The lure of China – yet Canada hesitates on free trade

By Jeffrey Simpson
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Just over a year ago, in February of 2012, Prime Minister Stephen Harper visited China. While there, his Chinese hosts proposed a free-trade deal between China and Canada. Mr. Harper had to know the public offer was coming, because the host country would not spring such an offer on a visitor.

Mr. Harper was suitably cautious and, a year later, he still is. In Beijing, he described free trade with China as "premature." Presumably, he still believes that, because his government hasn't accepted the Chinese proposal. And that leads to the question: At which point will the Chinese take no answer for a No?

Dealing with China is not for the impatient. In May of 2012, Ottawa and Beijing signed a foreign investment protection agreement after 18 years of negotiations. So even if Canada said it wanted to start talking about a possible free-trade deal, a decade would be a very optimistic time frame for achieving one. Australia, a big natural resource supplier to China, has been talking free trade inconclusively for eight years.

Does Canada really want such a deal? The big push by the Harper government is to ship raw materials, especially bitumen oil, to China. A free-trade agreement is not necessary for that. China's trade surplus with Canada in 2010 and 2011 was about $32-billion. Overall bilateral trade would undoubtedly rise with a free-trade deal; the imbalance would not likely change.

A potential deal with China is enticing and forbidding – enticing because of the sheer size and growing prosperity of China's population, forbidding because the Chinese economy doesn't function like others. The Chinese government is investing massively in next-generation technologies: electric cars, airplanes, clean technology, computers and advanced electronics.

Half of China's economy is controlled by state-owned enterprises. There are 121 of these SOEs, and each has dozens of subsidiaries. In addition, the World Bank estimates there to be 114,500 SOEs owned by provincial or local governments. The Chinese government insists that SOEs operate just like private companies in the rest of the Chinese economy and around the world. It isn't true.

They receive preferential loans from state-owned banks. Governments favour SOEs in procurement contracts, many of which are closed to foreign suppliers. The government has declared large sectors of the economy off-limits for foreign investment. And in areas where foreign investment is allowed, it's often permitted only as part of a joint venture, in which the Chinese entity doesn't respect the patent protection of the non-Chinese firms.

Indeed, senior Canadian national security officials have warned major Canadian companies about Chinese industrial espionage and cyber-hacking and urged them to pay much more attention to securing their information systems. In the United States and the European Union, widespread and systematic Chinese theft of patents and industrial espionage is now considered a serious economic and political threat, from which Canada also isn't immune.

The Organization Department of the Chinese Communist Party selects, evaluates and promotes all the senior executives of SOEs whom the Organization Department often rotates. They're all party members who must remember to whom they owe their positions and loyalties. And then there's corruption at every level in China, despite the "anti-corruption" edicts and episodic arrests of party officials.

Mr. Harper seemed to recognize implicitly that SOEs are not like private companies when he decided to allow CNOOC, the Chinese oil company, to take over Calgary's Nexen, but then laid down much stricter standards for future takeovers by SOEs.

Negotiating any free-trade deal with China would be fraught with challenges beyond those between Canada and other largely market-oriented economies – which might account for Mr. Harper's hesitation. So might the ambivalent attitude of Canadian public opinion toward China, and the hostility within elements of his own party. So might concerns about China's authoritarian government.

Set against these challenges is the lure of the Chinese market, the pressure from the business community for better market access in China, the need to diversify trade from reliance on a slow-growth U.S. market, and the certainty that, with each passing year, China's economy will get larger, with reasonable estimates suggesting long-term growth of perhaps 7 per cent a year.