have been prompted by political and economic tensions to implement stricter screening and assessment measures for Chinese investors; a policy brief from the Peterson Institute for International Economics (PIIE) (2019) says Chinese investment in both the US and the European countries has declined since 2016. This decline is also due, in part, to Chinese concerns about capital outflows.

After years of rapid FDI expansion, China decided to control capital outflows abroad in late 2016 and 2017 based on the consideration that large capital outflows could pose a risk of devaluation of China's currency and foreign exchange reserves. As a result, the decline in Chinese investment in 2018 is also partly due to China's intention to retain capital within the country (Dobson, 2019; Dollar, 2017). Chinese companies in the real estate, hospitality and entertainment sectors have been the key targets of these restrictions, with entertainment and real estate being the second-largest sectors for Chinese investment in Canada in terms of value (CCBC, 2021).

The direct impact on investment in 2018 came from two primary sources: tightening capital outflows within China and stricter investment scrutiny in Canada due to national security concerns. In between, the US hardening of its stance on Chinese investment, the trade war, and the political fallout from the Meng Wanzhou affair all created a disincentive for Chinese investment flows to Canada. Putting aside the direct causes mentioned above, the study by Li et al. (2019) found that most negative attitudes toward Chinese FDI were due to misconceptions about the size of Chinese FDI and Canadian regulation of such investments. These misconceptions led to public disapproval of many Chinese investments and indirectly contributed to the decline in Chinese FDI to Canada in 2018. In addition, studies have confirmed that bilateral relations and political factors are important determinants of Chinese firms' investment decisions. A study by Tan et al. (2021) found that "intimate" bilateral relations have a positive impact on Chinese FDI in the energy sector; for example, each additional visit by a senior leader would lead to a 5.44% increase in Chinese energy FDI in the host country. The study by Tan et al. is relevant because energy ranks third in China's investment by value, and fluctuations in energy sector investment would lead to noticeable fluctuations in overall

investment volume (CCBC, 2021). In terms of overall investment, Liu et al. (2018) note that China's FDI decisions take more political factors into account when China's currency depreciates. While China, from late 2016 to 2017, tightened capital outflows to prevent further currency depreciation, it illustrates that Chinese investment during this period of currency depreciation is more susceptible to political factors.

4.2.2 Canadian Investment in China

China, as a developing country, has attracted huge investments after its opening-up policy took place in the 90s; however, Canada only invested a small amount in Asia and Africa compared to other G7 countries (Yergeau, 2019). According to the Global Affairs Canada report (2020a), China accounts for only 0.6% of Canadian overseas FDI flows, whereas the US has 36%. Moreover, Statistics Canada (2022b) shows that Canadian FDI in China only started to reach 10 million annually in 2015, and the investment amount has been consistently lower than Chinese investment in Canada. The average difference between Chinese FDI to Canada and Canadian FDI to China is 6.2% over the past 5 years. As Figure 9 reveals, Canadian FDI in China since 2015 has either remained at a similar level or increased, until a 19% decrease was observed in 2019 (2022b). From Figure 9, we see that the decrease in 2019 corresponded with the timeline identified in the previous chapter – Meng's arrest and the China-US trade war in 2018. The following paragraphs explain the link between this decrease and bilateral relations.

The Asia Pacific Foundation of Canada has found that Canadian pension funds were responsible for 84% of all Canadian outbound investments into the Asia-Pacific region in 2021 (Adams, 2021). And banks, insurance and pension funds are the leading investors in China, in which the pension fund business has retained up to 15% of all assets in the Canadian financial

sector (CCBC, 2021). Pension funds' investments in China also drew lots of discussions at the beginning of the political tensions in December 2018. A few days after Meng's arrest, the

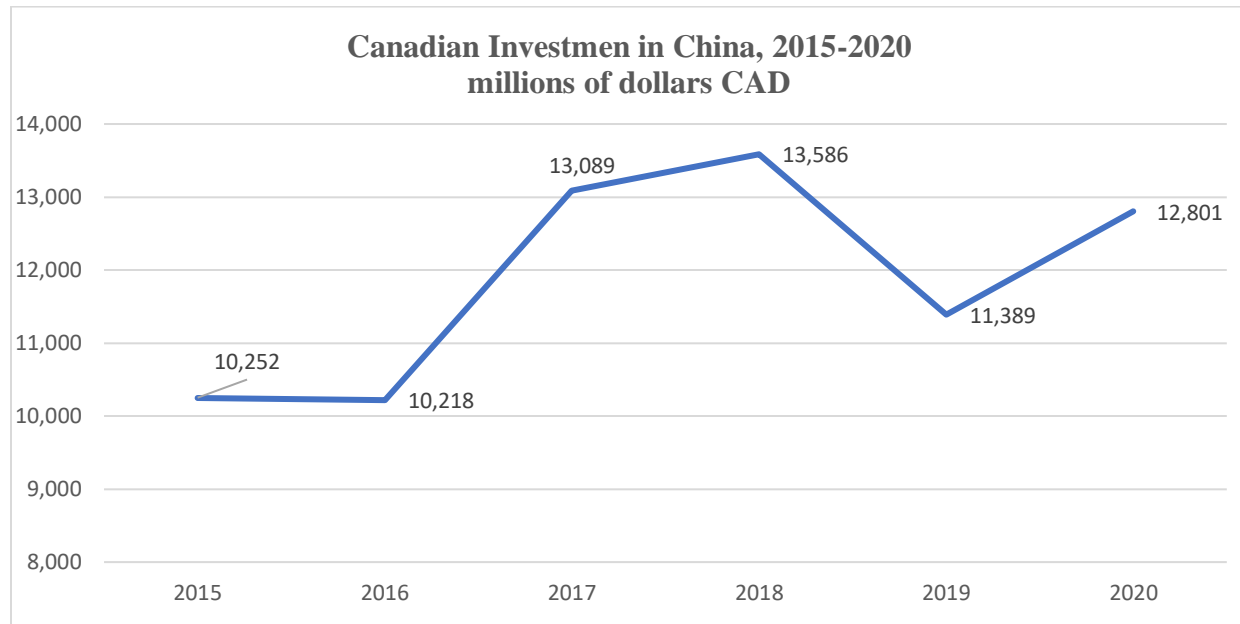


Figure 9: Canadian Investment in China, 2015-2020

Source: Statistics Canada

Canada Pension Plan Investment Board (CPPIB), one of Canada's most prominent public pension funds, expressed that they would continue to engage and deploy capital in China regardless of political tensions because CPPIB has spent two decades and maintained a long relationship with China. CPPIB hoped "people can reach a pragmatic agreement and move on" (Rocha, 2018). Even as the tensions went on in 2019, Canada's vast pension fund stuck with China. Mark Machin, president and chief executive of the CPPIB, said he saw China as a "potential to diversify his portfolio as outweighing any shorter-term economic setbacks" (Turak, 2019). In 2019, CPPIB had \$280 million worth of assets in China and was aiming to double it by 2025. A few months later, CPPIB faced criticism and pressure with continuing to invest in China amid human-rights violations in Xinjiang (The Canadian Press, 2019). Both companies that CPPIB invested in were involved in manufacturing surveillance equipment that restricted the

freedom of the Uyghurs in the region. Moreover, the CPPIB, the British Columbia Investment Management Corp. and the Ontario Teacher's Pension Plan (OTPP) have together invested more than \$12 billion in Chinese companies that were alleged to involve in the Xinjiang human rights abuses (Scanlon, 2021). And, for many, Canada's investment in these companies equates Canada with the support for of human-rights abuses.

Even though the CPPIB's investment in China was not as robust in 2018 as before, the CPPIB's 2019 annual report still recognized China as an emerging market that could diversify its portfolio and offset its reliance on the US. However, in terms of financial performance, CPPIB recognized that the US-China trade conflict, as well as the higher interest rates in the US, caused a decrease in return in the third quarter of 2019 (Bettcher, 2019; CPP Investment Board, 2020). Not only does the CPPIB keep investing in China, but other large pension funds such as the OTPP and Caisse de dépôt et de placements du Québec (CDPQ) are also increasing their Chinese portfolios (Luedi, 2019). The CPPIB's successful investments in China have been praised by many, and the reason it is among the top 10 sovereign wealth funds in the world is inseparable from its investments in China (Luedi, 2019). Senior CPPIB officials have said on several occasions that despite the rocky relationship, China is an important partner to work with in the long run from a long-term gain perspective (Porado, 2020; Turak, 2019). Although investment experts often warn that Canadian pension funds should be extra cautious about their investments in China due to human rights issues, geopolitical risks associated with the Russia-Ukraine conflict, and investment risks associated with unpredictable policy changes in China, Canadian pensions still account for the majority of Canadian investments in China and are likely to continue to invest in the coming years. It is clear from this that the poor bilateral relationship has not deterred Canadian pension funds' investments. Investment decisions are more focused on

long-term benefits. Even with all the accusations of human rights violations in their investments, these large pension fund firms still are unwilling to cut their ties with China. The bigger reason for the decline in 2019 is likely to be a reduction in investment returns due to changes in the global economy, which was partly influenced by the trade war between the US and China.

Besides the financial sector, the retail and services industry has also been expanding its presence in China. Retail brands such as Canada Goose, Tim Hortons, Lululemon have been thriving in China. For example, Canada Goose has over 10 stores in China where the only other store in Asia is in Tokyo, Japan (CCBC, 2021). Meng's arrest in late 2018 led to calls for a boycott of Canadian brands by the Chinese public, and Canada Goose became the prime target of this action. Canada Goose's stock plummeted due to concerns about the brand and investment instability; by January 2019, the loss was said to be \$60 million (Kiladze, 2019). However the calling for boycotts did not seem to affect much of the sales; Canada Goose said that the growth returned in Mainland China in 2020 and they were able to open a few other stores (Rastello, 2020). In 2021, Bloomberg (2021) reported that Canada Goose and a few other foreign retailers were being charged because of misleading consumers, amid their home countries expression on concerns over human rights and forced labour issues in China. There were suspicions that these charges arose from political reasons.

It is clear that the political situation in 2018 and 2019 took a financial toll on both the financial and retail sectors. However, Canadian firms reported that they felt the necessity to establish a presence in China in order to become a competitive international supplier (CCBC, 2021). The same is true for the financial industry, which has chosen to leave political issues behind in the face of positive returns on its investments in China. It is reasonable to conclude that the deterioration of bilateral relations has caused financial losses for Canadian investments in

China, but this has not stopped Canadian investors from being profit-oriented and, therefore, wishing to continue investing in China.

Overall, the total amount of Canada-China bilateral investment is much smaller than bilateral trade but has fluctuated more than bilateral trade in recent years. In this regard, while picking up after 2018, Canadian investment in China has been far less robust than in previous years. One of the main reasons for this is the distrust of Canadian investment in state-owned Chinese companies due to discord over core values on political and diplomatic issues between the two sides, which has led to a strict Canadian foreign investment review policy. In addition, Chinese companies are more concerned about the impact of political factors on investment decisions in the face of the double whammy of Chinese domestic restrictions on capital outflows and Canadian restrictions on investment. The timeline and root issues of the 2018 breakdown in Sino-Canadian relations identified in the previous chapter of this paper aptly echo the investment trend. Several factors led to the almost half-decrease in Chinese investment in Canada that we saw in 2018. On the other side, the smaller number of Canadian investments in China also seems to have felt more or less the inconvenience of political disagreements. These inconveniences have undoubtedly resulted in some economic losses and public discussion. However, this does not stop them from valuing the benefits and prestige that the Chinese investment market brings to them. So, while it is true that some political factors played a role in the decline in 2018, they were not a decisive consideration in the decisions of the investing companies.

Generally speaking, the overall trend in bilateral trade is more positive than bilateral investment under political tension. It is observed that both exports and imports of trade in goods starting to fluctuate from 2018 to 2019, corresponding to the friction in bilateral relations. As China managed to use trade to put pressure on political issues, some Canadian exports received

disproportionate impacts, with the canola oil industry suffering a significant blow due to Chinese sanctions. On the other hand, services imports and exports, represented by tourism and international students, also suffered bumps due to the pandemic and bilateral relationship. Ultimately, the events of 2018 have had a more severe impact on the export of goods, but this does not hinder the long-term upward trend of bilateral trade. As Fraser et al. (2022) explain, China and Canada are two highly complementary countries in trade, so it is not realistic for both sides to want to cut off and significantly reduce trade with each other, as it would harm both societies.

Chapter 5: How Does the Bilateral Relationship Affect Canada

In the first two chapters, we analyzed not only the causes and timeline of the deterioration of bilateral relations between China and Canada, but also how political relations affected trade and investment. This chapter analyzes how Canada-China politics, trade and investment have affected the lives of Canadians. The analysis is divided into two parts: one is the economic impact and the other is the social impact.

5.1 Economic Impact

Canada's trade-to-GDP ratio³ in 2018 was 66%, the second most trade-dependent country in the G7, behind Germany (87%) (CCBC, 2021). Cross (2016) observed that both exports and imports are beneficial to economic growth by increasing productivity; and firms that export have much higher productivity than firms that do not export.

Other than increasing productivity, trade is important because it can be directly related to the well-being of Canadians, such as jobs. For example, international trade accounts for

³ The trade-to-GDP is a metric used to assess how significant international trade is to the economy. It is the sum of exports and imports divided by GDP.

approximately 3.3 million jobs in Canada; more specifically, the jobs that are linked to Canadian exports to China were 182,026 in 2019. (Global Affairs Canada, 2020; Scarffe, 2020). However, it is important to note that Statistics Canada only provides estimates for total jobs supported by exports. The OECD suggests that the actual number may be much higher (CCBC, 2021).

According to CCBC's (2021) calculation based on previous years' data, exports to China grew from 3.11% to 3.86% of total exports between 2009 and 2015, while Canadian jobs supported by these exports grew from 4% to 7.7%. This means that a slight increase in exports to China can lead to an increase in domestic employment.

CCBC's analysis found that 274,028 jobs were linked with Chinese demand for Canadian goods and services in 2015, which is much higher than the number estimated by Statistics Canada. The jobs associated with exports to China, however, declined slightly from 2019 to 2020 (292,378 to 277,188) in the middle of the ongoing bilateral tension as well as the Covid-19 pandemic. The numbers suggest that trade engagement with China is beneficial for Canadians' wellbeing. Analysis shows that the average income for employment embodied in foreign final demand from China is \$49,428, leaving an approximately \$2,000 gap between the Canadian average individual income in 2019 (CCBC, 2021; Statistics Canada, 2020).

In 2019, the total value of Canada's exports of goods climbed to \$533.3 billion, and SMEs accounted for 40.6% of this total; China was the second and third most significant destination for goods produced by small and medium businesses, respectively (Innovation, Science and Economic Development Canada, 2020). As Canada moves increasingly towards policy shifts towards China and imposing restrictions on supply chains to eliminate human rights and forced labour violations, it invariably creates difficulties for Canadian businesses. In 2020, Canada committed to banning imports made of forced labour in CUSMA and later implemented

the change by amending the Customs Tariff ; the Tariff classifies “goods manufactured or produced wholly or in part by prison or forced under tariff code 9897.00.00, which are prohibited from importation” (O’Hara et al., 2022). In 2021, Canada and the United Kingdom made parallel announcements to combat forced labour in Xinjiang. Canada announced measures to address the risk of being “complicit in human rights abuses” in Xinjiang, China. One of the measures included prohibiting imports of goods made with forced labour (Global Affairs Canada, 2021). Following the announcement, Bill S-211, proposes to impose obligations on certain private sectors and government institutions to report to the Minister of Public Safety and Emergency Preparedness about the measures taken to prevent the risk of involving forced labour in supply chains (O’Hara et al., 2022).⁴ Pellerin (2021) argued that it is challenging to comply with these responsibilities when a company’s supply chain is so intricate and made up of networks spanning multiple countries. This makes it difficult to pinpoint problems outside the importers’ capabilities, especially in the case of SMEs. Although 90% of the Government of Canada’s online survey (2021) respondents supported to further addressing forced labour, there are still many difficulties in understanding supply chains because many businesses lack the capacity and tools to monitor and influence their suppliers.

Over the past 30 years, Canada’s exports and imports to China have increased in spite of political tensions. Trade and investment statistics illustrate the resilience of the trading relationship between the two countries. As mentioned in previous chapters, even though public opinion toward China and trade with China shifted dramatically in 2018, the contradiction between political tension and the economic benefits China brings Canadians is hard to reconcile.

⁴ [Bill S-211](#) passed all three readings in the Senate and on June 1st, 2022, it passed the House of Commons second reading. Now with the standing committee in Foreign Affairs and International Development for consideration.

While trading less with China is often discussed in Canadian public debates about relations with China, the economic benefits that China brings to the Canadian economy, such as jobs and wages, make it hard for Canada to cut off the engagement. In addition, as Canada stands with like-minded countries to advocate for attention to human rights-related issues in China, it must also address the ability of domestic companies to keep up with policy changes that are closely linked to the health of the Canadian economy.

5.2 Social Impact

In previous chapters, we identified multiple public opinion polls showing that the number of Canadians holding favourable views toward China has declined since 2018; for instance, an Angus Reid Institute poll (2020) found only 14% of Canadians had a positive view of China. The numbers sparked an upsurge in media commentaries demanding that Canada “stand up to Chinese bullying” (Ritcher, 2021). And policymakers, in some instances, responded to public pressure. For example, Prime Minister Justin Trudeau asking about China’s role in the global Covid-19 pandemic for the first time was seen as a signal that Canada would get tougher on China (Fisher, 2020). However, Li’s (2021) study on Canadian public opinion suggests many misconceptions about China are prevalent; there is a need for policymakers to better comprehend the nuances and patterns in public opinion in order to address growing public concerns about China’s influences on Canadian society. And perhaps one of the most obvious impacts that are closely linked to Canadian society is immigration.

From 2016 to 2021, Canada’s population increased by 1.8 million and 80% of the new residents came from outside of Canada (Gordon, 2022). China is the second source-country for new permanent residents; approximately 1.8 million Canadians are of Chinese heritage, accounting for approximately 5.1% of the total population (Immigration, Refugees and

Citizenship Canada, 2021). CCBC (2021) found that Chinese immigrants' national average GDP contribution is consistent with the overall trend of increased Chinese immigration into Canada. The accumulative contribution of Chinese immigration from 2010 to 2021 is nearly \$49 billion. Not only have Chinese immigrants profoundly impacted the Canadian economy but also the social and cultural landscape. Since the 20th century, Chinese heritage has been settled across Canada and contributed to Canadian literature, sports, education, politics, charity, and infrastructures; Chinese community, made up of immigrations and Canadian-born, makes a key player in Canada's "multicultural mosaic" (Chui et al., 2005). Yet scholars found the majority of Canadian media coverage of China is negative as the political tensions are ongoing; anti-China sentiments and anti-Asian hate are also growing (Evans and Woo, 2021). This trend was recognized by Trudeau when he was asked to respond to reports that scientists at the Winnipeg Infectious Disease Laboratory were working with Chinese military researchers. Trudeau stressed that Canada should be more worried about anti-Asian racism and urged Conservative lawmakers not to "[fall] into intolerance" (Reynolds, 2021). The tense political situation between Canada and China not only fostered issues of discriminations but also created individual-level problems. From a humanistic psychological perspective, Gao's (2021) work offered an insight that the plight of Chinese immigrants in Canada is caused not only by the broad issue mentioned above, but also by their close cultural, social, and political ties with China. The author argues that one of the reasons for the mental health challenges faced by Chinese immigrants is the lack of identity and sense of belonging associated with international political tensions.

Facchini et al.'s (2013) paper confirmed that both economic and non-economic forces could impact immigration policy by shaping public opinion. One of the non-economic factors identified was mass media. Depending on the media outlet, immigration may be consistently

presented negatively or positively; this affects the audience's views about the topic. The impact of significant negative media coverage from ongoing tensions between China and Canada could shake the country's social stability through, for example, discrimination. Since immigration, particularly from China, is a major factor in Canada's development, evidence that political tensions pose a risk to immigrants and those who wish to immigrate to Canada must lead Canadian policymakers to address these serious issues in future policy development.

To summarize the two aspects of this chapter, the relationship between Canada and China should not be underestimated, as it is inextricably linked to the local Canadian society, both economically and socially. On an economic level, the number of local jobs in Canada related to exporting to China is not huge but has been growing over time and the average wages are higher than jobs that are not associated with exporting to China. Further, Canada's forced labour policy against China needs to be further strengthened with local investigations to ensure that SMEs' business is not weakened by politically driven policy changes that target trade and investment to and from China. On a societal level, the amount of negative media coverage resulting from the political frictions between the two countries is not good for the already deteriorating public opinion on China. The role of the media is particularly important in society, especially since they have the power to influence public opinion. Therefore, Canadian policymakers have to consider the political challenges to Chinese Canadians and other minority communities. Both Chinese immigrants and Canadians of Chinese heritage have received varying degrees of influence and discrimination in this political battle, and in a multicultural society, any unfair treatment of one ethnic group can cause social instability.

Chapter 6 The Future of Canada's Relationship with China

Since the deterioration of relations in 2018, there has been no shortage of trade and international relations experts and scholars who have expressed the need for Canada to strengthen its presence in the Indo-Pacific and come up with a new strategy to navigate the future relationship with China (Karadeglija, 2021; Kurl, 2022; Nagy, 2021a). As this region has become increasingly influential internationally and will continue to impact Canada's development in the future, Canada's Foreign Affairs Minister, Mélanie Joly, announced in June 2022 that Canada's new Indo-Pacific strategy will be made public in the coming weeks; specifically, Joly stated, "we want to make sure Canada has a relationship with China" (Blatchford, 2022). Currently, an advisory committee comprised of representatives from the public and private sectors as well as civil society has been tasked to provide recommendations and independent perspectives on the strategy (Global Affairs Canada, 2022b). In this last chapter, we use our analysis to develop insights into the likely future of this bilateral relationship from a Canadian perspective.

The Canadian government's upcoming Indo-Pacific Strategy is a response to the Minister of Foreign Affairs' mandate letter to "develop and launch a comprehensive Indo-Pacific strategy" to strengthen regional partnerships (Prime Minister of Canada, 2021). Global Affairs Canada (GAC) began to develop new strategic agenda with China in 2019 after the imprisonment of the two Michaels and the trade restrictions that China imposed on important Canadian exports to China such as canola and pork. Some predict the new policy will be a means of reducing Canada's economic and trade reliance on China, as well as an increasingly "hawkish" foreign policy (Nardi, 2022). Others predict that Canada will move to "rekindle" and "mend" the relations with China, as Heisler (2022) observed that Canadian business leaders expressed eagerness to resume business with China while Canadians hold negative views toward

China (Blatchford, 2022). It would seem that one of these two approaches will define Canada's relationship with China in the future. However, a third, middle-ground approach is preferable.

Consistent with the findings from our analysis, Nagy (2021), Balloch (2020) and Robertson (2020) all recognize that trade and investment with China have a significant impact on the Canadian economy, which makes them important aspects of future bilateral relations with China. Nagy (2021) called the trade relationship with China a “paradox” because it has remained strong during a low point in the relationship. Trade with China extensively permeates almost every aspect of Canadians' daily lives. From this economic perspective, it would be wise to maximize Canada's economic engagement with China so that Canadian regions with a large economic dependency on China are not sacrificed; meanwhile, Canada should also seek deeper cooperation with other Asian markets (Balloch, 2020). On the same front, Robertson (2020) suggests that Canada should deepen economic relations with Association of South East Asian Nations (ASEAN) members while “in expectation of closer economic relations” with China. The rationale of our analysis would suggest the same, that economic ties with China are strong regardless of diplomatic tensions. Still, Canada has to keep in mind the great potential that China's trade and investment decisions have on Canadian supply chains. Therefore, it would be wise to keep the economic door open while continuing to diversify partnerships with other countries in the region. Canada's diversification in the region remains imperative since it increases the ability for Canada to hedge risks from China's trade and investment sanctions when political tensions arise.

Our findings also suggest that the reason for the political tensions between China and Canada is the difference in fundamental understandings of core values, which means that economic interactions should not be the only factor to consider. Tiberghien (2021) and Touch

(2021) pointed out that US-China relations increasingly shape Canada-China relations, and this triangular relationship also makes China a determinant of the US-Canada relationship. In February 2022, the White House announced a new “free and open Indo-Pacific Strategy” that offers support for regional connectivity, trade and investment, as well as strengthening bilateral and international relationships in the region (Freeman et al., 2022). One major emphasis of the new strategy is to enhance “new approaches to trade that meet high labour and environmental standards” (Freeman et al., 2022). China perceived this strategy negatively. China’s Foreign Minister, Yi Wang, told the press that the US’ Indo-Pacific strategy is a plan to contain China and the attempt is “bound to fail” (Ministry of Foreign Affairs of the People’s Republic of China, 2022). As we mentioned in the previous chapters, Meng’s arrest has not only made China-Canada relations fraught with disrespect and mistrust but has also made China feel that Canada is a puppet of the US. And due to the above perceptions, it is important that a Canadian foreign policy independent of the US is required, but it is also a challenge because the US landscape has changed significantly since Trump’s tenure as president. Canada’s foreign policy must reflect caution as the policy has to represent both independence and cooperation.

Moreover, the Canada-China relationship also needs to adapt to the “polycentric” way of global governance, meaning Canada needs to realize the fact that China is not going to develop into a western-like country that upholds similar values to Canada: the “emboldened China is not going away” (Massot, 2019; Paris, 2020). The new norm of a China policy for Canada would be to keep many doors open such as climate change and economic cooperation while shutting down a few windows such as sticking with rules-based international order and human rights. The road ahead not only requires Canada to work with like-minded partners in the Indo-Pacific region to diversify and protect Canadian interests, but also a change of mindset. The logic of seeing China

as either “no evil” (a critical market) or “only evil” (a threat) needs to be abandoned. Woo (2021) mentions that Canada should see China as a global neighbour rather than a competitor, partner, or enemy. The idea highlights the reality that Canada is in proximity to China on many fronts and yet in between in some other areas; there is no single answer to the complex question of how to deal with neighbours that live nearby. In all, the future of the Canada-China relationship will likely be characterized by three considerations: the triangular relationship of the US-Canada and China, the diversification goal in the Indo-Pacific Region, and the change of mindset toward China. The relationship is about finding a balance between preserving Canadian interests through areas that benefit both sides and sticking to the core values through diversification with other like-minded countries in the Indo-Pacific region. Given the fundamental differences in this relationship, even though the current bilateral relationship may not have improved significantly in recent years, Balloch (2020) reminds us that China is not static and is subject to constant change. It underwent fundamental reforms decades ago, a fact that opens up the possibility of greater cooperation in the future.

To conclude, this major research paper aimed to answer two research questions: namely, how have political tensions between Canada and China in recent years affected trade and investment between the two countries, and what does the investment and trade situation tell us about Canada-China relations in the coming years? First, we examined the timeline of the development of the relationship between the two countries to identify the time period and causes of the intensification of tensions. In between, we also considered factors that exacerbated the conflict, such as public opinion and US-China rivalry. We found that this tension was rooted between the two countries from decades ago, but because the two countries kept the issue behind economic cooperation, it was not until 2018 and 2019 when the unbridgeable foundational values were

pushed to the core of the conflict under the influence of Meng Wanzhou's arrest and the US-China trade war. Next, we explored the impact of political contradictions on trade and investment. Through our analysis, we concluded that the bilateral relationship, which declined precipitously since 2018 and 2019, does have an impact on trade and investment activities. Nevertheless, trade shows an overall upward trend despite the tensions. It is worth noting, however, that different industries are not hit equally by trade restrictions due to political conflict. Also, we observed that Canada is dependent on Chinese imports, which are also important for Canadian supply chains. Moreover, the investment data suggest that FDI is more sensitive to political events. Specifically, Canada's current foreign investment review policy, which has intensified due to distrust of Chinese SOEs, poses a significant obstacle to Chinese investment in Canada. This strict review regime for Chinese investment has added to the momentum, especially at a time when China is tightening capital outflows. In short, the answer to the first question in this paper is that continued political tensions do affect trade and investment activity, however, the impact is uneven across sectors.

To answer the second question, we measure trade and investment trends and the impact of the tense bilateral situation on the Canadian economy and society. On the economic side, we analyzed that Canada's economic ties with China remain critical to Canada's economic prosperity. In terms of social analysis, Canada's people-to-people ties with China has laid the foundation for a relationship unlike any other bilateral relationship. The importance of Chinese immigrants and ethnic Chinese to Canadian society cannot be underestimated, which means that Canada's future China policy must include important considerations of these two points. Finally, by analyzing the impact of trade and investment on Canadian society, this paper suggests that Canada would be wise to remain economically engaged with China while actively seeking

partnerships with other like-minded countries to better protect Canada's interests. Of course, future strategies for relations with China will need to take into account additional factors, such as China's relationship with the United States. In essence, the way forward requires a commitment to finding a balance between maintaining economic ties with China and not abandoning fundamental Canadian values. At the same time, Canada needs to diversify its relations with the Indo-Pacific region and other countries to reduce the risk of economic sanctions from China, and be careful in its relationship with the United States, as the triangle of China, Canada and the United States is critical to the bilateral relationship between China and Canada.

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