

Summary Report
NRCan Industry Consultation on Trade and Investment with China – March 22, 2017

Plenary

Neil Bouwer, Assistant Deputy Minister, Strategic Policy and Results Sector, Natural Resources Canada (NRCan), outlined how the Chinese political and economic context, forms the starting point for NRCan's 4-pronged China Strategy to:

- advance the government-to-government relationship;
 - expanding two-way trade to develop new markets and address barriers to market access;
 - use science and technology to create commercial opportunities; and,
 - deepen NRCan China expertise.
- Canada has had tremendous success in expanding exports of natural resources to and attracting investment, particularly in the energy and mining sectors.
 - While there has been much progress in deepening trade and investment, there is more to be done. NRCan is eager to receive industry views on how best to do this, particularly in the context of a possible Free Trade Agreement (FTA) with China.

Steve Verheul, Associate Assistant Deputy Director, Trade Agreements and Negotiations, Global Affairs Canada, positioned the China FTA opportunity in the context of other trade agreements, including the CETA and imminent NAFTA negotiation.

- He noted significant opportunities related to the large Chinese market, and in attracting Chinese capital, but also challenges (e.g., China as a competitive low-cost supplier).
- He emphasized the long-term nature of trade agreements, noting that negotiators and companies need to think about the trade relationship of 2030 and beyond.
- He highlighted the importance of broad consultation with stakeholders to support the exploratory phase and define the scope of issues that Canada will need address before discussions on a free trade agreement could formally begin.
- **Research** – The authors of five NRCan-commissioned papers on China presented preliminary findings on 4 sector-specific market studies as well as a paper on science and technology (S&T) cooperation. The presenters were:
 - Bruce Dudley, The Delphi Group (clean technology and mining),
 - Jeff Phillip and Laura Dawson, Dawson Strategic (energy),
 - Fred Spoke & Margaret Stewart, MSC Marketing Solution Consulting (forestry), and
 - Margaret McCuaig Johnston, China Institute, University of Alberta (S&T paper).
- The key 'take aways' were that: an FTA should be a complement to, but not a substitute, for government-to-government relations; some of the best opportunities with Chinese partners are not 'quick hits', but require long-term relationships/investments; companies should take

advantage of existing platforms where possible (e.g., industry associations, research networks, universities), and build relationships on the ground in China.

Graham Shantz, President, Canada China Business Council, gave the keynote address providing insights to the current and future Chinese context.

- China's shifting demographics, the increased automation of manufacturing, labour mobility, and the growing middle class, all reinforce the need to design a free trade agreement with a future China in mind.
- Companies can demonstrate the seriousness of their interest in China by not only having a China strategy, but city-specific strategies.
- The China-Australia Free Trade Agreement can help to inform a Canada-China FTA. For example, there are important lessons learned on dispute settlement and investment that can benefit Canada in its negotiations.

Sector-Specific Breakout Sessions

There were four breakout sessions, each focussing on a different sector: mining, clean technology, energy and forestry. Summaries of the breakout sessions can be found in Annex A.

Government Response to the Breakout Sessions

Sarah Taylor, Director General, North Asia and Oceania, Global Affairs Canada provided reactions to the summary of the four sector-specific rapporteurs.

- China should be approached as a diverse, heterogeneous market representing unique business and regulatory environments with a number of approaches to doing business. This can be challenging, especially for small and medium enterprises (SMEs).
- Canada recognizes that government-to-government relationships are an important tool to support Canadian industry in China and is dedicated to building mechanisms that support Canadian companies in China.
- There is a perception in China of Canada as a high cost, highly regulated investment climate. The Government of Canada is responding by promoting a strong value proposition built upon a skilled workforce, high standard of living, and privileged access to the North American market.
- While taking advantage of the new opportunities in China's transitioning economy and growing middle class, Canada needs to play to its strengths and promote our efficient and sustainable natural resource production and world-class clean technology.
- The Canadian Trade Commissioner Service (TCS) has over 100 trade commissioners at work in China to support Canadian companies doing business in China.

Annex A

Mining Breakout Session

Challenges/Risks

- Lack of transparency in decision-making, inconsistency of policies and assessment procedures between various levels of government in China.
- Joint venture requirements: Chinese restrictions on specific minerals exploration and mining; currency controls (money in/out); import licenses; and limited mobility for Canadian executives.
- Chinese SOEs' interest/experience in Canada: perception that it is a high cost environment; lack of awareness regarding the importance of consultations and engagement; SOEs have different economic models and access to public funds, which makes it challenging for Canadian publicly traded companies to compete against them.

Opportunities

- Maintaining / increasing market share for Canadian commodities via the FTA, despite market diversification efforts and a transition from a manufacturing to a services-based economy in China.
- Opportunity to improve resource governance regime in China; exchange best practices on environmental performance and green mining technologies; and review the foreign investment catalogue for encouraged, restricted, and prohibited industries.
- Building on Canadian Trade Commissioner Service expertise to help resolve challenges of operating in China, as well as attract investment to Canada.

Role for Government

- Link the FTA to demands for improved transparency of decision-making in China.
- Ensure negotiations are an opportunity to improve understanding of Indigenous and treaty rights in Canada.
- Ensure negotiators are briefed on the different challenges and asks for specific commodities exporters within the mining industry; when formulating Canada's positions for specific FTA chapters, negotiators should thoroughly analyze unfair trade practices brought against China in the WTO.

Best Practices

- Understanding the local context and developing long-term relationships improves likelihood of success.
- Timely access to goods and meeting Chinese delivery standards are key to business partnerships.

Clean Technology Breakout Session

Challenges/Risks

Main challenges/risks identified by participants to working with/in China.

- **China's policy of tech transfer**
 - China is acquiring technology from abroad to suit its internal needs, through various means. Technology transfer can result in job losses, a reduced tax base, and a loss of government investment in innovation. At the macro level, Canada needs to engage to retain its clean technology sector and at the micro level, companies need to continuously reinvest to remain ahead of China.
- **Addressing challenges in commercial collaboration with China**
 - Canadian cleantech companies working in/with China need a strong technology team, a focus on CAPEX and to proactively protect their intellectual property (IP) with Chinese lawyers. Adapting to the large and fast-paced Chinese market also means adjusting technology solutions and business approaches, as well as identifying the right partners.
- **Cleantech priorities for FTA negotiations** were noted around:
 - IP protection; addressing market access barriers (e.g., closed procurement markets, preferential treatment, market entry requirements such as standards/regulations); addressing Chinese ownership requirements.
 - It was also proposed that Canada seek specific protection for the cleantech sector, as its innovations have been supported by government programs and measures.
 - The negotiation strategy will need to reflect cleantech sub-sectors' different needs (e.g., some focus on licensing while others involve build/own/operate projects).

Any existing or new challenges/risks participants noted that a possible FTA might exacerbate.

- **Ramifications for US relations**
 - An FTA with China will have positive and negative dimensions in relation to accessing the US market. For example, Canada will become more of a Chinese cleantech industry target market, including as an entry point into the US market. In addition, American rules of origins could be of concern for cleantech products designed in Canada and manufactured in China.

Opportunities

Opportunities in working with China.

- Chinese interest in cleantech: China is looking for clean technology solutions from around the world. Air pollution is an urgent, pressing issue and there is strong political pressure to act. China's appetite for cleantech is higher than in any other market worldwide. The Chinese carbon market coming online in 2017 could offer huge potential.
- "Umbrella" companies: large, established Canadian firms such as SNC Lavalin and Hatch are willing to provide a platform for Canadian cleantech SMEs in their projects in China.
- Canada's positive image in China can be leveraged by Canadian cleantech firms.

Advice on how a possible FTA could enhance these opportunities, or create new opportunities.

- An FTA would provide a framework and trade governance structure, and could clarify and reduce regulatory compliance procedures which currently result in sizeable costs to companies.
- The FTA negotiating strategy should reflect that cleantech trade is largely about services. For example, 90% of IP pertains to engineering.
- Cleantech sub-sectors can have vastly different needs (e.g., some focussed on licensing, while others build/own/operate projects), which would be served through different Chapters. Participants also asked if the FTA could contain provisions to facilitate technology demonstrations in China.

Role for Government

- Cleantech companies asked that the Government protect Canada's cleantech ecosystem, balancing market opportunities with defensive interests, including by undertaking due diligence of inward investment from China.
- Most Canadian cleantech firms are SMEs that need support from government to facilitate their engagement with China. Support could take the form of a focussed federal cleantech strategy on China, a multi-department presence on the ground, cleantech market analysis, measures to help retain/attract global talent, commercial negotiations support, guidance on IP, and information on tools and programs. The Canada-China Cleantech Working Group was identified as a potential anchor.
- The creation of a Canada-China codes and standards group, involving the Standards Council of Canada, was proposed to align approaches in the fast-paced world of cleantech, and for Canadian government and industry to work together to arrive at a national position.

Best Practices

- "A la Toyota": Keeping sensitive information in Canada with a distributed manufacturing model through separated business units. For example, Canadian Solar keeps best-in-class engineering and R&D in Canada, with manufacturing abroad for sales and growth worldwide. Another approach is to engage with China only on older technology.
- Knowing the Chinese culture and how to negotiate with China, using people-to-people linkages, recognizing that Chinese employees are loyal to their country above loyalty to a foreign company.
- Using "landing pads": for example, the Canada-China Business Council is involved in incubators/accelerators in China, the Quebec government has an agreement with the Yixing Industrial Park, some existing joint ventures could be leveraged by other Canadian firms, and working through Hong Kong/Singapore is a good option to engage with Mainland China partners. Also noted was the need to connect with the Trade Commissioner Service for profile and support.

Energy Breakout Session

Challenges/Risks

- China's mercantilism, influence of the State and dominance of State-owned enterprises in China's energy sector and China's need to have majority control.
- IP infringement.
- Regulatory predictability, including potential competing regulatory requirements of CETA, NAFTA, China FTA leading to uncertainty regarding which regulations will eventually dominate and become the standard, creating non-tariff barriers within other agreements.

Opportunities

- Sustainable development while respecting environment – opportunity for cooperation and global leadership – develop a new feature to FTA.
- Leverage perception of Canada as stable business partner, despite higher costs of business.
- Develop unique FTA appropriate to the Canada-China trade and investment relationship that would benefit both, but that acknowledges new considerations such as community development and sustainable development.

Role for Government

- Creating an agreement that will allow investments to flourish within the context of corporate responsibility and community development / engagement.
- Negotiate a deal for the Canada-China relationship of 20 years in the future with respect to demographics, wealth distribution, resources, economic engines, trading relationships.
- Create a strong, effective dispute resolution mechanism, but get provincial governments on-board via effective communication on standards, regulations and resolution process.

Best Practices

- Some participants encouraged embracing the imbalance of working with China while developing partnership opportunities.
- Encouragement of continual innovation to stay ahead of potential IP infringement or reverse-engineering.

Forestry Breakout Session

Challenges

- CAD/CNY conversion: It is often difficult and uneconomical to exchange Canadian dollars to Renminbi with Canadian banks and the preferred approach is usually to do the exchange via the USD with US banks.
- Lumber sizes: China is a market that requires a large variety of sizes. It is difficult for Canadian mills to change sizes from the North American ones because the production decreases significantly when they do so. Competitors in the EU are able to cut different sizes on demand and service any market.

Risks

- Log exports: Canada needs to retain its ability to control the export of logs. China wants access to the primary product and as such, access to more logs is expected to be a demand in a possible FTA negotiation.
- Competitor: China is doing second and third transformation and has become an important exporter of value-added forest products.
- State Owned Enterprises: Chinese SOEs can influence prices of certain products which could impact the competitiveness of Canadian forest products exports.
- Ownership: China is interested in resource ownership. Most forest land in Canada is publically owned and therefore not available for sale, but there is nonetheless a need to think about the implications of China potentially owning more forest land and operations in Canada.

Opportunities

- Tariff reduction for Canadian forest products (although there is a significant value added tax in China and it is likely not something that can be addressed through an FTA)
- Dispute Settlement: It is an opportunity to negotiate a strong and effective dispute resolution mechanism because the quality of a trade agreement is only as strong as its ability to resolve trade conflicts (e.g. Dissolving pulp case at the WTO).
- Bilateral Committee on Forest Products: Establishment of a formal committee through the FTA to discuss market access and trade issues and resolve them before they become non-tariff barriers to trade.
- Value-added products: Need to focus on new opportunities for value added products. China is a cost-sensitive market and Canada is relatively high-cost market given the sustainable way we manage our forests.

Role for Government

- Market Access and Development for forest products through continued support for Canada Wood China.
- Continue to support SMEs and Indigenous Peoples that are dependent on the forest sector.
- Continue efforts to protect the environment.