When interests converge

AGRICULTURE AS A BASIS OF RE-ENGAGEMENT WITH CHINA

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CARLO DADE AND
SHARON ZHENGYANG SUN

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Canada West Foundation
110 – 134 11 Avenue SE
Calgary, Alberta T2G 0X5
Phone: 403-264-9535
Email: cwf@cwf.ca

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EXECUTIVE SUMMARY

Canada has a wide range of significant challenges in its relationship with China. Yet, one would be hard pressed to see this reflected in the current public discussions heavily weighted toward specific elements of the relationship, certain sectors and one set of policy responses – punitive measures, with some going so far as suggesting a path of disengagement.

The conversation has become too narrow. If Canada wants to defend its interests, then it needs to actively consider and put into play the full array of interests and policy responses that include opportunities to continue to engage with China – not walk away.

Our allies, who are also our competitors for the Chinese market, have figured this out. While conflict, security clashes and tariff wars may dominate the news cycle, there are other measures receiving less attention. Australia and New Zealand, for example, have yet to rescind their trade agreements with China and are, in fact, renegotiating and updating existing agreements. The U.S., despite waging a cold – bordering on hot – war with China recently inked an "America first" Phase One trade agreement with China that addresses American agricultural issues at the expense of Canada. That the Americans did so after signaling to Canada in the recent NAFTA negotiations to not entertain trade negotiations with China, underscores how important it is for Canada to set its own path. Not doing so will not harm China, it will only help our competitors.

This is neither a new idea nor a new path for Canada. Under difficult circumstances at the height of the Cold War, the Diefenbaker government was able to balance Canadian interests and sell grain to China as it suffered through its greatest famine – against objections from the U.S.

The most effective approach for Canada to engage with China is to once again start where our interests align. As this report documents, agriculture is one of the strongest areas where Canadian and Chinese interests converge.

This report makes the case that China's food security has been put at risk by its recent Phase One agreement with the U.S. For China's food security concerns, this report empirically demonstrates that Canada is one of only a handful of secure food exporters with excess capacity and a track record of not using food as a political weapon or banning agricultural exports. For Canada, hopes to grow its food exports and the investments the country is making to do this in the future, make access to the world's largest agricultural importer critical today and tomorrow.

Agriculture, both trade in commodities and in the technologies to produce them, provides a key convergence of interests in the short run to solve problems that both countries have arising from the U.S.-China Phase One agreement. Even if the two sides are not prepared to engage today, Canada cannot wait for an eventual thaw in the relationship to prepare for re-engagement. The current circumstances will change eventually, and Canada needs to be ready.

Canada is one of only a handful of secure food exporters with excess capacity and a track record of not using food as a political weapon or banning agricultural exports.

There are other challenges in the Canada-China relationship and other approaches to engagement. There have been and will be other reports dealing with those. This report focuses on the *potential* of agriculture and the need to place it front and centre now in anticipation of future change in the relationship. Not doing so will squander the opportunity and will harm, not advance, Canadian interests and the communities, individuals, businesses and families tied to them. China may reject the idea of rebuilding the relationship based on convergence of interest. If so, that will be an important signal that will shape Canadian engagement with China, and the Canadian agriculture community will face harder choices.

List of abbreviations

ACA	Agricultural Cooperation Agreement
AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine of China
BRI	Belt and Road Initiative
ChAFTA	China-Australia Free Trade Agreement
CFIA	Canadian Food Inspection Agency
COFCO	China Oil and Foodstuffs Corporation
FDI	Foreign Direct Investment
MOFCOM	Ministry of Commerce, People's Republic of China
MOU	Memorandum of Understanding
MRL	Maximum residue limits
NTB	Non-tariff barriers
NX	Net exports
OIE	World Organization for Animal Health
TRQ	Tariff-rate quota
WTO	World Trade Organization

INTRODUCTION

For the past decade, China has been Canada's second largest market for agricultural exports and the first or second largest agricultural export market for each of the prairie provinces. While not impossible, gradually replacing large parts of Canada's $6 billion (in 2019) of agricultural exports to China will be arduous, especially for a country that just two years ago had planned to double agricultural exports to China by 2025.[1] Disengaging from and suddenly losing the market would be economically and politically traumatic for Canada's agricultural supply and value chain and the families, communities and businesses that comprise them. Canada is not a government controlled economy. Directing private sector actors in agriculture would be particularly politically problematic for a country that, recently, abolished its government-run wheat board.

Diversification is important in order to avoid placing all our eggs in one basket. But as is the case with the U.S., China's market size, growth and market power makes true diversification difficult and disengagement more so.

As this report shows, for several crops of importance to Chinese food security, Canada is one of only a handful of global swing producers, countries that export a significant portion of what they produce.

While Canadian exports of all goods and services to China have been growing at an average rate of 10% over the last two decades,[2] agricultural exports have been growing even faster at 15%.[3] As of July 2020, monthly export data shows that it is still growing. Where Canada has seen drops in exports, it has been on exports targeted by Chinese government action in specific years. China, on the other hand, has been hit with a series of natural disasters and disease that have significantly harmed food production and set back long-standing efforts to raise domestic contributions to food security.

Given Canada's somewhat unique agricultural production status and the critical human and political importance of food security in China, there is a natural convergence of interests on agricultural trade. Yet, while recent trade tensions and political events have pushed this connection to the background, they have not changed the basic calculation of who has food and who needs food. In the longer term it remains in each country's interest to find a way to work together on agricultural trade. The question is whether the two sides can bring themselves to a point where common interest overcomes tensions of the moment. Agriculture is only the tip of the iceberg in thinking through difficulties in disengaging from China; it is not the full story. As with an iceberg, the deeper one goes the more difficult it gets.

For Canada, given the parameters of the economic realities that define its connection with China, and given Canada's history of managing, rather than diversifying or disengaging when faced with trade challenges in the U.S. and elsewhere, the question for Canada with China is how to better manage this trade relationship. The usual path to do this, negotiating a traditional trade agreement to improve rules of trade, does not appear to be an adequate solution. These types of agreements have not brought the expected relief on the use, or abuse, of health, safety, and other concerns to restrict trade, i.e., non-tariff barriers, to countries that have negotiated them with China. The

1 Government of Canada, 'Ministers Morneau and Carr Co-Chair Successful Canada-China Economic and Financial Strategic Dialogue in Beijing', news releases, gcnws, 12 November 2018, https://www.canada.ca/en/department-finance/news/2018/11/ministers-morneau-and-carr-co-chair-successful-canada-china-economic-and-financial-strategic-dialogue-in-beijing.html.

2 This is compared to only 3% export growth respectively from Canada to the U.S.

3 This is compared to only 5% export growth respectively from Canada to the U.S.

U.S.-China Phase One agreement appears to be a more effective alternative. Canada, of course, will not be able to extract the exact same concessions from China as the Americans. Nor, considering how those concessions were forced upon China with a lingering resentment, should it try to do so if it wants to use this as an opening for a positive reset to the relationship.

While Canada lacks the political and economic negotiating clout of the U.S., it does have other incentives to offer. And importantly, it shares a major new problem in common with China – dependency on the U.S. The critical questions here are: 1) Can China and Canada change the relationship by choosing to pursue a common interest? 2) Do the inadvertent consequences of the new U.S.-China Phase One agreement provide enough of an impetus to do so? And, 3) can both sides find in the U.S.-China Phase One agreement elements to create a new type of agreement on agricultural trade?

China has put new concessions on the table that redefine what is possible to negotiate. Canada can use the U.S.-China Phase One agreement as a benchmark. Furthermore, the experience of Brazil and Australia (countries with roughly analogous economic and political clout to Canada) provides insight into how Canada could negotiate with China; not to gain the type of agreements and arrangements that those countries have, but something new to build on and borrow from – including the new type of agreement that the U.S. has achieved.

The importance of agricultural trade – exports for Canada and imports and production for China – is laid out in this report and in depth in the accompanying annex on Canada-China agricultural trade and non-tariff barrier issues. This report identifies areas of vital interest for each country in agriculture and food that overlap to create common interests. The report then shows how the recent U.S.-China partial trade agreement has made these interests more important – creating a shared urgency to act and benefits from cooperating to do so. Finally, the report looks at the experiences of Australia and Brazil for how Canada can manage negotiations and engagement with China on this new path.

This idea of a shift from a coincidence of interests to a more compelling convergence of interests, lays out the basis for a new path forward. Within the larger story about managing relations with China are lessons on avoiding similar problems with future large emerging market economies.

The critical questions are:

01

Can China and Canada change the relationship by choosing to pursue a common interest?

02

Do the inadvertent consequences of the new U.S.-China Phase One agreement provide enough of an impetus to do so?

03

Can both sides find elements in the U.S.-China Phase One agreement to create a new type of agreement on agricultural trade?

THE STARTING POINT

Problems in Canada's second largest agriculture export market

The significance of trade with China

China has been Canada's second largest export market for all products for the last nine years (since 2012) and overall imports for the last 18 years (since 2003). Figure 1 illustrates the growth in Canada's two-way trade with China as a percentage of Canada's two-way trade with the world over the last 24 years. While the U.S. is still Canada's largest trading partner, accounting for 63% of Canada's total two-way trade compared to only 8% with China as of 2019, trade growth with China over the last two decades has averaged 12% per year compared to 3% with the U.S. Furthermore, this small growth with the U.S. has been declining at an average rate of -1% over the last 24 years compared to an average growth of 8% over the last 24 years for China. The point is that Canada is growing at a faster rate with China than with the U.S. The significance of this growing trade with China is of particular concern for Western Canada which ships close to two-thirds of all Canada's exports to China.

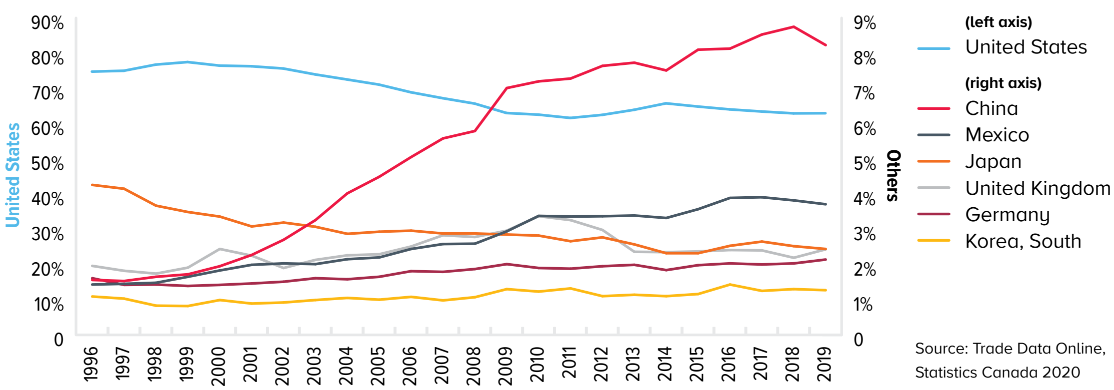
Given the range, depth and volume of the trade relationship, China will continue to be an important trading partner for Canada, especially for agricultural exports. Agricultural exports to China have grown at an average rate of 20% per year since China's accession to the WTO in 2001.

Issues for agricultural trade

The importance of China as an export market is particularly true for agricultural commodities and agri-foods, which account for one-third of Canada's total exports to China (Figure 2, Page 8). As of 2019, 9% of Canada's total agricultural exports to the world were shipped to China. Figure 2 shows that over $6 billion or 27% of Canada's exports to China were agricultural products in 2019. Of this 27%, nearly three-quarters came from the four western provinces (Figure 3, Page 8). However, it is important to note the significant decline in Canadian agricultural exports from 2018 to 2019 as a result of non-tariff barrier issues – as Figures 2-4 illustrate.[4]

This decline demonstrates that Canada's agricultural trade growth with China has been accompanied by periodic economic and political tensions when China has restricted imports for reasons that Canadian exporters *do not believe* are based on legitimate concerns. These non-tariff barriers (NTBs) involve the use of technical, scientific, health, safety or similar concerns not based on scientific evidence, or involve deliberate misreading or misrepresentation of evidence to restrict imports from Canada to China.

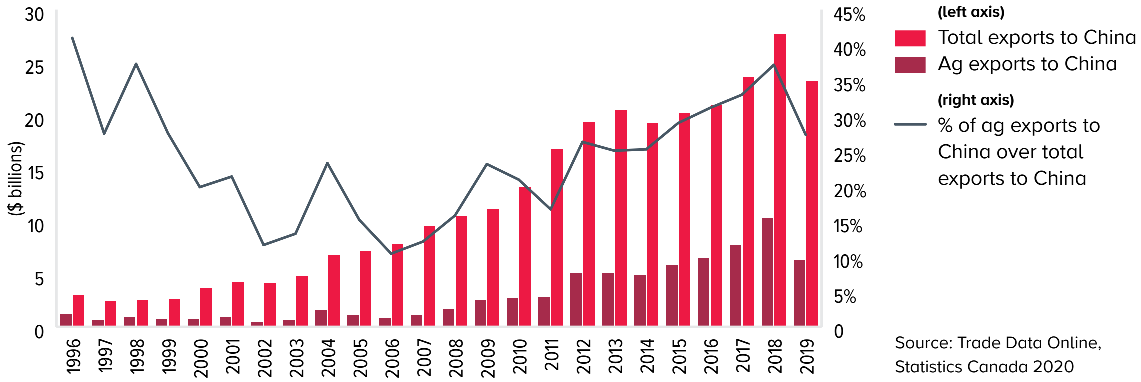
Figure 1: Canada's bilateral two-way trade to its top five trading partners as a percentage of total Canadian two-way trade to world (1996-2019)



Source: Trade Data Online, Statistics Canada 2020

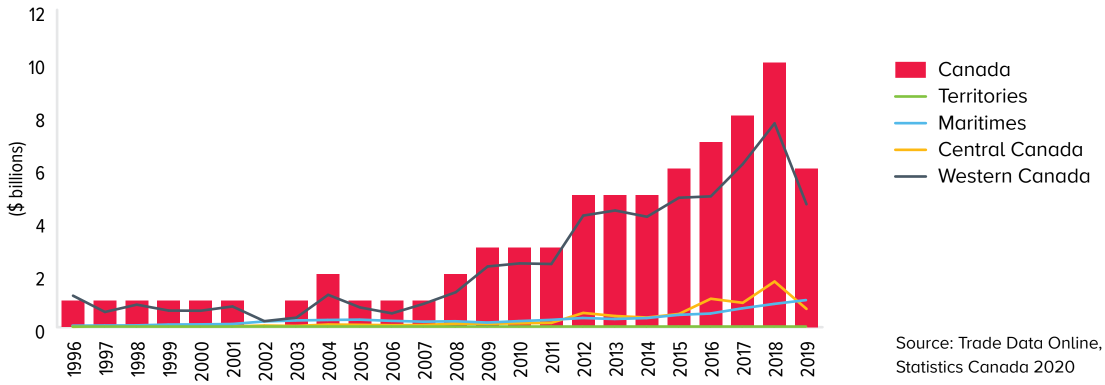
[4] It is important and interesting to note that, while the decline of Canadian agricultural exports to China has declined between 2018 and 2019 resulting in an overall decline in Canada-China's two-way trade, Canada's overall two-way trade with almost all of its key partners has declined, not just with China. These countries include China (-5%), Mexico (-2%), Japan (-2%) and South Korea (-1%). Canada's growth with the U.S. between 2018 and 2019 has slowed as well, a growth of 1% compared to a growth of 6% between 2017 and 2018. The only country that Canada has significantly increased in two-way trade during 2018-2019 is the UK.

Figure 2: Canada agricultural exports to China as percentage of Canada's total exports to China (1996-2019)



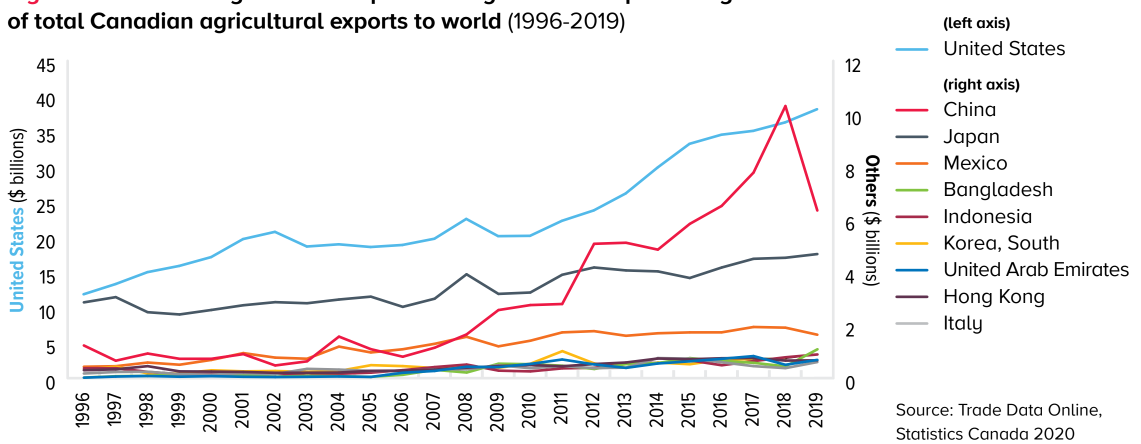
Source: Trade Data Online, Statistics Canada 2020

Figure 3: Canadian agriculture exports to China by region (1996-2019)



Source: Trade Data Online, Statistics Canada 2020

Figure 4: Canadian agricultural exports to key markets as percentage of total Canadian agricultural exports to world (1996-2019)



Source: Trade Data Online, Statistics Canada 2020

Figure 5: Key harmed products that contributed to Canada's 2018-2019 agricultural exports decline with China

HS4	2018	2019	2018-2019 Change
HS 1201 Soya Beans	$1,714,506,364	$33,336,846	-98%
HS 1205 Canola or Colza Seeds	$2,788,422,886	$822,348,982	-71%
HS 1514 Canola, Colza or Mustard Oil and their Fractions (Not Chemically Modified)	$1,130,603,098	$843,354,674	-25%

Source: Trade Data Online, Statistics Canada 2020

The key impacted sectors that contributed to the decline of Canada's 2018-2019 agricultural exports to China are canola seeds, canola oil and soybeans. The damage to Canadian agricultural exporters from NTBs have cost Canada almost $2 billion in canola seed exports, $1.7 billion in soybeans and $287 million in canola oil from 2018 to 2019. Canadian producers increasingly believe it is a question of when and how, not if, the Chinese government will interfere with the entry of products into the Chinese market. This has created direct losses for exporters when the Chinese market is closed and opportunity cost losses from the inability to rationally invest and plan for what has become the world's largest agricultural market. Even when farm gate receipts have recovered, producers continue to face the cost of uncertainty.[5] Discounting the impact of this uncertainty simply because sales rebounded is a mistake.

See **Appendix I** for further discussion of NTB issues.

Despite challenges, agricultural exports to China are expected to grow post-COVID

Despite the public attention brought to the export decline and challenges of canola and soybeans during 2018-2019, there were many agricultural products that experienced export growth to China during the same period that have not received attention. Some of these include less-obvious Canadian agricultural exports of less than $1 billion that have seen the largest gains. These products include pig fat ($411 thousand to $4.5 million, 1000% increase), live fish ($1.1 million to 8.1 million, 590% increase), and other oilseeds ($930 thousand to $4 million, 335% increase), to name a few.

Furthermore, despite the downturn in bilateral relations, the significance of the Chinese market for Canadian agriculture is expected to continue to grow. Based on OECD projections, our analysis shows that by 2028, China will be the largest consumer for some of the key agricultural goods which Canada produces, such as oilseed, soybeans, protein meals and cereals (See **Appendix VIII**, Figure 5).

[5] 'China Brief | Edition 052: Free Trade Pilot in Beijing, China's Corn Shortage and Barley, COVID-19 Vaccine, Farm Receipts, Spotlight Feature | Canada West Foundation', accessed 23 October 2020, https://cwf.ca/research/publications/china-brief-edition-052-free-trade-pilot-in-beijing-chinas-corn-shortage-and-barley-covid-19-vaccine-farm-receipts-spotlight-feature/; https://www23.statcan.gc.ca/imdb/p2SV.pl?Function=getSurvey&SDDS=3437

A harsh but not unfair depiction of the choice for Canadian exporters is between pinning their hopes on a country that is digging a deeper COVID hole or a country that is already climbing out of that hole.

While the global economy has slowed, particularly, because of the COVID-19 pandemic, the Chinese economy has already shown signs of post-COVID economic recovery – ahead of the U.S. and other markets.[6] China has rebounded quickly in Q2 of 2020 (Figure 6, Page 11) and is still growing as Beijing's targeted stimulus campaign has succeeded in mitigating the worst effects of private sector bankruptcies and related unemployment. Financial authorities have also demonstrated sufficient resources and capabilities (technocratic skill and political will) to deploy resources in a manner that can swing momentum back toward growth in the short-term.[7] This contrasts sharply with the continued inability of the U.S. to manage the disease and the resulting economic consequences. The inability of the U.S. Senate to approve a COVID relief plan is a further worrying sign.

A harsh but not unfair depiction of the choice for Canadian exporters in their two largest markets is between pinning their hopes on a country that is digging a deeper COVID hole or a country that is already climbing out of that hole. Figure 6 shows the quarterly real GDP growth for China and the U.S. China's economy enjoyed more lift as it grew 4.9% y/y, thanks to a broad-based recovery and significantly higher than Q2's 3.2%. With a sharp increase in expected consumption that was gathering momentum as of September 30, China will almost certainly continue its upward climb in Q4. The numbers are also reflected in outlooks like the McKinsey Global Survey on economic sentiment, which shows higher, though moderating, levels of confidence by executives in China than any other region.[8]

Trailing 12 months (TTM) July 2020 is expected to see a $2.2 billion or 35% growth from 2019 in Canadian agricultural exports to China (Figure 7, Page 11). Q1 and Q2 of 2020 have already seen $1 billion or 27% growth compared to Q1 and Q2 of 2019, despite the current bilateral dynamic, the impact of COVID-19 had on demand and supply chains woes. The positive agricultural exports growth may be thanks to inflation, Beijing's stimulus program, and an increased demand from China worried about food security from COVID-19. While Canada's exports to the world are expected to drop 16.4% from 2019 to TTM July 2020, its exports to China are expected to increase by 3%. For agriculture, Canada is expected to see an export growth of 8% to the world compared to 36% to China for the same observed period. The majority of the 2019-2020 agricultural recovery are in vegetable products[9] (Figure 7) and in particular, wheat (122%) and peas (dried and shelled leguminous vegetables) with some momentum gained back for canola and soybeans exports (Figure 8, Page 11). Finally, while specific products such as canola were targeted and resulted in the 2019 decline, what is less discussed is the continuous growth in animal products (Figure 7).

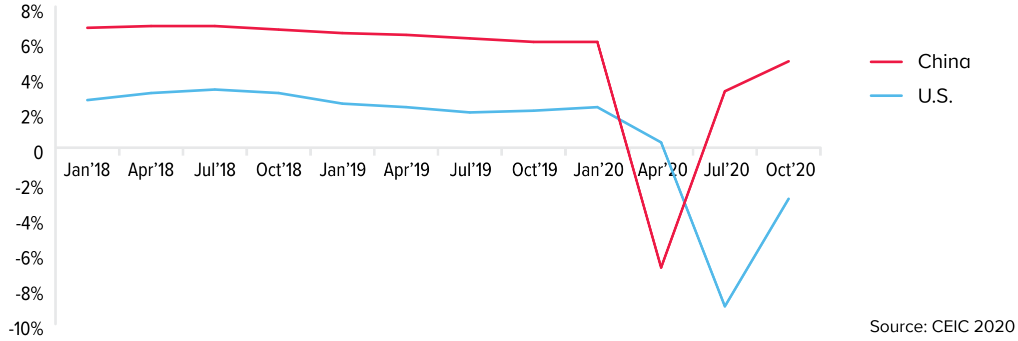
6 China's Economy Is Bouncing Back—And Gaining Ground on the U.S. https://www.wsj.com/articles/chinas-economy-is-bouncing-backand-gaining-ground-on-the-u-s-11598280917; Doubts cloud China's post-coronavirus recovery: Return to growth expected in Q2 but questions remain about health of economy https://www.ft.com/content/ce77bf91-be77-4d9f-94f8-16edcbf039ee; Coronavirus: Chinese economy bounces back into growth https://www.bbc.com/news/business-53399999, China's uneven recovery foretells unlikely growth in U.S. jobs, https://news.harvard.edu/gazette/story/2020/07/chinas-economic-recovery-may-predict-the-u-s-s/, https://www.mckinsey.com/business-functions/risk/our-insights/covid-19-implications-for-business#

7 Economist Intelligence Unit, 'Global Outlook: China's Growth Forecast Revised Upwards for 2020', Economist Intelligence Unit, 25 August 2020, https://www.eiu.com/n/global-outlook-chinas-growth-forecast-revised-upwards-for-2020/.

8 Heather Hanselman, 'The Coronavirus Effect on Global Economic Sentiment' (McKinsey and Company, 29 October 2020), https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/the-coronavirus-effect-on-global-economic-sentiment.

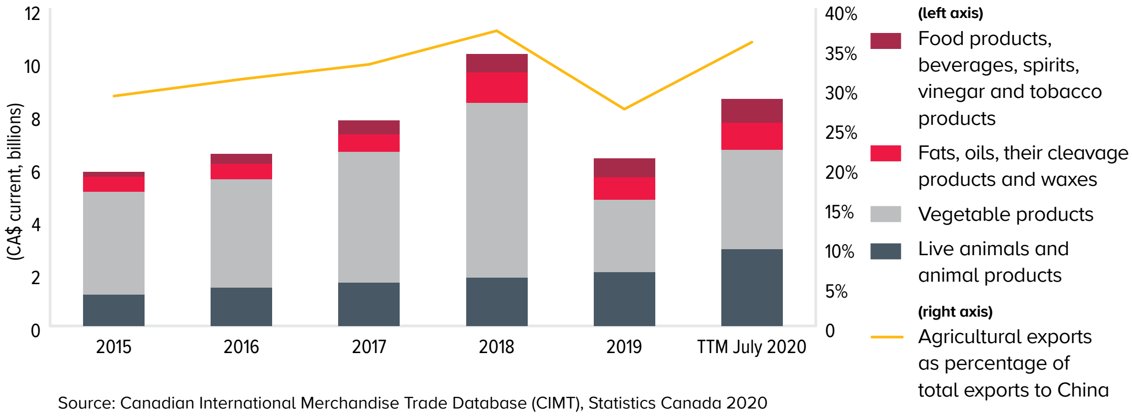
9 Vegetable products refer to cereals, grains, oilseeds, fruits and other field crops.

Figure 6: Real GDP growth, % (Jan 2018 to Oct 2020)



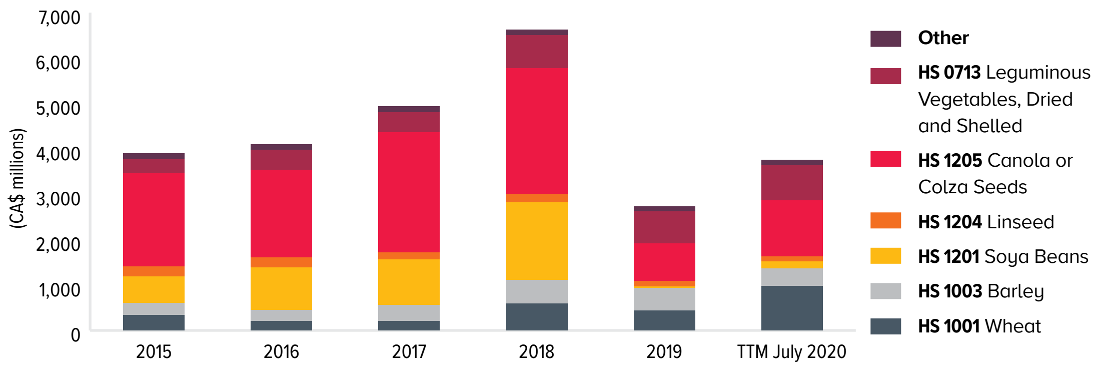
Source: CEIC 2020

Figure 7: Canada's agricultural exports to China (2015-2020)



Source: Canadian International Merchandise Trade Database (CIMT), Statistics Canada 2020

Figure 8: Canada's exports of specific vegetable products[10] to China (2015-2020)



Source: Canadian International Merchandise Trade Database (CIMT), Statistics Canada 2020

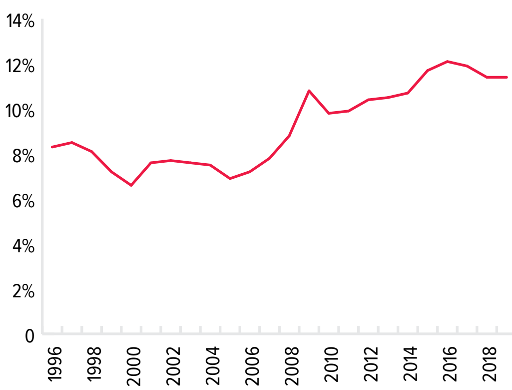
[10] Vegetable products refer to cereals, grains, oilseeds, fruits and other field crops.

No easy way out
Dependency vs. diversification

An extreme solution to the problems with China, is for Canada to walk away in whole or part from a market that has become problematic. But a simple look at Canada's agricultural trade data shows how difficult this would be for a country that exports close to 50% of its agricultural products. Agricultural exports account for 11.4% of Canada's total exports to the world in 2019 (Figure 9). As a percentage of GDP (total industries at base price), Canadian agricultural exports have steadily grown over the last 24 years, hovering at 3.32% as of 2016 (Figure 10). At the provincial level, agriculture is particularly important for the four western provinces – especially Saskatchewan and Manitoba, where 44% and 36%, respectively, of their total exports to the world are agricultural exports. Saskatchewan's agricultural exports accounts for 20% of its GDP (total industries at basic price) followed by Manitoba (9%), Alberta (3%) and British Columbia (2%), (Figure 11, Page 13). Such export dependence in agriculture makes walking away from the largest agriculture market very difficult.

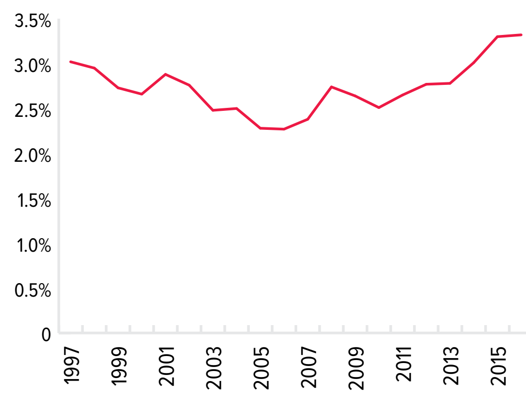
But it is not only the current trade levels that make walking away from China difficult. Increasing agricultural production and exports was a major focus of the current federal government's Advisory Council on Economic Growth, and the agricultural economic sector strategy roundtable that emerged from this announced plans to increase agricultural exports by 75% by 2025.[11,12] More recently, the Saskatchewan and federal governments have announced a $4 billion irrigation project to dramatically increase production of cereals, oilseeds and other crops for which China is currently a top export market.[13] (see **Appendix II** Table 1).

Figure 9: Canadian agricultural exports as a percentage of total exports (1996-2019)



Source: Trade Data Online, Statistics Canada 2020

Figure 10: Canadian agricultural exports as a percentage of GDP[14] (1997-2016)



Source: Statistics Canada, 2020

[11] Innovation, Science and Economic Development Canada, 'Report of Canada's Economic Strategy Tables: Agri-Food' (Ottawa, On: Government of Canada, September 2018), https://www.ic.gc.ca/eic/site/098.nsf/eng/00022.html.

[12] In terms of percentages of total agricultural exports sent to China, Canada is on a par with the U.S., far below Brazil and Australia but much higher than New Zealand and the E.U.

[13] Government of Canada, Western Economic Diversification Canada, 'Prairie Prosperity: A Vision for the Management of Water Resources across Saskatchewan and the Prairies' (Western Economic Diversification Canada, June 2020), https://www.wd-deo.gc.ca/images/cont/20081-en.pdf.

[14] Statistics Canada, 2020 https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610048701

Figure 11: Total agricultural exports as a percentage of total exports by province, 2019; and as a percentage of GDP (all industries, at basic price), 2016

Provinces	Agricultural exports as % of total exports by province, 2019	Average ag exports over total exports in 24 years by province	Agricultural exports as % of GDP by province, 2016
British Columbia	11%	8%	2%
Alberta	10%	10%	3%
Saskatchewan	44%	39%	20%
Manitoba	36%	35%	9%
Ontario	7%	5%	2%
Quebec	9%	7%	2%
Newfoundland & Labrador	6%	12%	4%
New Brunswick	17%	14%	7%
Nova Scotia	43%	28%	6%
Prince Edward Island	47%	63%	12%

Note: The four western provinces are highlighted in blue. Saskatchewan and Manitoba are most dependent on agricultural exports.

When agricultural exports are broken down by sector – animal, vegetable, fats/oils and food products – Canada's dependency on China becomes even more pronounced. For animal exports, China is Canada's third largest market after the U.S. and Japan. But even in third place it is still a larger market than the next *seven* markets combined. For vegetables, China is Canada's second largest market equalling approximately the next *two* markets combined.[15] For fats and oils products, China is again Canada's second largest market with $851 million exports in 2019. More than the next ten markets combined are required to displace Canadian fats and oils exports to China. For food products, China is Canada's second largest market – taking more than the next *four* markets combined.

To replace agricultural exports to China, Canada would have to deliberately move over US$6 billion of exports to other markets despite potentially stiffer than normal competition if other agricultural exporters, driven by the same factors as Canada, are looking to diversify from China at the same time.

The case of canola demonstrates the difficulty in fully displacing and reallocating Canadian exports to China (Figure 12, Page 15). Specifically, in 2019, the $2 billion decline in canola seeds have been sold to many countries. The largest increases include Germany, Portugal, Bangladesh, Australia, France, UAE and Pakistan. The combined sum of growth in canola export to all the countries that displaced China in 2019 adds up to $1.4 billion, which still does not cover the $2 billion gap from China. The overall exports of

[15] In 2018, exports to China for vegetables were larger than those to the next nine markets combined. While the drop from 2018 to 2019 would seem to indicate that diversion is possible, what the data shows is how difficult further diversification would be. The canola example in this report (see Figure 12, Page 15) demonstrates this.

canola seeds declined between 2018 to 2019 and Canada's inability to displace China may be one factor that contributed to this decline. Furthermore, all of Canada's key canola seed export markets – Japan and the U.S., not just China – declined between 2018 and 2019, which also demonstrates the difficulty in diverting specific agricultural products to cushion the Chinese declines. Finally, Australia has particularly increased imports of canola seeds from Canada during this period – an increase from $384 thousand to $2.3 million – redirection of trade by selling to China indirectly. However, the 2019 data shows that this redirection is still not enough to replace the potential of the Chinese market directly. This dynamic applies not only to canola, peas are another crop for which Canada is highly dependent on the Chinese market. (See **Appendix II**, Figure 2)

Data shows that Canadian agricultural trade with China is positive in general and when there are bilateral tensions, Canada sees an impact on a few targeted products that bring down Canada's overall exports. However, the majority of other agricultural products are still growing. If NTBs are addressed, then Canada can expect continued agricultural export growth with its second largest agricultural trading partner, potentially making China the largest by 2050 (according to the OECD agricultural consumption projections, see **Appendix VIII**).

Finally, although Canada does not rely on trade with China as much as the U.S., intertwined supply chains, particularly for agriculture, makes disentanglement difficult. Canada also has a limited array of agricultural products to sell, wheat not grapefruit or bananas. And the products it can produce have limited markets. Other jurisdictions produce similar crops to what Canada exports and these jurisdictions are also looking to increase their exports. Further complicating matters in Canada, these crops are grown in coordinated, rotating groups to balance impact on soil and profit. Therefore, while the recent trade pressures on Canada by both of its largest partners – U.S. and China – call for diversification, the realities of the agricultural sector and trade data show that such massive reallocation of trade from the two largest economies in the world would be economically disruptive, technically difficult and potentially ruinous for producers. Since Canada is not a centrally controlled economy, these decisions are in the end, made by private trading companies and there is little government can do to redirect trade. Short of economic sanctions or tariffs, government action is limited to the nudges of export assistance and incentives.

Despite the targeted negative trade impact on specific sectors in specific years, the overall bilateral two-way trade with China, for both agricultural and non-agricultural sectors, has grown at a significant rate compared to Canada's other key partners over the last 24 years, and continues to grow today. This continued agricultural and overall growth despite the targeted product barriers demonstrates the importance for Canada to address agricultural non-tariff barrier issues with China.

There is also Canada's track record elsewhere, and in particular the U.S., on diversification in the face of continuous harm from NTBs used in violation of international agreements. Here, softwood lumber is a compelling example.[16] (See the textbox on Page 16: "The difficulty of diversification: the case of Canada's reliance on U.S. lumber")

In this reality, diversification from China is less about drastic reallocation of trade as it is slowing the rate of growth of trade.

If that is the condition going forward, then the question shifts from "how to diversify" to "how to manage current dependency of existing trade and on-going engagement?"

Weakness of the current approach in mitigating agricultural exports problems with China

The on-going trade tensions, economic losses and uncertainty are evidence that Canada's current trade policy and engagement have not been effective. Approaches used by other countries such as Australia, have also not proven to be much more effective given their current relations with China. A problem for Canadian engagement with China is the lack of alternatives for engaging in the context of the unrelenting reality of deeper dependence.

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[16] Rabbson, "Softwood Producers Unstirred by Declining U.S. Exports."

Figure 12: Comparing Canadian canola exports between 2018 and 2019

HS 1205 Canola or Colza Seeds	2018		2019	2019-2018 % change	2019-2018 difference
China	2,788,422,886	Japan	1,075,976,770		
Japan	1,283,085,060	China	822,348,982	-71%	-1,966,073,904
Mexico	698,679,250	Mexico	522,014,393	-25%	
United States	321,112,902	Pakistan	392,178,205	42%	1,424,353,060
Pakistan	275,515,192	United Arab Emirates	361,168,739	64%	-541,720,844
United Arab Emirates	220,023,840	France (incl. Monaco, French Antilles)	322,413,847	94%	
France (incl. Monaco, French Antilles)	165,773,166	United States	297,885,444	-7%	
Nepal	27,598,725	Germany	121,690,216	988%	
Bangladesh	15,567,631	Belgium	113,916,851		
Germany	11,184,671	Bangladesh	112,830,173	625%	
Portugal	10,276,578	Portugal	81,534,704	693%	
Malaysia	4,245,610	Nepal	28,344,873	3%	
India	1,449,733	Israel	8,481,399		
Indonesia	547,992	Malaysia	3,249,277	-23%	
Chile	543,413	Australia	2,308,124	501%	
Australia	384,166	India	1,626,244	12%	
Algeria	250,727	Algeria	257,935	3%	
Israel	–	Chile	236,851	-56%	
Belgium	–				
Total exports to world	**5,825,081,659**	**Total exports to world**	**4,268,831,859**		

Source: Trade Data Online, Statistics Canada 2020

Note: Red highlights the significant decline in Canadian canola exports to China between 2018 and 2019.
Blue represents the countries Canada has increased canola exports with in order to displace the Chinese market.

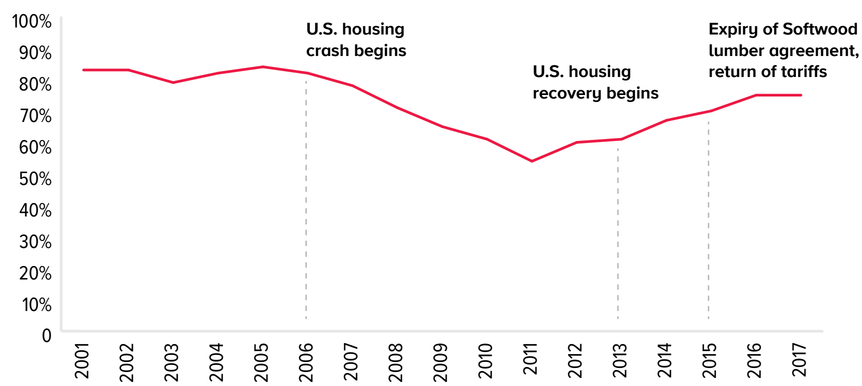
The difficulty of diversification

The case of Canada's reliance on U.S. lumber

Diversification is often, almost unavoidably, presented as a viable option in the Canadian policy response toolbox for dealing with trade and political tensions with the U.S. and China. It is also a staple of any good Canadian political stump speech on trade. Yet, what is rarely if ever mentioned is the reality of trade that makes makes diversification difficult to achieve. In the Canadian context, it is companies who trade, not governments. And telling them to diversify is in one sense asking them to ignore market signals that define the success or failure of their business. Companies will go where they know the market signals are favourable for trade. Where government can play a role is to assist and facilitate companies who want to follow market signals but lack knowledge, connections or other requirements. Governments can also prod, advocate and offer incentives. This is what Canadian provincial and federal governments have done in the case of softwood lumber. Responding to domestic political pressures arising from the damage of U.S. tariffs and other trade measures, which now almost seem like precursors to current problems with China, governments have pushed diversification with every tool in the box, including ironically pitching China as a market into which to diversify.[17] The results have been lackluster and are shown in Figure 13 below. While some individual companies have significantly diversified away from the U.S., including dramatically increasing sales to China, the overall numbers tell a story of lack of movement. Specifically, Figure 13 shows the severity of Canada's reliance on the U.S. market for lumber and the steady growth in percentage export of lumber despite the return of lumber tariffs and the expiry of the Softwood Lumber Agreement in 2015.

China is a more distant and complex market than is the U.S., which may make diversification seem easier. But the more important market dynamics that have muted diversification with softwood provide a stark warning against fantasies of easily diversifying away from the Chinese market for agricultural goods. Of course, if China slams the door shut to Canadian products as opposed to simply raising tariffs, then companies would be forced to find new markets. But this is not the type of diversification being suggested as a Canadian policy response.

Figure 13: Canada exports of softwood coniferous lumber (HS440710) to U.S. as percentage of total exports to U.S. (2001-2017*)



Source: StatCan, CIMT database, Keegan 2012
* 2017 is the latest year available

[17] 'China Market Key to Canada's Economic Diversification: Ambassador', Calgary Herald, accessed 22 October 2020, https://calgaryherald.com/business/local-business/china-market-key-to-canadas-economic-diversification-ambassador.

The answer lies in focusing on finding alignment with Chinese interest. What does China need and want that aligns with what Canada needs and wants?

China will not grant concessions to simply help Canada solve its problem, but it should do so to solve a Chinese problem.

A NEW REALITY

An alternative approach to gaining market access certainty

The Economic and Trade Agreement between the Government of the United States of America and the Government of the People's Republic of China (referred to in this report as U.S.-China Phase One) signed on January 15, 2020 has brought about three critical changes that should inform Canadian thinking on engagement with China in general and on agriculture specifically.

First, the agreement has completely reset the bar for what is possible in resolving agricultural NTB issues with China. It introduced a new, heretofore unimagined model for constraining Chinese use of NTBs, that provides the market access certainty needed by exporters.[18] Second, by placing Canadian exporters at a disadvantage to American counterparts, the agreement creates a whole new problem for Canada in the Chinese market. Third, the agreement has, inadvertently, created a problem for China by threatening to increase its dependency on the U.S. for critical food exports. For a country where food security is an overriding political imperative and foundation of regime legitimacy, dependency on an openly hostile U.S., a country with a track record of using food as a political weapon, is an even more dangerous problem.

The combination of these three factors provides a basis for imagining a new path for Canada to engage China, a new objective and a new means of realizing it.

The new opportunity

The Phase One agreement has five main areas of coverage: intellectual property and technology transfer (which may impact agricultural technology trade), financial services, exchange rates, purchase commitments, and agriculture and agri-foods.

Of the 53 pages of substantive text in the agreement, 22 are devoted to agriculture, providing an indication of its importance in this agreement. Of the HS 4-digit product specific purchase commitments in the agreement, just under half are agriculture or agri-food (see Figure 14).

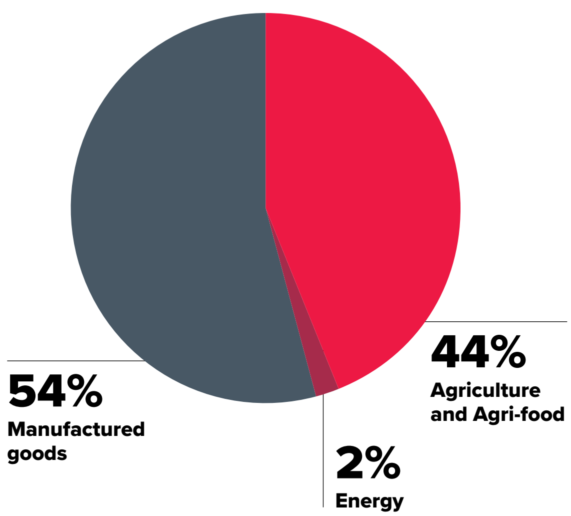
For agricultural trade, the agreement contains two provisions: purchase commitments and rules addressing non-tariff barriers to trade in agricultural and agri-foods products. There is a critical distinction between these two components of the agricultural parts of the agreement that is often overlooked or conflated in reporting.

It is not the purchase commitments

The purchase commitments for Chinese agricultural purchases of US$12.5 billion over 2017 levels by 2020 and additional US$19.5 billion over 2017 levels by 2021, theoretically would more than double the purchases from the U.S. at the expense of Canada and others.[19]

However, these targets are unrealistic and there is a broad consensus that the targets will not be met.[20] This may not technically be a violation of the agreement as China left itself some wiggle room, e.g., price, market condition, quality and other standard contract provisions. But the larger point is that the purchase agreements last, at best, two years.

Figure 14: Purchase committments by HS Code
U.S.-China Phase One agreement



[18] An important side note, the agreement was signed by President Trump two weeks before signing the updated North American Trade agreement (USMCA) on January 29, 2020 with its clause, 32.10, requiring notification and exchange of information on any trade agreements with any country considered by any USMCA signatory to be a 'non-market country'.

[19] Polansek, Karl Plume, Tom. 'China's "market Condition" Caveat on U.S. Ag Purchases Adds to Trade Deal Doubts'. Reuters, 16 January 2020. https://www.reuters.com/article/us-usa-trade-china-agricultureidUSKBN1ZE2QE.

Terence P. Stewart, 'Annex 6.1 to U.S.-China Trade Agreement'. Current Thoughts on Trade, 5 June 2020. https://currentthoughtsontrade.com/tag/annex-6-1-to-u-s-china-trade-agreement/.

[20] Scott Kennedy, 'Mystery Math: The U.S.-China Phase-1 Purchase Figures Do Not Add Up', CSIS Briefs, 10 March 2020.

It is the “structural changes” to the rules of trade

The less discussed NTB provisions in the U.S.-China Phase One agreement do not have a time limit and pose a greater threat to Canada. These provisions, referred to as “structural changes” by the U.S. government, give the U.S. longer-term structural advantages to sell to China and build long-term supply chain and production linkages with buyers.[21] U.S. gains on NTBs in the Phase One agreement were built upon years of negotiations on a wide variety of agricultural products, including sanitary and phytosanitary regulations, licensing, registration, certification, and multiple levels of scientific review. The specificity of these commitments applies lessons learned from past dealings with China and reduces room for capricious bureaucratic manoeuvres, interpretation, or delay – all forms of non-tariff trade barriers. The agreement has close to 120 specific commitments, the majority of which fall on China. Of these commitments, 52 require specific action with specific timelines, for example, either explicitly “upon entry into force of the agreement,” or “within X days of an action by U.S. exporters or the U.S. government Chinese authorities must carry out Y action.”

For example, for infant formula, the agreement states that:

> *“each time the United States provides China with an updated and complete list of infant formula facilities under the jurisdiction of the FDA, within 20 working days of receipt of the list, [sic China will] register the facilities, publish the list on the GACC website, and allow U.S. infant formula imports into China from those facilities, provided the infant formula product is registered with the State Administration of Market Regulation.”*[22]

Similar text in the agreement covers beef, pork, seafood, processed meat, rice, dairy, animal feed and pet food along with biotechnology. (See **Appendix III** and **IV**).

The agreement also advances long-standing U.S. requests such as updating the 2017 protocol that allowed U.S. beef, which had been banned since 2003 due to bovine spongiform encephalopathy (BSE). The 2017 protocol was viewed as onerous by U.S. exporters as it only allowed cattle under 30 months of age. From an American perspective, the U.S.-China Phase One agreement cleans up a lot of loose threads. New and expanded access for meat and processed meat products appear to be the areas where the U.S. made the strongest gains with specific commitments and time frames. For example, China agreed to accept U.S. safety assessments and certification of meat processing facilities within a set time and to start accepting exports from these facilities by a set time after receiving notice of certification by the U.S. (**Appendix III**: Chapter 3 of the U.S.-China Phase One trade agreement)

Finally, the agreement contains concessions by the U.S. toward China, highlighting the importance of reciprocity. China will not make concessions without extracting some reciprocal benefit. (**Appendix V**: U.S. Concessions). These are not as numerous as the concessions made by China and largely focus on assuring that China has the right and ability to inspect food processing operations in the U.S. Interestingly, the Americans did not make any concessions such as Mandarin speaking staff, services or training to facilitate this.

The problem for Canada

The U.S.-China Phase One agreement gives structural advantages to American exporters by greatly reducing uncertainty over market access for agricultural trade. The agreement eliminates the cause of fifteen years of frustration accessing the Chinese vegetable, livestock and agri-food markets – NTB measures used by China.

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[21] Robert Lighthizer and Sonny Perdue, ‘Interim Report on the Economic and Trade Agreement between the United States of America and the People’s Republic of China’ (Office of the United States Trade Representative and United States Department of Agriculture, 23 October 2020), https://ustr.gov/sites/default/files/assets/files/interim-report-on-agricultural-trade-between-the-united-states-and-china-final.pdf.

[22] United States Trade Representative, ‘Economic and Trade Agreement between the Government of the United States of America and the Government of the People’s Republic of China’ (2020), https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic_And_Trade_Agreement_Between_The_United_States_And_China_Text.pdf.

The concessions on NTBs in agricultural trade that the Americans won have gone beyond traditional trade and investment treaties to create a new type of market access *certainty*. American producers can plan, invest and produce for the Chinese market with a much higher level of certainty than other producers, as the discretionary power of the Chinese government to restrict trade has been significantly curtailed. This also creates an incentive for Chinese buyers, especially those who must keep food on store shelves and worry about disruptions, to favour U.S. imports. Some concessions granted by China to the U.S. apply to issues that Canada faces, such as age limits on cattle (see **Appendix IV**).

For Canada, gaining access certainty to the Chinese market — especially resolving NTB issues that the U.S. agreement has addressed — is a priority for the agricultural sector. Confidence on this model comes from the fact that the agreement has held even under the current poor state of China-U.S. relations.[23, 24, 25]

The problem for Canada is that agricultural exporters are at a competitive disadvantage in China suffering the direct and opportunity costs from not having the same market access *certainty* as U.S. exporters. Canadian exporters further lack the robust market access provisions that Australia and other competitors have. While there is little appetite in Canada to pursue a standard, old school, Australian type trade agreement, the same cannot be said for pursuit of a new type of agreement that would address uncertainty. Canada cannot expect to negotiate an identical agreement to the Americans – and nor should it – but given how the agreement was forced on China, the question remains as to whether this can serve as a starting point for both sides to build something new.

Of course, this begs the immediate question of how?

The answer lies in focusing on finding alignment with Chinese interests. What does China need and want that aligns with what Canada needs and wants? China will not grant concessions to simply help Canada solve its problem, but it should do so to solve a Chinese problem.

A new problem for China

The nature of the problem posed by the Phase One agreement on China is not obvious, but potentially more urgent and more complex than it is on Canada. The core of the problem is that the agreement – by giving unique market access certainty advantages to U.S. exporters, creating incentives for Chinese buyers to favor U.S. exports – causes China to become more dependent on a country with a history of using food as a political weapon. Food security is one of the most politically sensitive areas of national interest and regime legitimacy in China. **Appendix VI** discusses the importance of food security for China and the three key elements of why this is important in the current context.

First, most countries are naturally concerned about food security. In China, which based on its history could be called a country of famine, this is an obsession bordering on a national imperative. This is not immediately appreciated in a country like Canada. Second, historically grounded fears of famine are compounded by experience of food being used as a political weapon. During the Great Leap Forward famine under Mao, the U.S. exacerbated the lack of access to food by imposing an embargo that prevented China from getting enough grain to mitigate the starvation of its people. Beyond the explicit threat of agricultural trade embargos, China also sees threats in the structure of the global food markets that are dominated by large U.S. companies. In the Chinese view, these markets fail to guarantee supply because they operate to benefit massive U.S. multi-nationals at the expense of importers like China. This led to its own push to increase self-sufficiency in agricultural production (as illustrated by Made-In-China 2025 and discussed in later sections). However, total self-sufficiency in agriculture is not possible or efficient given environmental and natural resource limitations.

This may explain, the recent overtures to Russia (discussed below). China is attempting to cobble together a global response to the U.S. threat, to counter a new and growing problem it has with U.S. actions that threaten its food security.

[23] Bloomberg.com, 'U.S., China Signal Progress on Trade Deal as Relations Fray', *Bloomberg.com*, 25 August 2020, https://www.bloomberg.com/news/articles/2020-08-25/u-s-china-discussed-phase-one-deal-trump-administration-says.

[24] Office of the U.S. Trade Representative, 'USDA and USTR Announce Progress on Implementation of U.S.-China Phase One Agreement | United States Trade Representative', Press Release, Office of the U.S. Trade Representative, 25 February 2020, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/february/usda-and-ustr-announce-progress-implementation-us-china-phase-one-agreement.

[25] Office of the U.S. Trade Representative, 'USDA and USTR Announce Continued Progress on Implementation of U.S.-China Phase One Agreement | United States Trade Representative', Press Release, Office of the U.S. Trade Representative, 21 May 2020, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/may/usda-and-ustr-announce-continued-progress-implementation-us-china-phase-one-agreement.

A NEW PATH FORWARD

Moving from coincidence to convergence of interest

Short of withdrawing from the Phase One agreement, China has limited options to mitigate this threat of increasing dependency on the U.S. One solution is initiatives such as the recent soybean alliance China signed with Russia.[26] In August 2020, China proposed a "soybean industry alliance" with Russia, announced by Commerce Minister Zhong Shan in a videoconference with his Russian counterpart. This alliance is markedly different than the past broader Chinese trade agreements with countries like Australia that also happen to be food producers. The alliance demonstrates a recent, evolving response to current Chinese fears and challenges in its trade war with the U.S. and its concern over potential dependency on the U.S. The alliance is a deepening of a soybean cooperation agreement signed the year before. The alliance would also address shortcomings in the previous agreement that did not prevent Russia from cutting soybean exports to China as part of its COVID emergency response.

Chinese professor Chen Bo from the University of Science and Technology in Wuhan noted:

> *"Any country faces national security risks if it is overly reliant on an individual nation in crucial sectors such as grains and pharmaceuticals. China is hoping to deepen cooperation with various countries to secure its interests in soybean supply over the long term, and Russia is one of them."*[27]

But there are other options. Allowing market forces rather than government-led initiatives to dilute the U.S. advantages by making them less unique is another, stronger option for crops and food items where Canada, a country that does not have a history of export bans like Russia, competes with the U.S.[28, 29]

The significance of agricultural trade as well as the complementary issues shared by Canada and China create a point of convergence of interest where both countries face urgency to act. This may be strong enough to bring both sides to the table and potentially help push reconciliation on other tensions in the relationship or to repair the relationship if these other issues are resolved.

The immediate problem that brings Canada and China together is dealing with the consequences of the U.S.-China Phase One agreement. For China, this means mitigating the potential for increased dependency on U.S. agricultural exporters. Extending similar benefits to Canada can dilute the U.S. advantage thus weakening dependency. Canadian producers are familiar with how this works from their recent experience in Korea. When the U.S. signed a preferential trade agreement ahead of Canada, Canadian exports of pork plummeted. When Canada caught up and signed an agreement, it took back market share. For China, allowing market forces to dictate the outcome, rather than direct government intervention, solves its problem without complaint from the U.S. about government inference or China reneging its commitments and threats of U.S. withdrawal or retaliation. For Canada, gaining the same market access certainty that the Americans now have, solves its problem.

But shared interests go beyond dealing with the immediate harms of the U.S.-China Phase One agreement. Solving the problem that both countries have with the U.S.-China agreement can lead to broader conversation of deeper cooperation on similar shared interests on agriculture. But this requires understanding what the shared interests are, which requires a critical examination of the factors that make up the trade relationship.

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[26] Wendy Wu, 'China Calls for "Soybean Industry Alliance" with Strategic Partner Russia', *South China Morning Post*, 26 August 2020, sec. News, https://www.scmp.com/news/china/diplomacy/article/3098980/china-calls-soybean-industry-alliance-strategic-partner-russia.

[27] Wendy Wu, 'China Calls for "Soybean Industry Alliance" with Strategic Partner Russia', South China Morning Post, 26 August 2020, sec. News, https://www.scmp.com/news/china/diplomacy/article/3098980/china-calls-soybean-industry-alliance-strategic-partner-russia.

[28] Catherine Belton, Jack Farchy, and Javier Blas, 'Russia Grain Export Ban Sparks Price Fears', Financial Times, 5 August 2010, https://www.ft.com/content/485c93ae-a06f-11df-a669-00144feabdc0.

[29] Huang Ge, 'Russia Soybean Ban Won't Disturb Chinese Market Supply: Insider', *Global Times*, 9 April 2020, https://www.globaltimes.cn/content/1185154.shtml.

Elements of convergence of interest

China Interests	China Asset	Canada Asset	Canada Interests
Assurance of food security	Largest market for agricultural products	Secure agricultural production capacity that is politically stable. One of the few "swing" exporters with surplus capacity	Export dependent agricultural sector that needs market access certainty
The need to reduce U.S. dependency, which is further exacerbated by the U.S.-China Phase One	Largest market for agricultural products	History of independence from U.S. on agricultural trade embargos with China and Cuba	Ensuring ability to compete with U.S.
Worry that U.S. will expand "Huawei-style" pressure onto other sectors including agricultural technology as part of its efforts to contain China	Largest market for agricultural products and growing R&D in agricultural technology	No current U.S. export ban on or pressure not to sell agricultural technology	Desire to export agricultural technology and increase cooperation on innovation and research
Reduce potential dependence on U.S. as a result of inadvertent consequences of Phase One deal with the U.S. while not doing anything to void agreement	Ability to grant same concessions as the U.S. received under the U.S.-China Phase One	Ability to help dilute U.S. advantages	Remain competitive with the U.S. in China, offset competitive disadvantages of U.S.-China Phase One agreement
The need to seek quality diversification that guarantees stable supply	Largest market for agricultural products	History of pursuit of Canadian interest even when in conflict with the U.S., e.g. China, Cuba	The need to differentiate itself from U.S. on the use of food as a weapon and defence of Canadian interests
The need to increase self-sufficiency via industrial policy and fear that U.S. will cut access to foreign technology directly and through pressure on its allies			Competitive advantage in advanced agricultural technology and know-how such as soil remediation and crop optimization to improve yields, reduce pesticides, herbicides and fertilizers

China's need for food security and Canadian assurance of supply

The significance of China for Canada's agricultural trade, particularly for western provinces means that disentanglement from the Chinese market is difficult. On the other hand, Canada ranks only sixteenth as China's most important source of agri-food imports. However, this does not tell the full story.

Canada is a critical source of agricultural imports for China

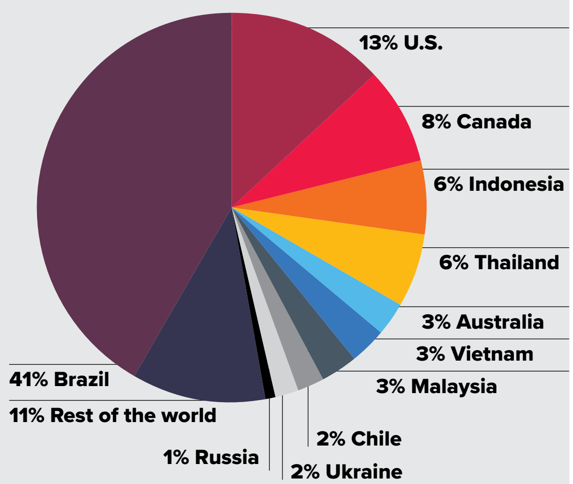
Canada is China's third largest source for vegetables well ahead of Russia in 11th place (Figure 15) and is China's sixth largest source of animal products and 13th largest source of processed food as of 2018.

Canada is one of a few secure suppliers for China

Not only is Canada a top agricultural sourcing country for China, it also tops the list for assuredness. Canada is not the largest producer for all the agricultural products that China imports, however, there are very few countries in the world with production capacity that can consistently generate significant net exports in excess of their own needs. Canada is one of the top ten countries to consistently produce more than it consumes along with countries such as Argentina, Australia and Brazil. In 2017, Canada exceeded 30% net exports in excess of their own production while some of the largest agri-food exporters in the world, such as the U.S. and Russia, exported smaller percentages of their production base with 22% and 29% respectively.[31] This means that in the event of a bad crop year or a crisis such as COVID-19, a country like the U.S. – where domestic consumption takes up a large percentage of what is domestically produced – would be a less reliable import source for China.

Figure 15: Top sourcing countries of vegetable products[30] for China (2018)

	PARTNER	IMPORT (US$ thousands)
1st	Brazil	$ 29,240,598
2nd	United States	$ 9,616,213
3rd	**Canada**	**$ 5,532,763**
4th	Indonesia	$ 4,553,859
5th	Thailand	$ 4,450,115
6th	Australia	$ 2,149,873
7th	Vietnam	$ 2,146,187
8th	Malaysia	$ 1,964,713
9th	Chile	$ 1,772,079
10th	Ukraine	$ 1,216,669
11th	Russia	$ 846,644
12th	Philippines	$ 834,343



Source: World Bank, World Integrated Trade Solution, 2020.
WITS data only available for 2018.

[30] Vegetable products refer to cereals, grains, oilseeds, fruits and other field crops.

[31] Mussell, Bilyea and Hedley. 2020. The New Trade Economy of Food Security: Repositioning Canada. Independent Agri-Food Policy Note. Agri-food Economic Systems.

Figure 16 on Page 27 illustrates some key aspects of the export reliability of the world's largest producers of beef, wheat, soybeans and oilseeds. These goods are key agricultural imports for China. All numbers are from 2018 and production surplus/deficit, export and net export are measured in thousands of tonnes, summed into an aggregate across the illustrated agricultural products. The difference between production and consumption (production surplus/deficit), as well as domestic consumption as a percentage of production, demonstrates whether the country is a net producer or net consumer of a product. Very few countries have surplus capacity to offer agri-food products to others, particularly when the exporting country's imports of like product is netted from its exports. Therefore, net export (column: NX) is calculated to reflect this, and all tables are ranked by largest to smallest in Net Export capacity. Net export as a percentage of production (column: % of NX over Production) is the export capacity metric that reflects the material capacity of a country to generate net export more than their own needs. Each column is colour coded with a three-colour scale that is based on percentile. Specifically, yellow is the lowest value (worst), blue is the highest value (best) and the midpoint or 50th percentile is white. Based on these metrics, the most reliable supplier of beef, for example, includes Brazil, Australia, India and Canada. A similar story can be told for pork.

Another example is oilseeds. Canada produces the largest surplus in oilseeds and is the largest net exporter in the world. Not only is it the largest in absolute capacity but also in relative capacity after considering domestic consumption, imports and exports. This results in 54% of net export over production. On the other hand, China experienced the largest deficit (consumption greater than production) of oilseeds in 2018, consuming 118% of what it produced. This deficit is almost entirely covered by imports. This data has implications for the 2019 canola NTB issues between China and Canada. While the NTB issues have hurt Canadian canola exports (evident of Figure 4 and 5), the measure of food export reliability shows that the NTB costs China as well, and signals that while China may be able to afford such cost in the short-run, it is not a long-term efficient or viable solution for China in terms of sustainability. Therefore, it is in both Canada and China's interest in being aware of the long-term losses from bilateral disengagement.

It is in both Canada and China's interest in being aware of the long-term losses from a bilateral disengagement.

China's need for food security

Agriculture Technology

China has a deep concern bordering obsession for the security of food supply that engenders a need to go beyond an ability to simply import more food. One obvious response to food insecurity is to increase domestic agricultural production capacity. **Appendix VI** discusses how China has increased production in key crops such as rice, wheat, corn, soy and oilseeds. However, a self-sufficiency objective requires continual improvements in how food is produced. It also comes with an environmental cost that requires technology to mitigate.

China's successful achievement of food security in recent decades has resulted in serious damage to the environment of the agricultural sector. China is moving to increase size and mechanization of farms to reduce environmental harms and maintain production levels. The country is already pushing the envelope on what is possible by feeding close to 20% of the world's population on 10% of the globe's arable land.

[32] We have created a measure of "food export reliability" that attempts to show factors of importance to a buyer or importer. This includes not just production and export volumes but the chance that a surge in domestic consumption or a bad harvest in the face of strong domestic consumption could imperil exports.

Figure 16: Measuring food export reliability[32] (2018)

BEEF

Country	Surplus/deficit* (produced minus consumed)	% production domestically consumed	Exported*	NX* (export minus import)	% of NX over production
Australia	1,914.54	26%	1,924.77	1,914.54	74.1%
Brazil	1,657.91	82%	1,692.44	1,657.91	18.4%
India	1,528.89	40%	1,529.01	1,528.89	60.5%
New Zealand	596.20	12%	595.80	586.10	86.6%
Canada	**476.55**	**67%**	**676.29**	**458.91**	**32.2%**
European Union	395.77	95%	728.00	395.77	5.5%
Argentina	358.00	88%	365.00	358.00	12.3%
Paraguay	323.71	29%	342.09	323.71	70.6%
Mexico	300.95	85%	438.62	300.95	15.4%
Pakistan	68.41	96%	73.60	68.41	3.6%
Ukraine	56.18	85%	59.20	56.18	15.2%
Colombia	55.49	93%	63.12	55.49	6.8%
South Africa	47.42	95%	126.99	47.42	4.5%
United Kingdom	-203.78	122%	138.82	-203.78	-22.5%
United States	-268.33	102%	1,447.65	-284.65	-2.4%
China	-1,318.65	121%	36.30	-1,318.65	-20.7%

OILSEEDS

Country	Surplus/deficit* (produced minus consumed)	% production domestically consumed	Exported*	NX* (export minus import)	% of NX over production
Canada	**10,735.15**	**47%**	**11,240.85**	**10,992.85**	**54%**
Ukraine	2,484.20	86%	2,280.00	2,244.20	13%
Australia	845.51	63%	1,383.46	1,362.51	60%
Argentina	777.30	83%	778.00	777.30	17%
Kazakhstan	533.00	51%	540.00	533.00	49%
India	210.86	98%	665.86	355.86	3%
Russian Fed.	236.71	98%	391.47	186.71	1%
United Kingdom	141.57	94%	339.58	141.57	6%
Brazil	85.50	82%	105.00	99.50	21%
Nigeria	38.50	98%	42.00	38.50	2%
South Africa	-59.86	106%	2.66	-22.84	-2%
United States	-117.30	103%	632.80	-45.00	-1%
Indonesia	-254.90	140%	1.40	-255.60	-41%
Turkey	-711.09	140%	52.10	-661.40	-37%
Pakistan	-1,290.00	273%	5.00	-1,315.00	-177%
European Union	-3,540.88	113%	804.02	-3,537.72	-13%
China	-5,245.00	118%	615.00	-5,145.00	-18%

(more reliable) **BEST**
50^{TH} Percentile
WORST (less reliable)

Source: OECD-FAO Agricultural Outlook 2018-2028.
*Numbers in thousands of tonnes, 2018

WHEAT

Country	Surplus/deficit* (produced minus consumed)	% production domestically consumed	Exported*	NX* (export minus import)	% of NX over production
Russian Fed.	31,202.61	56%	35,500.00	35,235.00	50%
United States	20,983.54	59%	27,216.00	23,405.76	46%
Canada	**22,630.82**	**29%**	**22,693.32**	**22,603.32**	**71%**
European Union	9,680.26	92%	22,603.35	15,784.72	13%
Ukraine	15,468.18	37%	15,663.18	15,608.18	64%
Argentina	13,446.00	30%	14,007.74	14,004.74	73%
Australia	8,833.81	48%	9,661.61	9,641.62	57%
Kazakhstan	8,580.00	43%	8,500.00	8,440.00	56%
Pakistan	-306.07	101%	999.93	993.93	4%
India	2,429.96	98%	599.96	429.96	0%
United Kingdom	-46.79	100%	1,334.43	-78.65	0%
Iran	-1,250.00	109%	100.00	-100.00	-1%
Turkey	-2,705.20	114%	4,394.80	-605.20	-3%
China	5,320.00	96%	90.00	-3,410.00	-3%
Brazil	-6,396.39	214%	220.62	-6,596.39	-117%

(more reliable) **BEST**

50TH Percentile

WORST (less reliable)

SOY

Country	Surplus/deficit* (produced minus consumed)	% production domestically consumed	Exported*	NX* (export minus import)	% of NX over production
Brazil	66,850.41	42%	65,260.41	64,850.41	56%
United States	63,654.29	49%	50,356.80	49,583.62	40%
Argentina	9,497.00	82%	12,967.00	7,997.00	15%
Paraguay	6,095.00	41%	5,400.00	5,395.00	52%
Canada	**5,094.05**	**32%**	**5,745.35**	**5,345.35**	**71%**
Ukraine	2,724.00	32%	2,709.00	2,704.00	67%
India	372.00	97%	280.00	230.00	2%
South Africa	311.00	80%	5.00	-5.00	0%
Nigeria	-10.00	101%	10.00	-10.00	-1%
Russian Fed.	-1,040.00	124%	975.00	-717.00	-17%
Indonesia	-2,548.00	492%	2.00	-2,598.00	-400%
Mexico	-4,176.77	1057%	0.23	-4,099.77	-940%
European Union	-12,731.29	487%	772.51	-12,673.97	-385%
China	-93,700.00	686%	100.00	-91,300.00	-571%

Source: OECD-FAO Agricultural Outlook 2018-2028
*Numbers in thousands of tonnes, 2018

China will be a competitor in some areas of agricultural technology, a collaborator in others and an important market for others.

Access to agricultural technology is a critical need and another area of greater potential collaboration between Canada and China.

In response, China has prioritized the development of and access to advanced agricultural technology and practice to mitigate these problems. In 2007, the Chinese ministry of agriculture launched a program to increase development and production of modern agricultural technology.[33] There is also a focus on agricultural technology in Made-In-China 2025, China's industrial policy to achieve greater self-sufficiency in specific advanced manufacturing sectors. Specifically, the policy targets smart-agricultural technology – advancing agricultural machinery and equipment and increasing international research collaborations on crop optimization and soil remediation, where existing bilateral cooperation between Canada and China could be built upon. The policy has been successful in increasing development and production of agricultural technology, including expanding exports.[34] China will be a competitor in some areas of agricultural technology, a collaborator in others and an important market for others.

For China, assistance to address food security goes beyond simply offering to export agricultural products and food. Ideally, it would also include assistance on food production in China, which is a major focus of food self-sufficiency efforts. Access to agricultural technology is a critical need and another area of greater potential collaboration between Canada and China. But here, there is a threat from increasing U.S. proscriptions on technology exports to China including U.S. pressure on its allies, including Canada, to follow suit.[35] Potential expansion of U.S. technology sanctions and trade proscriptions into agricultural technology is a threat to both China's food security and Canada's ability to realize a return on its investments to build a global agricultural technology sector.[36, 37] An agreement now with China would enable Canada to get out ahead of, and potentially mitigate, future U.S. pressure. This would be similar to how Canada has managed U.S. pressure from its Cuba embargo regime without suffering direct economic consequences. Such an agreement would also help make the case now that agricultural technology does not have the same security implications as internet and communications.

[33] Xinhua Net. 'China to Accelerate Construction of Modern Agricultural Industry Technology System in 2010'. Ministry of Commerce of the People's Republic of China Department of Foreign Investment Administration, 29 December 2019.

[34] 'China Paving the Way in Agricultural Technology - China - Chinadaily.Com.Cn', accessed 23 October 2020, http://www.chinadaily.com.cn/kindle/2018-12/09/content_37377116.htm.

[35] For a good discussion of expansion of U.S. pressure on non-U.S. companies to conform to U.S. demands to limit technology trade with China, see, Lauly Li and Cheng Ting-Fang, 'Inside the US Campaign to Cut China out of the Tech Supply Chain', *Nikkei Asia*, 7 October 2020, https://asia.nikkei.com/Spotlight/The-Big-Story/Inside-the-US-campaign-to-cut-China-out-of-the-tech-supply-chain.

[36] Chris Freimond, 'Canada's Export Potential with Agricultural Technology', *EDC TradeInsights* (blog), 25 September 2017, https://www.edc.ca/en/blog/canadas-export-potential-with-agricultural-technology.html.

[37] Bruce Dudley, 'Agtech: A Billion-Dollar Opportunity?', *GLOBE Series* (blog), 31 January 2019, https://www.globeseries.com/blog/2019/01/31/agtech-a-billion-dollar-opportunity/.

POLICY RECOMMENDATION

How to prepare for the convergence of interest with China

01

FIRST STEP

Change the language of engagement to mutual interest

China will not devote time or political capital to solve Canada's problems, but will do so to solve its own problems.

Fears of dependence on U.S. food exports is a potential significant problem for China. Growing U.S. food exports to China is also a problem for Canada if it displaces Canadian exports.

There needs to be a change in language and approach to China from pursuit of Canadian interest to solving a mutual problem. The starting point for this new conversation should be addressing and solving a mutual problem that inadvertently damages both countries – the U.S. throwing its weight around to advance an "America first" agenda.

02

SECOND STEP

Agriculture as the heart of interests

This conversation on shared interests and mutual problems goes beyond the U.S.-China agreement and includes the shared interests of the actual and potential agricultural trade relationship as identified above in the *Convergence of Interest* section. This convergence of interests, including access to food and technology to improve food production in China, has been intensified by the U.S.-China Phase One to the point where it may be the basis for a new engagement to solve critical dependency problems that the U.S.-China agreement has created for both countries. At the very least, this convergence of interest should provide a starting point for resetting the relationship when the desire to do so exists on both sides.

A potential starting point to solve the problem that both countries share includes:

- Agriculture is the heart of both China and Canada's interest and this needs to be discussed.
- In exchange for gaining the same type of market access certainty that the U.S. has in its Phase One trade agreement with China, Canada would guarantee supply access certainty to China.
- This would include Canada guaranteeing that access to Canadian agricultural products, agri-food and agricultural related technology would not be restricted for political reasons.
- China would gain defined, guaranteed access to invest in agricultural production, agricultural processing and agricultural related technologies.

This would be a basis for negotiations that would then determine specifics.

Issue 01

Independent Canadian policy

A primary goal for government and exporters is advancing and protecting Canadian interests in foreign markets. The harm that Canada has suffered has not come solely from actions by China. Actions taken by the U.S. in defence of their interests have also harmed Canadian interests. While the direct harm done by the U.S. America First foreign policy has not gone unnoticed in Canada in other areas such as national security tariffs on steel and aluminum and softwood lumber charges, the damage done by the U.S.-China agreement has received less attention. The competition between Canada and the U.S. abroad is not new, but neither is the history of the U.S. pressuring Canada to not sell to a market only to then turn around and take Canadian market share in that jurisdiction. This occurred in Cuba where successive U.S. governments threatened Canada for trading with the island only to reverse course in 2000 and allow agricultural exports after years of complaints from U.S. farmers – not in response to any significant policy changes in Cuba. In the 1950s, Canada also broke ranks with the U.S. to sell wheat to China partially from anger at aggressive U.S. tactics including buying grain from U.S. farmers to offer abroad as food aid and take market share from Canadian exporters.[38]

Engaging with China on agriculture in defence of Canadian interests and to repair harm done by the Americans is a continuation of historical precedent, one that occurred in difficult times such as the height of the Cold War. But in this instance, Canada would be following instead of breaking precedence with the U.S. The U.S. could not object under the new North American trade agreement (USMCA) section 32.10, because it could not deny Canada an arrangement that it itself has signed. Or, to put it more bluntly, should the U.S. administration trigger section 32.10 of USMCA and request information on Canadian objectives in negotiating with China, Canadian authorities could simply forward a copy of the U.S.-China Phase One agreement.

The story Canada needs to tell in China

Few Canadians know of Canada's involvement in China in the 1950's. A succinct case for the importance (for both Canada and China) of Canada's decision to oppose the U.S. and sell grain to China at the end of the 1950's during the Great Chinese Famine is made by Donaghy and Stevenson:

Although Canada was a committed member of the western alliance and publicly supported Washington, DC's efforts to isolate communist China, Ottawa embarked on large-scale wheat sales to Beijing in the late 1950s in the face of sustained US opposition…the three main factors that encouraged the Canadian government in this course: growing doubts about the wisdom of isolating communist China; mounting anger at Washington, DC's use of subsidized wheat sales to capture traditional Canadian markets; and a surging sense of Canadian nationalism that sought a distinct role for Canada on the world stage. Clearly, as was so often the case in postwar Canadian foreign economic policy, a narrowly defined national interest easily trumped the ideological pressures of western solidarity.

This was in the post-Second World War period where Canada had made the leap from trade dependence on the U.K. to dependence on the U.S. with exports there rising from 38% to over 60% and not long after China had sent troops across the border to face Canadian soldiers in Korea.

The point with this story is not whether the motivations for Canadian actions was altruism or self-interest, it is the ability and willingness of Canada to act contrary to U.S. interests in the face of a certain hostile response. Whether Cuba or China, the U.S. will abandon political and diplomatic principles to gain market share, especially at Canada's expense. The U.S.-China Phase One agreement is only the latest example of this.

[38] Greg Donaghy and Michael D. Stevenson, 'The Limits of Alliance: Cold War Solidarity and Canadian Wheat Exports to China, 1950-1963', *Agricultural History* 83, no. 1 (2009): 29–50, https://www.jstor.org/stable/20454911.

Issue 02

Re-engagement is not only possible; it is a matter of time

The current serious difficulties in the Canada-China relationship make talk of re-engagement seem out of place if not inappropriate. However, the reality is the relationship has been and — based on the increasing levels of integration — will be long term. In that context, re-engagement is a question of when and how, not if. The relationship may worsen in the near term or it may improve. A good example is China managing to look past a semi-official visit to Taiwan with photos of handshakes between the soon-to-be president of Brazil and the head of government in Taipei.[39, 40] On the other hand, in November 2018 Prime Minister Justin Trudeau announced a strengthening of the Canada-China partnership, and in 2019 China began banning Canadian canola. Canada must think two steps ahead. That means preparing now, both for a worsening and for an improving scenario. Preparing now does not sacrifice or predetermine outcomes to current irritants; it simply prepares for a future thaw.

Issue 03

Re-engagement is worth the effort

One barrier to re-engagement is the perception of China as an unreliable trade partner that will break negotiated agreements at will, a seemingly unsurmountable barrier for Canada.

First, on its new agreement with the U.S., China has diligently met the requirements for changes to rules of trade. Even on the less stringent purchase agreements, China has made significant progress. What is most striking here is that China has done all of this despite continued and intense hostile trade action by the U.S. and in a climate of worsening political relations.

Second, since China's accession to the WTO, dispute data from the WTO shows that China has a significantly better compliance record than the U.S. (refer to the textbox on Page 34: China's WTO Record), Canada's largest trading partner, the country with which it has just re-negotiated its largest trade agreement. Almost immediately after the new NAFTA agreement came into effect, Canada was faced with a renewal of national security tariffs on its aluminum exports to the U.S. Despite this, there have not been calls for Canada to walk away from the new NAFTA agreement. Canada has managed to survive a difficult trade relationship with a country with a worse WTO reputation than China's. The trade relationship with the U.S. is marked by an even higher level of dependency for Canada than the relationship with China and Canada has managed this relationship.

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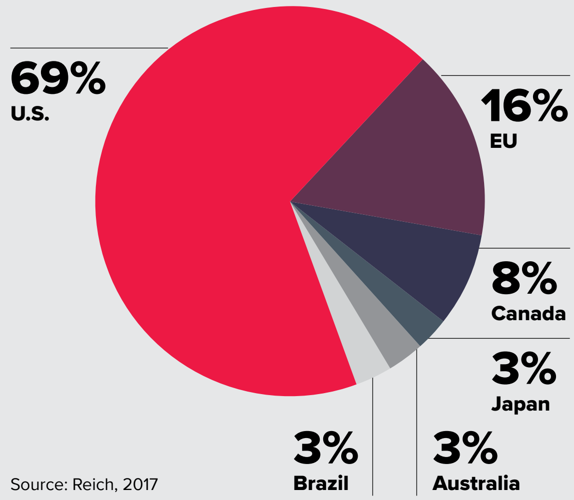
[39] Yimou Lee and Ben Blanchard, 'Taiwan "immediately" Congratulated Brazil's President-Elect', *Reuters*, 30 October 2018, https://www.reuters.com/article/us-brazil-election-taiwan-idUSKCN1N414U.

[40] Platforma Media, 'Lack of Will and China Move Brazil Away from Taiwan, Says Taiwan Diplomat', Plataforma Media, 3 September 2020, https://www.plataformamedia.com/en/2020/09/03/lack-of-will-and-china-move-brazil-away-from-taiwan-says-taiwan-diplomat/.

China's WTO Record

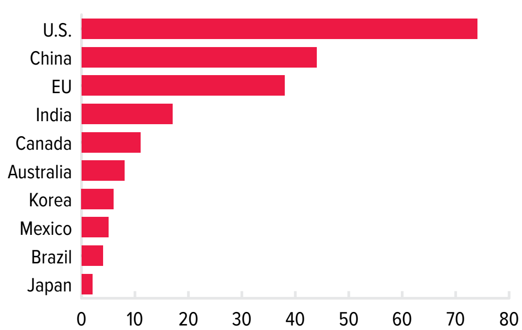
China acceded to the World Trade Organization on December of 2001. Showing comparative data starting with 2004 accounts for the two-year 'honeymoon' period when it was unlikely that cases would be brought against China. During this period, it ranks a distant second to the U.S. as a respondent in complaints by another WTO member. On escalation of complaints, cases where a state has lost a dispute settlement procedure, continuously fails to comply with the ruling of the WTO's dispute body and the state bringing the complaint asks for "suspension of concessions" or countervailing duties to force compliance with the ruling – China does not rank. Given the number of complaints, it is not surprising to find that the U.S. is also the country with the most requests for suspensions. But what is surprising is how much worse the U.S. is. Between 1995-2015 there were 141 WTO disputes where at least one violation of WTO rules was found. From these there were 38 suspension of benefits requests – 68% of these requests were against the U.S., 16% against the E.U. and in third place Canada, with close to 8% of total requests. Brazil and Australia had the remainder with 2.6% each. China had zero escalated cases despite having the second largest number of disputes.[41]

Requests for Suspension of Concessions against Countries (1995-2015)



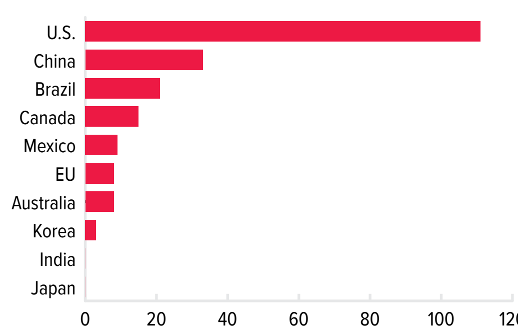
Source: Reich, 2017

Total Disputes brought against Country at WTO (2004-2019)



Source: Canada West Foundation calculation from WTO database

Multi and bi-lateral technical barriers to trade, measures in force, HS codes 01-24 (2004-2019)



Source: Data query from, World Trade Organization, TIP Goods: Integrated analysis and retrieval of notified non-tariff measures. http://i-tip.wto.org/goods/Default.aspx

[41] Reich, "The Effectiveness of the WTO Dispute Settlement System: A Statistical Analysis."

Issue 04

Re-setting the relationship based on convergence of interest: a Canada-China solution to shared problems from the U.S.-China Phase One agreement

The U.S.-China Phase One agreement has reset the bar for what is required to be competitive in China. Whether this can be achieved is a different question than whether it should be a basis to guide negotiations. The U.S. agreement has also raised new food security concerns for China, and this places a new negotiating opportunity on the table. Agriculture in light of the new U.S.-China Phase One agreements presents an opportunity to *solve a problem that China and Canada share in common*.

Following the U.S. example (but not necessarily their means of achieving it) means that Canada would commit to a phase two, or in other words, commit to achieving a full comprehensive agreement (should WTO discipline return). As with the U.S. agreement, a Canadian version would have to go beyond just agriculture and may include some sensitive issues desired by China, like investment in agriculture, energy and banking. For both countries the Phase One agreement would, as is case with the American agreement, be a test of faith and test of the ability of the other side to hold to its commitments. This will only occur when China initiates a course correction in its foreign policy, most likely in response to the rising global backlash from its current attempts to secure its interests. If China does not wish to pursue win-win scenarios based on – and disciplined by – transparent articulation of mutual interest, then Canada will have to face the harder choice of accepting these terms of trade, walking away or continue to muddle along with the current approach. Securing a Phase One agreement is critical for Canada for the same reasons that motivated the Americans to accelerate their partial agreement with Japan. Canada cannot afford to cede ground and advantage to the Americans in the Chinese market. And China may be receptive based on current tensions with the U.S. and fear of the Americans resorting to use food as a weapon and encouraging (or forcing) its allies to join it as it has done with telecom technology.

Issue 05

Prevent the TikTok-ification of agricultural technology trade

Agricultural technology is an area of competition, but also an area of potential cooperation and sales for both Canada and China in terms of meeting bilateral environmental commitments and objectives as well as increasing agricultural production efficiency. This opportunity may be threatened if Canadian agricultural technology is dragged into the U.S. technology war with China, which has expanded from 5G and Huawei to include TikTok and semi-conductors. This expansion of the technology war may make sense for the U.S. but not for Canada. The U.S.-China Phase One agreement has brought about changes in Chinese domestic law on copyright that increase the attractiveness of this trade for all foreign providers. Agricultural technology also has fewer, if any, national security complications of other technologies. It is important for Canadian aspirations in agricultural technology trade that access to the Chinese market be preserved. Clear policy statements and notice to allies that agricultural technology trade is not a national security concern will help protect Canadian interests from potential future U.S. demands.

Issue 06

Broader engagement: whatever is agreed will need additional support

As seen in the cases of Australia and Brazil, (see **Appendix XI**) investments in exchanges, technical cooperation, capacity building and relationship building are all critical with China. Canada has made some of these investments; the pace, intensity and amount will have to be increased. More importantly, the agricultural industry needs to increase its investment in China to build local talents and establish more local market presence. The E.U., U.S., Australia and others are already doing so. One way to think of this is where there is an Australian agricultural representative, there needs to be a Canadian. China has concerns over food safety and quality, as does Canada. While Canada has a well regarded safety system, it is not perfect and there have been failures. Canada needs to build greater understanding, first-hand experience and transparency by making it easier for Chinese officials, businesses and consumers to see, understand and judge for themselves how Canada's system performs. Making information available in Mandarin and providing Mandarin-speaking contact points will mitigate future miscommunication and lessen excuses. Canada will have to follow Australia in putting more boots on the ground in China to support scientific and commercial exchanges.

Technical cooperation and capacity building in areas where Canada genuinely has something to offer for development in China's priority sectors is something that could help facilitate a Canadian Phase One agreement and its eventual expansion. The best place to start is on something specific that China wants, matching scope and funding, such as a new agricultural cooperation fund to address joint research on issues relevant to expanding trade. Australia did this by establishing the Australia-China Agricultural Technical Cooperation (ATC) Program at the start of FTA negotiations in 2005. (See **Appendix IX**)

The ideas presented in this report form a possible path forward. A full discussion of Canada's relationship with China that advances and defends Canadian interests must include the full range of options for advancing those interests. For engaging China, a better path may exist, but the discussion needs to move toward how we better manage the relationship. Failing to prepare for the eventualities outlined in the report, will not harm China. Only Canada stands to suffer.

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