

CHINESE STATE-OWNED ENTERPRISES IN AN ALBERTA- CHINA STRATEGY:

*Role, Opportunities, and Challenges with Special Reference to a
Potential Canada-China Free Trade Agreement*



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EXECUTIVE SUMMARY

The importance of Chinese State-Owned Enterprises (SOEs) in the overall Chinese economy has declined in recent years. Over the past decade, SOEs' share of the total number of Chinese firms decreased from 10% to 5%. The share of SOE revenue from principal business dropped from 34.4% to 21.8%, while the proportion of total industrial assets possessed by SOEs decreased from 48.1% to 38.8%. Furthermore, the contribution of SOEs to total national employment fell from 27.2% to 18.2%. Consequently, at the macroeconomic level, SOEs' share of the total Chinese economy has declined to less than 30%.

Regardless, Chinese SOEs continue to dominate several key sectors of China's economy, such as oil and gas, petroleum refining, construction, automobile, telecoms, utilities, and banking. Central and local governments treat SOEs favourably in order to protect and develop them, an important consideration for present and future international negotiations and dispute settlement processes. These benefits include both financial and non-financial support extended by authorities, which are in turn reinforced by a variety of legal mechanisms. Policymakers should consider domestic and international market distortions brought about by SOEs, and the less-than-even playing fields these distortions may create for Canadian/Albertan enterprises, in preparation for any future free-trade agreement (FTA) negotiation.

The most recent FTAs signed by China, including those with Australia and South Korea, demonstrate that the country is attempting to liberalize trade in a number of key areas traditionally monopolized by SOEs. While it remains unclear whether financial and administrative favours for SOEs have been regularized or made more transparent, China has opened up to Australian and Korean services sector firms, including financial services,

education, architecture and urban planning, hospitals and aged care institutions, tourism, and agriculture, etc. However, while the China-Australia FTA is widely considered to be the most comprehensive bilateral FTA involving China, the issues surrounding SOE investment and tariff suppression on certain sensitive agricultural products (such as rice, sugar, and others where SOEs enjoy principal roles) have been mostly left aside for later consideration. These sectors may be of interest for Canada should it pursue an FTA with China: Canada is regarded as a reliable supplier of quality food products and associated food safety and security services; knowledge of these topics, which are important preoccupations for China, will be an asset for Canada.

Chinese SOE investment in Canada and Alberta specifically has dominated the policy conversation and media attention in recent years. However, Canadian companies have also invested in China, and this investment has grown significantly over the past five years: about 14,000 Canadian companies, with USD\$10 trillion in asset values, operated in China in 2015. These companies are mainly focused in tourism, telecommunications, power, mining, and real estate. As previously noted, China's investment in Canada has also grown in the past decade, particularly in energy, agriculture, and mining, but with new diversification into entertainment, real estate, and other service sectors.

Alberta is a trade-oriented province with a growing regionally-focused knowledge and business competency in China. Alberta has great potential for expanding engagement with Chinese partners, and indeed a strategic imperative to do so, particularly for the oil and gas, agriculture and agri-food, forestry, manufacturing, engineering services, and life-sciences sectors. However, policymakers should be aware of the role of Chinese

SOEs in pursuing government objectives which can serve protectionist ends. Likewise, the less-than-transparent political relationship between the Chinese government and SOEs can create an uneven playing field for Canadian firms operating in China. Such practices could cause future tension between Canadian and Chinese firms. Therefore, Albertans should exercise caution when defending and promoting Albertan interests. Despite these challenges, Canadian firms have years' worth of experience doing business with some of the largest Chinese SOEs, including CNPC, Sinopec, and CNOOC in the energy sector, and COFCO in the agri-food sector. This experience is an advantage that can be further leveraged.

Knowledge and preparation will be important in the lead-up to formal FTA negotiations. The results of this paper find that SOEs not only reflect broad government policy priorities – energy security, food security/safety, technology development, etc. – but can also

influence government priorities to serve their individual commercial interests. In fact, the relationship between the government and SOEs is often skewed in favour of the latter, with energy sector SOEs in particular exercising policy leadership. A Canadian trade strategy will need to exhibit a strong awareness of how SOEs operate and have evolved in recent years.

Likewise, while trade negotiations will be conducted by Chinese government entities, SOEs (as well as non-state actors with substantial state connections) can significantly influence trade negotiations with Canada, or with any other country. While tariff and non-tariff barrier reduction remains an important goal for Canadian policymakers, we should also consider the current and future role and impact of Chinese SOEs and aim to develop medium- and long-term strategies for Canadian engagement in Chinese markets.

1. INTRODUCTION

The first paper of this series laid out the nature and evolution of SOEs in contemporary China. Paper I shows that SOEs' share of total output and employment in China's economy has diminished, though SOEs remain dominant in several strategic sectors, including some areas of key interest to Alberta. Paper I also demonstrates a general but uneven trend toward decentralization and devolutions of authority and decision-making – not only on most matters of day-to-day management, but also selectively and with conditions on matters such as overseas investments or procurement actions. Paper I shows SOEs' greater commercialization at home, and perhaps particularly in the subsidiaries of SOEs abroad. Paper I further identifies accompanying shifts in the governance and operating style of SOEs toward a model that is closer to other international firms. At the same time, Paper I outlines the mixed missions of contemporary Chinese SOEs – as both instruments of national policy and strategic objectives, as well as corporate entities. The evolution and complexity of Chinese SOEs will challenge the promotion of Canadian/Albertan interests abroad and domestic trade policy management here in Canada.

This paper will examine these challenges as they relate to Canadian and Albertan interests. We survey both Alberta's opportunities and capacities in the Chinese market by sector and the role of SOEs within those sectors. Further, this paper will outline the significant and evolving role of SOE investment by China, both worldwide and in Alberta, throughout sectors such as energy and resource development. We examine issues raised by SOE engagement, particularly as it relates to the pursuit of Albertan objectives in China. Specifically, this paper will consider how SOEs, both reformed or otherwise, might shape the priorities, strategies, and practices adopted by the Chinese government. If Alberta and Canada are to be competitive in attracting Chinese investment,

smart business strategies will need to be developed and implemented, and Canadian goods and services will need enhanced market access in China. However, this investment should be on terms that meet the expectations of local communities, and that are matched by equitable treatment of Canadian investors in China.

Although they have changed and reformed, SOEs are not without controversy, particularly in the context of investment. China's poor human rights record and the real or perceived shortcomings of SOEs on a variety of public interest issues – environmental degradation, corporate governance, and social responsibility – are likely the principal inhibitions facing Canadian policymakers, and will have a significant effect on the scope and pace of Canada's economic relationship with China.

For a number of China's economic partners, SOEs remain symbolic of the uneven playing field faced by firms, agricultural producers, or financial institutions that pursue business with China. This view arises from the political, financial, and regulatory favours that SOEs receive, both at home and abroad. These perceptions may be either dated or exaggerated, but they are not without root in reality. As such, negative perceptions of SOEs remain a significant obstacle to Canada-China economic relations, and will notably have to be overcome in the context of any future FTA that may be pursued. Given that such an FTA is already the subject of exploratory talks between the federal government and the Chinese government at the time of writing, it will be essential for policymakers and Canadian firms to understand these challenges.

Chinese SOEs and the favours extended to them by the Chinese government raise important market access, subsidies, and reciprocal treatment issues for investors in China. Informed by developments in the Chinese

marketplace and the role of SOEs therein, as well as by Canadian sector strengths, this paper will attempt to isolate and target where both improvements with China should be sought and pressure from the Chinese side can be expected. We trace the evolution of SOEs themselves, as well as how SOE issues have been approached in the context of other trade and investment negotiation processes. These insights can help shape Canadian/Albertan approaches and priorities in ways that are both realistic and ambitious.

2. SOEs IN THE GLOBAL MARKET

SOEs continue to play increasingly diverse and important roles in China's international trade and outbound investment in line with the Chinese government's strategic planning. Even where the statistical profile of an SOE has diminished in total trade and investment flows, these firms' political influence and private sector links can significantly shape the marketplace, particularly in several key sectors, such as resource development and energy. In terms of aggregate trade, Chinese SOEs remain major players in exports and imports, though as outlined below the relative share of SOEs in the overall market has dropped significantly in recent years. SOEs influence import quota management and other aspects of market access. SOEs also continue to enjoy monopoly status – albeit gradually diminishing – in some areas.

SOEs can be important intermediaries and supply chain partners both in and out of China. Foreign firms can utilize these relationships to enhance 'value-added' and diversified success in the Chinese market, as well as to gain government connections that may be useful to advance commercial agendas. On the investment side, SOEs remain the principal players, particularly with respect to energy resources and financial services, and SOEs or state sector-linked firms have high influence on technology acquisition and the terms of technology transfers for foreign firms entering the Chinese market.

As noted in Paper I, since 2000 the Chinese government has encouraged SOEs to expand their presence abroad as part of the 'Go Global' strategy. As a result, China's

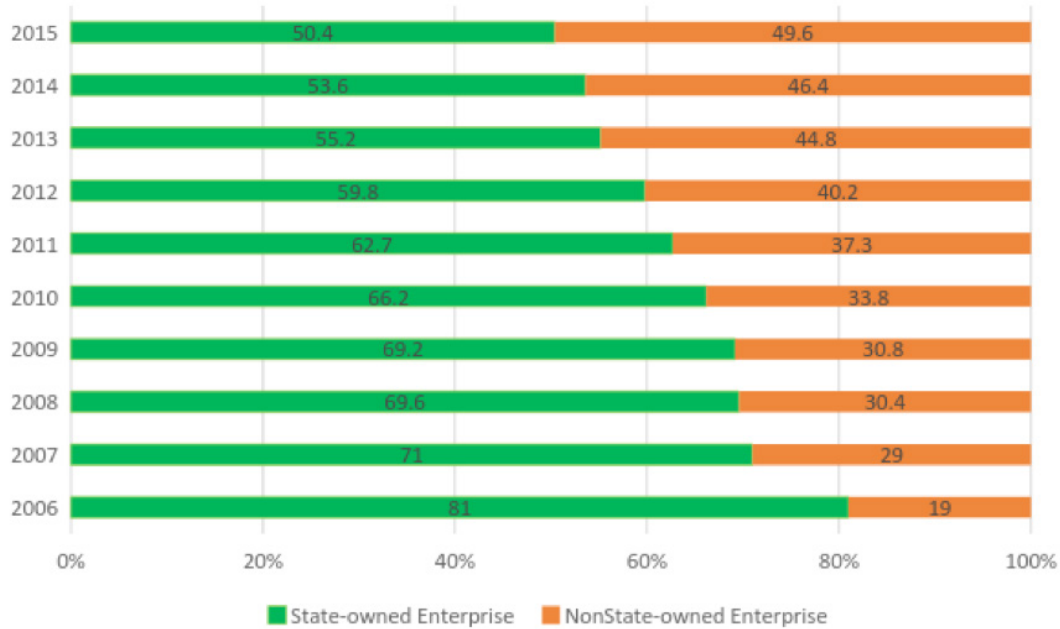
annual foreign direct investment flows to the rest of the world have increased tenfold, and SOEs account for the majority of China's outbound investment, as shown in Figure 1 below. Expansion at the global level is likely motivated by China's desire to access new markets, acquire natural resources, raw materials, and advanced technologies, and open new channels to enhance their corporate brand values. To promote the internationalization of SOEs, the Chinese government initiated several measures, including Ministry of Finance and Ministry of Commerce start-up funds that support overseas investments. Other entities, such as the National Development and Reform Commission (NDRC) and the Bank of Export and Import, contributed by setting up policies to support key overseas projects and creating loan programs and streamlined investment procedures.

The share of SOEs in China's outbound investment has declined in comparison to private firms, as shown in Figure 1 below. In 2006, 81% of China's outbound FDI stock came from SOEs; by the end of 2015, however, SOEs represented only 50.4% of China's 938.2 billion non-financial outward FDI. The share of non-state enterprises for the latter year was 49.6%,¹ an increase of 15.8% since 2010. From 2006 to 2015, the contribution of state-owned enterprises to China's total outward FDI stock decreased by over 30%.

In the past fifteen years, Chinese SOEs developed ambitious international investment strategies targeting specific industries around the world. For instance,

¹ Non-state enterprises include limited liability companies (32.2%), incorporated companies (8.7%), private enterprises (2.1%), joint-stock cooperative enterprises (2.1%), foreign-invested enterprises (1.5%), Hong Kong, Macao, and Taiwan-invested enterprises (0.4%), collective enterprises (0.3%), and others (2.7%).

Figure 1: Proportions of State-owned Enterprises and Non-State Enterprises in China's Outward FDI Stock, 2006-2015



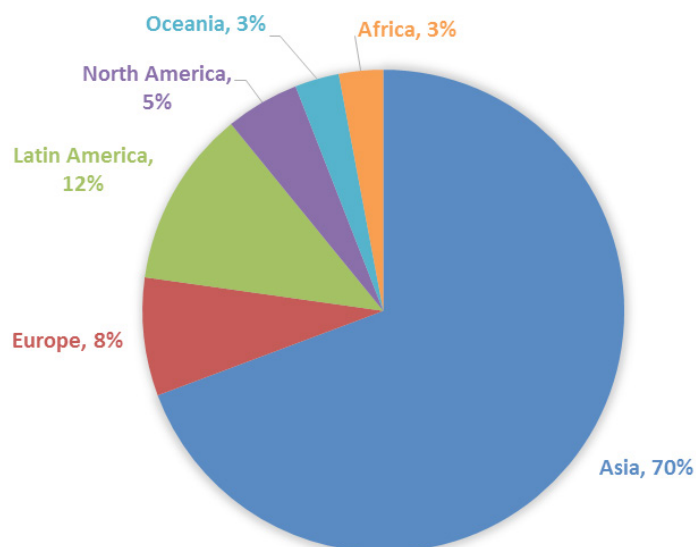
Source: MOFCOM (2016)

national companies such as CNOOC, China National Petroleum Corporation (CNPC), and Sinopec are now major players in the global energy market, with affiliates listed on international stock exchanges. Many of these industries are crucial to Canada-China economic relations: as the private sector continues to grow, SOEs remain a significant source of Chinese investment, particularly in Alberta. Thirteen Chinese companies appeared in the top 100 spot of the 2016 Fortune Global 500 rankings; Industrial and Commercial Bank of China (ICBC), China Construction Bank, China State Construction Engineering, Agricultural Bank of China, Bank of China, Ping An Insurance, China Mobile Communications, SAIC Motor, China Life Insurance, China Railway Engineering, China Railway Construction, Dongfeng Motor Group, and China Resources National China Southern Power Grid. These SOEs are dominant firms in Chinese energy, financial services, automotive, construction, utilities, and telecommunication sectors, and even hold monopolies in some markets such as oil and gas, telecommunication, and power.

Chinese government policy and SOE investment abroad are largely driven by a need to secure access to resources,

generally through either mergers and acquisition, or greenfield startups. Yet the evolution of Chinese SOE investment, both domestic and abroad, increasingly reflects a desire to move from cheap products to more sophisticated technologies. Chinese firms must acquire competence in innovative products and services manufacture to move up global value chains. This strategy involves diversifying out of the low-margin Chinese market into higher-margin foreign markets, and building alliances with major clients. Chinese SOEs have also adopted a second approach by strategically acquiring targeted companies abroad. These acquisitions are intended to both secure technology that can bolster SOEs' positions in the domestic market and develop competency in core technology assets and expertise needed for operating in global markets. Of particular note are China National Chemical Corporation's (ChemChina) 2015 and 2016 acquisitions of Pirelli and Syngenta, and Dongfeng Motor's purchase of a 14% share in the automobile company PSA Peugeot Citroën. Similarly, the high profile USD 7 billion purchase of the U.S. firm Smithfield Foods in 2015 gave China both access to state-of-the-art food technology and a global position in that sector.

Figure 2: Geographical Distributions of China's Outward FDI stock, 2015



Source: MOFCOM (2016)

Chinese SOEs have evolved by not only investing in the manufacturing sector and high tech companies, but also by expanding into service sectors such as the tourism and leisure industry. These companies acquire well established high-end brands with the aim of reorienting them to cater to the growing Chinese clientele traveling abroad. For example, Jinjiang International Group, a Shanghai-based state-owned enterprise, recently purchased the Louvre Hotels group and 11.7% of AccorHotels, a well-known French multinational hotel group. In 2015, China's outward FDI had spread across 188 countries, or 80.7% of the total number of countries in the world. Asia, including Hong Kong, Singapore, Indonesia, Macao, and Kazakhstan, received the largest share of investment at USD 768.9 billion, accounting for 70% of the total sum invested. The second largest region targeted by Chinese investment was Latin America, which accounted for 11.5% of the total sum invested (Figure 3). Four-fifths of China's outward FDI stock was distributed in developing economies, accounting for 83.9% of total investment.

Chinese investment in Europe is greater than that in North America: SOEs represent nearly 70% of Chinese

Overseas Foreign Direct Investment (OFDI) in Europe, but less than half of global investment in the United States. This is perhaps partly due to the fact that Chinese investment is less politicized in Europe than in the United States, or even in Canada. This trend may also be explained by Europe's simpler review procedures, which would speed up the rate of investment there: following the 2008 global financial crisis, the economic and financial difficulties suffered by many European countries have eased the acceptance of Chinese investments, which have in turn financed infrastructure projects or bailed out debt-ridden firms.

Table 1 provides a breakdown of Chinese OFDI in the various regions of the world. While China has committed to massive leasing and business services investment in Asia and Latin America, Chinese firms have a strong presence in the mining sectors of Africa and Oceania, due in large part to the abundance of natural resources in those regions. In Europe and North America, Chinese SOEs have also heavily invested in the manufacturing and financial services sectors through Chinese banks and insurance companies in the United States. This reflects the type of Chinese investment

Table 1: Top Five Industries of China's Outward FDI Stock in Each Continent, 2015

REGION	INDUSTRY	STOCK (in billion USD)	SHARE (%)
ASIA	Leasing & business services	331.31	43.1
	Financial services	103.09	13.4
	Wholesale & retail trade	100.43	13.1
	Mining	71.46	9.3
	Manufacturing	40.71	5.3
	Subtotal	647	84.2
AFRICA	Mining ²	9.54	27.5
	Construction	9.51	27.4
	Manufacturing	4.63	13.3
	Financial services	3.42	9.9
	Scientific research & technical services	1.46	4.2
	Subtotal	28.56	82.3
EUROPE	Mining	24.18	28.9
	Manufacturing	16.08	19.2
	Financial services	15.34	18.3
	Leasing & business services	8	9.6
	Wholesale & retail trade	5.86	7
	Subtotal	69.46	83
LATIN AMERICA	Leasing & business services	60.25	47.7
	Financial services	23.07	18.3
	Mining	12.15	9.6
	Wholesale & retail trade	9.62	7.6
	Transportation, storage & postal services	4.55	3.6
	Subtotal	109.64	86.8
NORTH AMERICA	Manufacturing	12.19	23.4
	Financial services	12.17	23.3
	Leasing & business services	6.57	12.6
	Mining	6.48	12.4
	Real estate	3.76	7.2
	Subtotal	41.17	78.9
OCEANIA	Mining	18.57	57.9
	Real estate	2.99	9.3
	Financial services	2.56	8
	Leasing & business services	2.34	7.3
	Manufacturing	1.33	4.1
	Subtotal	27.79	86.6

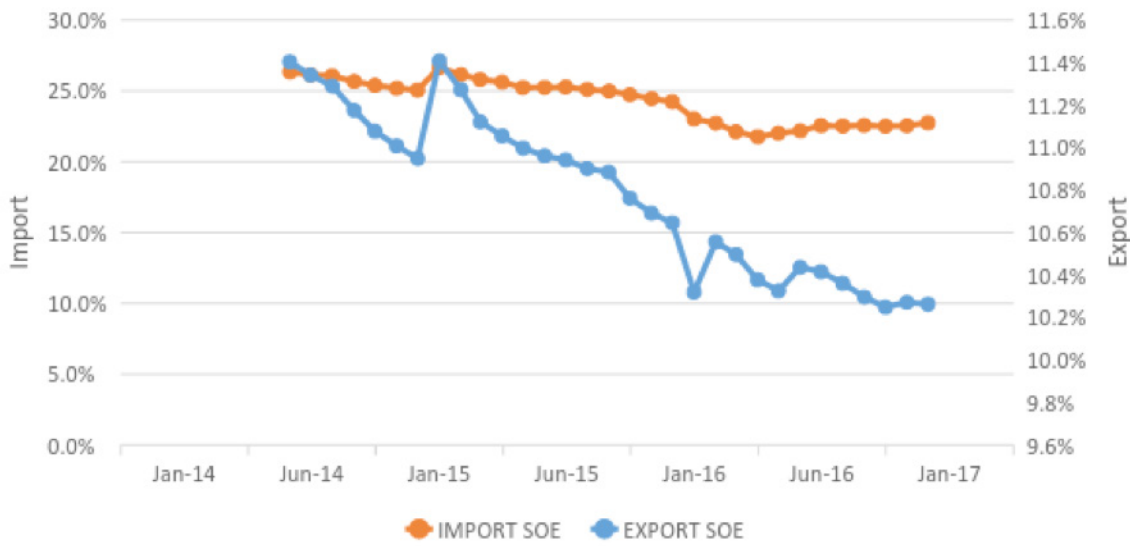
Source: 2015 Statistical Bulletin of China's outward foreign direct investment

varies in response to changing specificities and opportunities in each region across the world. Typically, SOE investment is responsive to regional strengths.

In the context of trade, Chinese SOE exports have steadily decreased over the past three years (Figure 3).

Estimated to be about 11.4% of total Chinese exports in June 2014, the share of state-owned enterprises fell to 10.3% by the end of 2016. Meanwhile, the import share decreased from 26.3% to 22.7% during the same period.

Figure 3: Chinese SOE shares of trade exports and imports in relation to total values



Source: China Customs (2017)

3. THE CHINESE PROFILE IN CANADA: THE SOE DIMENSION

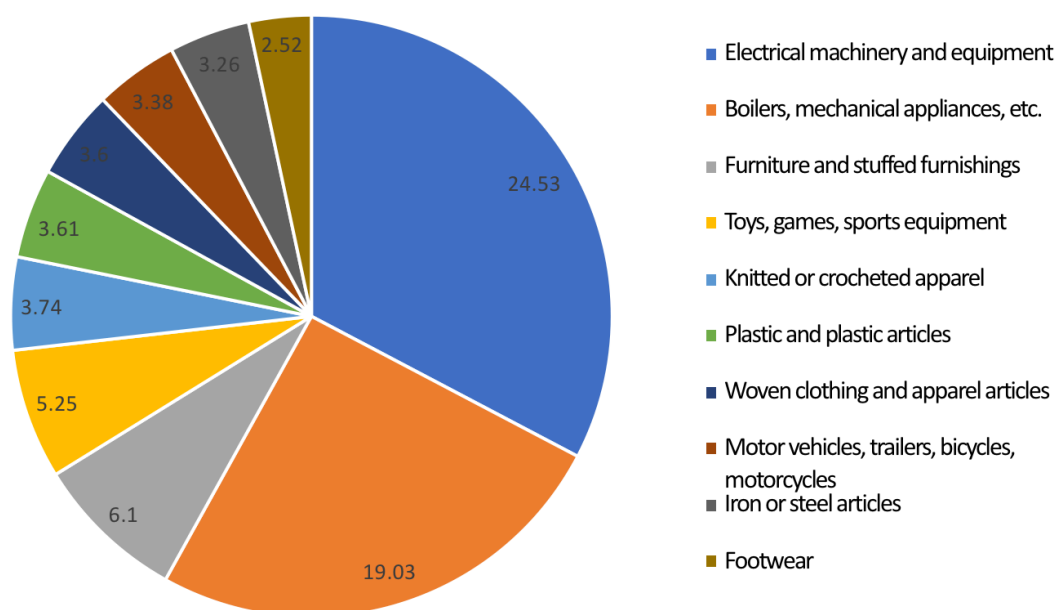
China continues to be Canada’s second-largest trading partner, after the United States. However, Canada has a trade deficit of CAD 44.23 billion with China. In 2016, Canadian exports to China and imports from China to Canada totaled CAD 20.15 billion and CAD 64.38 billion, respectively. The following pie charts illustrate Canada’s merchandise trade with China in selected sectors in 2016.

As shown in Figures 4 and 5, imports to Canada from China are heavily concentrated in electronic equipment and machinery, and consumer products such as furniture, toys, games, and sports equipment. In

comparison, Canada-to-China exports are concentrated in sectors such as wood, wood pulp, and paper products, agri-food (mainly oilseeds, grains, etc.), and products of the mining and energy industries (e.g., metal ores and byproducts, coal, and chemicals). Albertan imports from and exports to China generally follow this trend. Following canola seeds, acyclic alcohol represents the second largest industry for Alberta-to-China exports from 2012 to 2016.

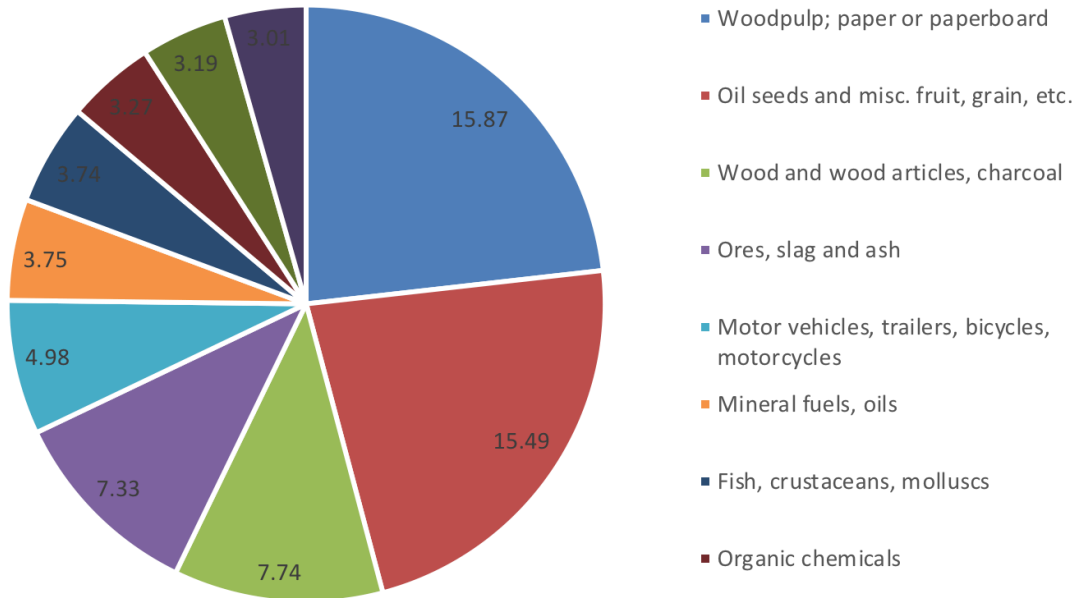
Bilateral investment activities have also increased over the past decade. As of 2015, 14,000 Canadian companies, estimated to have up to USD 10 trillion

Figure 4: Canadian Imports from China, by sector, 2016



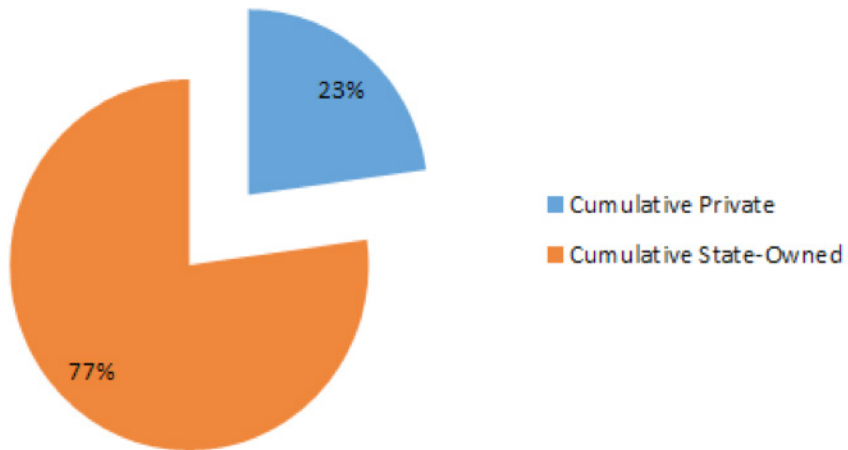
Source: Asia Pacific Foundation of Canada

Figure 5: Canadian Exports to China, by sector, 2016



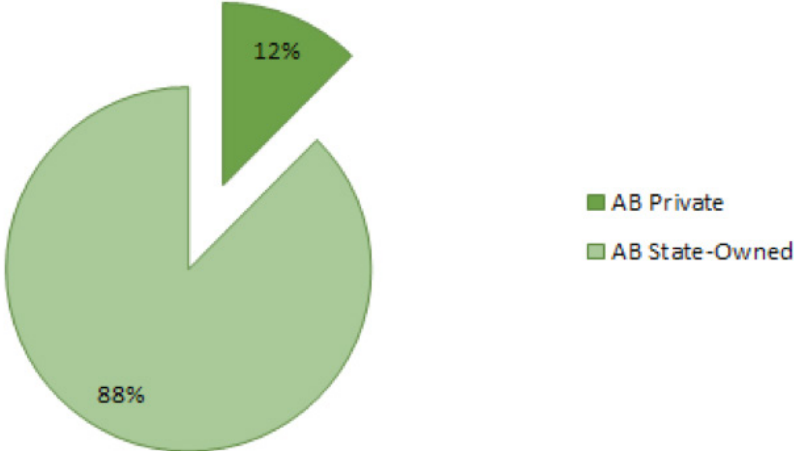
Source: Asia Pacific Foundation of Canada

Figure 6: China's Cumulative Investment in Canada by Ownership, 1993-2016



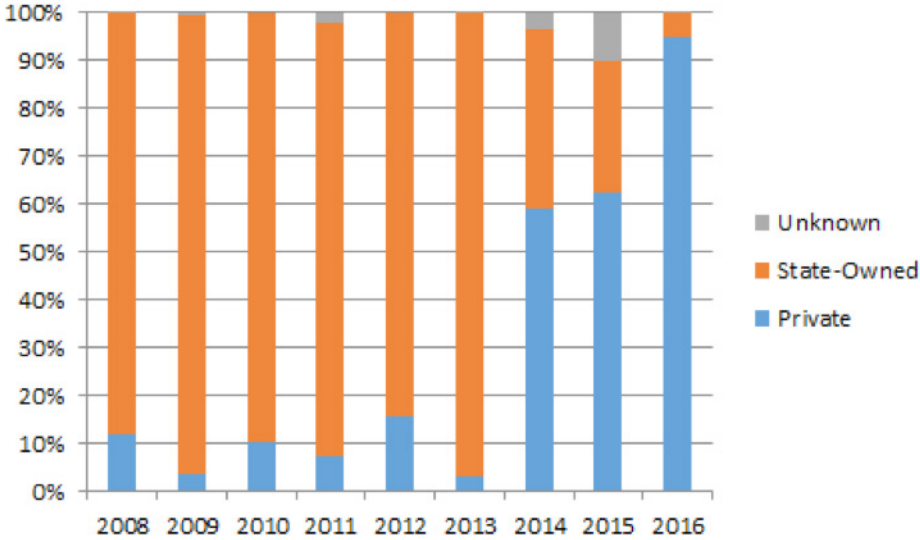
Source: China-Canada Investment Tracker, China Institute, University of Alberta

Figure 7: China's Cumulative Investment in Alberta by Ownership, 1993-2016



Source: China-Canada Investment Tracker, China Institute, University of Alberta

Figure 8: China's Annual Investment Flow in Alberta by Ownership, 2008-2016



Source: China-Canada Investment Tracker, China Institute, University of Alberta

in assets, were established in China, with a focus on tourism, telecommunication, power, mining, and real estate.² Importantly, China's investment in Canada has shown a salient upward trend in the past decade, most of which clusters around the energy, agriculture, mining, entertainment, and real estate sectors. For Alberta, Chinese investment appears more concentrated when compared with Canada as a whole: in 2015, more than 95% of Alberta-destined Chinese investment flowed into the energy sector. The entertainment and real estate, metals and minerals, and transport and construction sectors captured the rest of Chinese capital in Alberta.

Chinese SOEs also dominate China's investment activities in Canada and Alberta. From the data gathered by the China Institute at the University of Alberta (see Figure 6 below), from 1993 to December 2016 roughly 77% of CAD 72.69 billion of Chinese investments to Canada was made by SOEs. In Alberta, 88% of the cumulative Chinese investments of CAD 48.54 billion came from Chinese SOEs, as illustrated by Figure 7 below. Chinese SOEs are therefore significant players in Chinese outbound investment in Canada, in both the Canadian and Albertan contexts, and particularly with respect to the Canadian energy sector.

Chinese investment in Canada is currently shifting. Most significantly, the share of SOEs in annual investment flow from China has decreased in recent years. Taking Alberta as an example (as shown in Figure 8), the portion of SOE investment was about 90% of the total Chinese investment in 2008 while in 2016, SOEs' share of the total annual flow to Alberta from China dropped to 5%. Private investment has now surpassed the SOEs' in terms of flow and has emerged as the most dynamic aspect of new investment into Alberta.

Chinese SOEs' investment in Canada is diversifying into a broad range of industries, notably energy, metal, and minerals, but this trend also extends to agriculture and food, automotive and aviation, consumer products

and services, finance and business services, health and biotechnology, basic materials, and information and technology. However, as shown in Figure 9, most of the cumulative stock remains concentrated in two sectors: the energy sector and the metals and minerals sector, which represent 83.23% and 16.35% of total investments from Chinese SOEs, respectively. As noted above, SOEs remain a dominant component of Chinese investment in Canada, particularly in Alberta, despite an increase in smaller-scale private Chinese companies in the oil sector: nearly CAD 2 billion-worth of smaller scale deals have occurred since 2012, and in amounts under the Investment Canada Act's review threshold.³

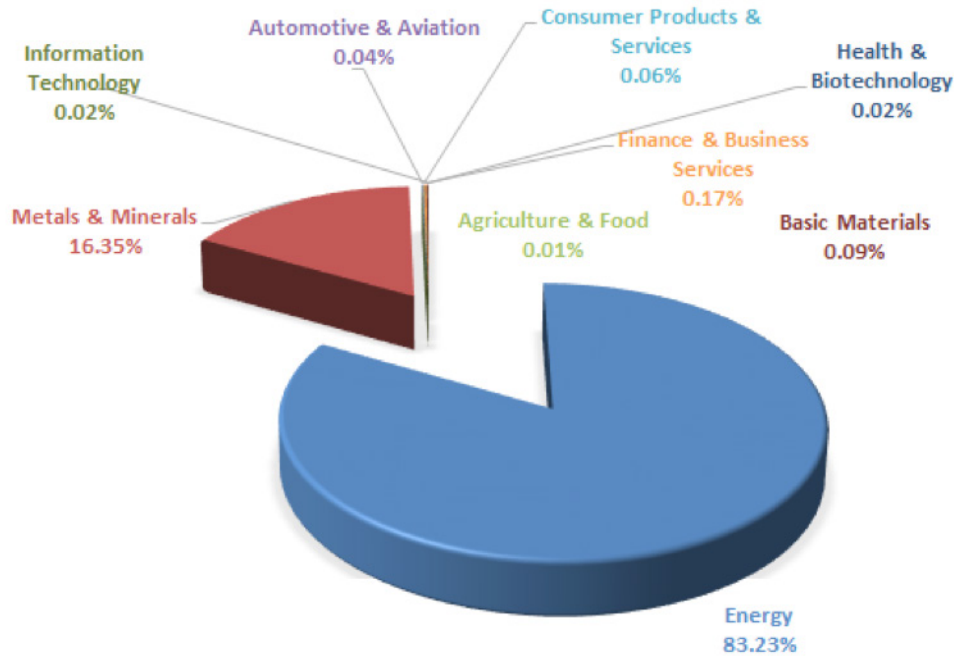
Table 2 below summarizes all Chinese investment from eleven centrally-governed SOEs in Alberta since 2004. The energy sector absorbs 99.5% of SOE investment, totaling CAD 42.3 billion for the 2004 to 2016 period. Entertainment and real estate, metals and minerals, and transport and construction constitute the remaining investment, amounting to CAD 2.1 billion. The top three state-owned energy companies, CNPC, Sinopec, and CNOOC, are the most active investors, contributing 95% of total Chinese investment in Canadian energy companies, and 66% of total Merger and Acquisition (M&A) deals. 80% of the deals occurred after 2010, and SOE investment decreased as the international oil price slumped in 2014. Table 2 also shows that seven SOEs focus on the sectors included in the State-Owned Assets Supervision and Administration Commission's (SASAC) nine basic pillar industries to China's national economy, including oil, metals and minerals, and aviation. Furthermore, Chinese SOEs, particularly central SOEs, are well-known for their asset size: seven out of the eleven SOEs are among the top 500 companies ranked by Fortune magazine.

Out of the eleven SOEs invested in Alberta, eight are owned by the central government, and operate under SASAC,⁴ China Banking Regulatory Commission, China Insurance Regulatory Commission, China

² Ministry of Commerce of the People's Republic of China, "An Introduction of Trade and Investment between China and Canada," Department of American and Oceanian Affairs, Last modified August 2, 2016. Accessed August 9, 2017. <http://mds.mofcom.gov.cn/article/NoCategory/200210/20021000042972.shtml>.

³ Jeff Lewis, Jeffrey Jones, and Nathan Vanderklippe, "Under the Radar: China's Stealthy Return to Alberta's Oil Patch," *The Globe and Mail*, May 19, 2017. Accessed August 9, 2017. <https://beta.theglobeandmail.com/report-on-business/industry-news/energy-and-resources/chinese-investment-alberta-oil-deals/article35061644/?ref=http://www.theglobeandmail.com&At.the.beginning.of.2017.the.threshold.amount.was.CAD.600.million.but.was.raised.to.1.billion.on.June.22.2017>.

Figure 9: Chinese SOEs' Cumulative Investment in Canada by Sector, 1993-2006



Source: China-Canada Investment Tracker, China Institute, University of Alberta

Securities Regulatory Commission, and other ministries and agencies of the State Council. The remaining three SOEs are owned by local/provincial governments. We find that the majority of (or seven out of eleven) SOE investment in Canada is consistent with both the focus of the company, as well as the priorities of the Chinese government.⁵ This would imply that Chinese SOE investments and related activities in Canada are for the most part aimed at expanding assets in target sectors, and developing business strategically to secure access to resources, food, or technology, or to position and operate more effectively on global platforms.

As for SOE ownership, four central SOEs – China National Petroleum Corporation (CNPC), China Petrochemical Corporation (Sinopec), China National Offshore Oil Corporation (CNOOC), and China Aerospace Science & Technology Corporation (CASTC) – are supervised and managed by SASAC. China Investment Corp and CITIC Group directly report to the State Council. The Bank of China and China Life Insurance Group run under the supervision of China Banking Regulatory Commission and China Insurance Regulatory Commission.

⁴ For the full list of names of SOEs under the SASAC, please see <http://www.sasac.gov.cn/n2588035/n2641579/n2641645/index.html>

⁵ For SOEs whose investment in Alberta is not directly in line with their company focus, including BOC, Changjiang Investment Group, CASTC, and China Life Insurance Group, their main sector focus is financial services (BOC and Changjiang Investment Group and China Life Insurance Group), or Aviation (CASTC). Their investment in energy and entertainment & real estate sector in Alberta is mostly aimed at profit, rather than strategically expanding their businesses in the global market.

Table 2: SOEs that have invested in Alberta since 2004

SOE	# OF DEALS	VALUE (MILLION CAD\$)	YEAR	SECTOR OF DEALS	CENTRAL OR LOCAL	INVESTMENT MATCHES WITH COMPANY FOCUS?	SOE ON SASAC LIST?	SOE AMONG NINE BASIC & PILLAR INDUSTRIES?	FORTUNE GLOBAL 500 RANKING
CHINA NATIONAL PETROLEUM CORP. (CNPC)	9	10704.450	2005, 2010, 2012, 2014, 2015	Energy, transport & construction	Central	Yes	Yes	Yes	3
CHINA PETROCHEMICAL CORP. (SINOPEC)	6	7287.160	2005, 2009, 2010, 2011, 2012, 2014	Energy	Central	Yes	Yes	Yes	4
CHINA NATIONAL OFFSHORE OIL CORP. (CNOOC)	4	22385.290	2005, 2011, 2013	Energy	Central	Yes	Yes	Yes	109
CHINA INVESTMENT CORP.	3	1399.735	2010, 2012	Energy	Central	Yes	No	No	No
BANK OF CHINA LTD. (BOC)	1	100.000	2011	Energy	Central	No	No	No	35
CHANGJIANG INVESTMENT GROUP CO. LTD.	1	unknown	2013	Energy	Local	No	No	No	No
CHINA AEROSPACE SCIENCE & TECHNOLOGY CORPORATION (CASTC)	1	3.945	2004	Entertainment & real estate	Central	No	Yes	Yes	344
CHINA LIFE INSURANCE GROUP CO.	1	70.000	2011	Energy	Central	No	No	No	54
CITIC GROUP	1	31.226	2006	Energy	Central	Yes	No	Yes	156
JINCHUAN GROUP CO. LTD.	1	214.000	2008	Metals & minerals	Local	Yes	No	Yes	No
SHANXI YANCHANG	1	320.000	2014	Energy	Local	Yes	No	Yes	No

4. CANADA AND ALBERTA'S KEY SECTORS WITH HIGH POTENTIAL IN CHINESE MARKETS

Canada and China have an established foundation for bilateral trade, and this relationship is expected to flourish under a potential FTA. Canada is the tenth-largest economy in the world, with strong service, manufacturing, and natural resource industries. The service sector contributes 72% of Canada's GDP, followed by the manufacturing sector at 13% and the natural resource sector at 7%. A report released in February 2017 by the Conference Board of Canada assesses the sectors in which Canadian companies have strong competitiveness and great potential for trade with China, particularly with respect to the increasing demand in the Chinese market. According to this report, the following Canadian industries are considered "very competitive" and "well prepared":

- Scientific research and other technical services
- Mining
- Crop production
- Animal production
- Fishing, hunting, and trapping
- Finance and insurance services
- Computer and information services
- Food manufacturing
- Recreational and entertainment services

The Canadian industries that have potential to meet the growing demand in China, but lack capacity and preparedness to take effective advantage are:

- Wood product manufacturing
- Aerospace product and parts manufacturing
- Vehicles and parts manufacturing

Alberta contributes 16% to Canada's GDP. Alberta has great potential for expanding trade with its Chinese partners in the oil and gas, agriculture and agri-food, forestry, manufacturing, financial services, and life sciences sectors. As shown in Figure 10 below, vast Chinese investment entered Alberta's energy sector during 2010-2013, and then sharply declined in response to a globally-declining oil price. While the growth of oil and gas exports has been slow, uneven, and generally low (due mainly to logistical constraints), Alberta's agricultural products, such as canola seeds/oil, beef, wheat, and barley, are among Canada's top exports to China. An increased presence of both Chinese firms and immigrants in Alberta has led local companies to gain tangible experience and value linkages for future interaction with some of the largest Chinese SOEs, such as CNPC, Sinopec, and CNOOC in the energy sector, and COFCO in the agri-food sector. The following sections detail the major sectors in the Chinese market where Canadian and Albertan companies can become important players with a high level of competitiveness and, with sound strategy and infrastructure in place, capacity to supply.

⁶ Julie Adès, "Responding to Chinese Demand: Canadian Industries' Competitiveness and Capacity," The Conference Board of Canada, 2017. Accessed August 9, 2017. <http://www.conferenceboard.ca/e-library/abstract.aspx?did=8543>.

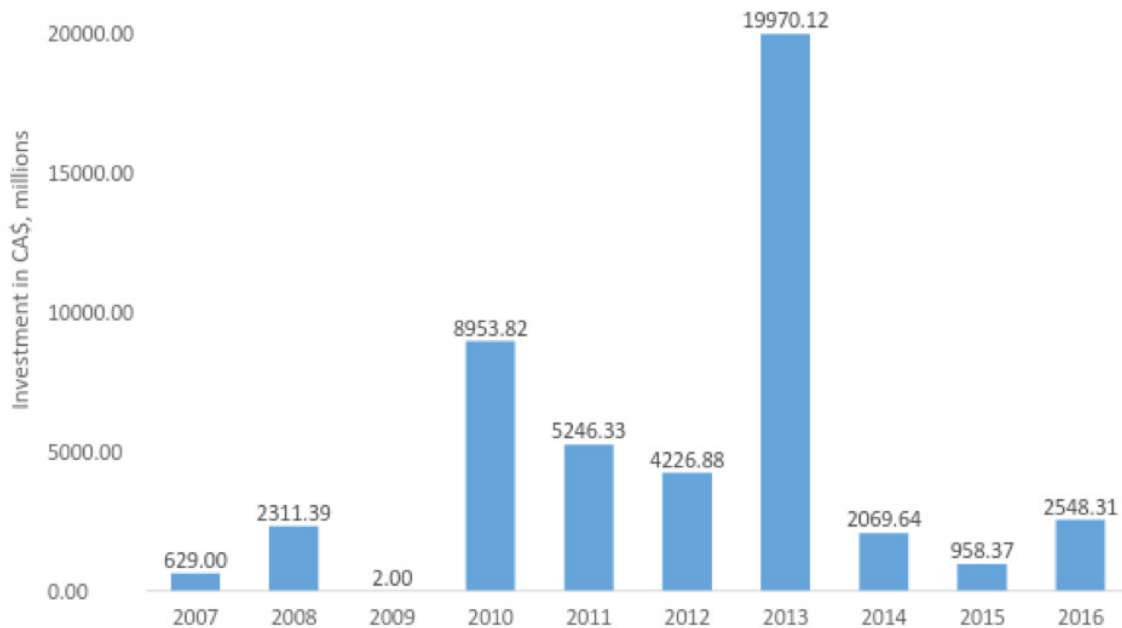
4.1 ENERGY

China's energy sector has long been dominated by three leading energy majors: CNPC, Sinopec, and CNOOC. These three companies remain crucial for the stability of the national economy, account for 9% of the total profit earned by all Chinese SOEs, and earned a total profit of USD 600 trillion in 2015.⁷ Among all sectors that have received Chinese investment, the Canadian energy sector has attracted the greatest interest. Figures 10 and 11 below illustrate the investment in Canadian energy sector made by Chinese companies over the past decade. Chinese investment grew substantively between 2010 and 2013, and its annual flow rose to CAD 20 billion in 2013. However, this growth has fallen flat since 2014. These figures also show that Alberta attracted more than 90% of Chinese investment in the Canadian energy sector, and around 89% of Chinese energy investment in Canada was made by SOEs such as CNPC, Sinopec, and CNOOC. The investment peak in 2013 is largely attributable to a single sale: the purchase of Nexen by CNOOC for USD 15 billion. Nevertheless, the plunge in

Chinese energy investment in Alberta following 2013 was likely exacerbated by Canada's restrictive regulations on investment by foreign SOEs in the oil sands, introduced in December 2012 following public pressure created by the CNOOC-Nexen acquisition. Amendments were also made to the Investment Canada Act in 2013 which confirmed that SOEs, or any firm deemed substantially controlled by a government, would be subject to lower thresholds in order to trigger "net benefit" reviews. This outcome will be discussed later in this paper, as Chinese officials have made clear they wish to see addressed in any FTA context.

The change of FDI policy aimed at strengthening public scrutiny for foreign SOEs has raised questions as to whether, and to what extent, Canada may lose attractiveness as an investment destination to other countries – or indeed appear "unwelcoming" with respect to foreign investment. This is particularly crucial for Albertan companies, which have in the past attracted more than 70% of Chinese SOE investment.

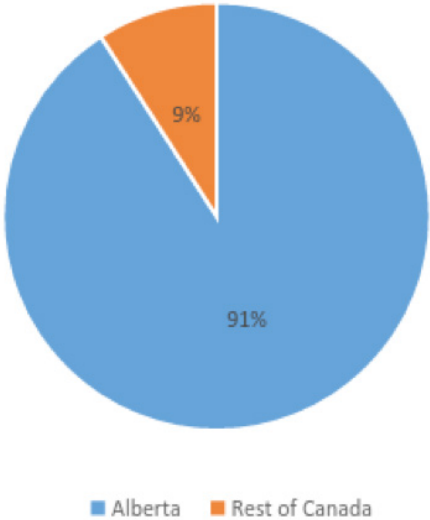
Figure 10: Chinese Investment Flow in Canadian Energy Sector, 2007-2016



Source: China Institute, University of Alberta

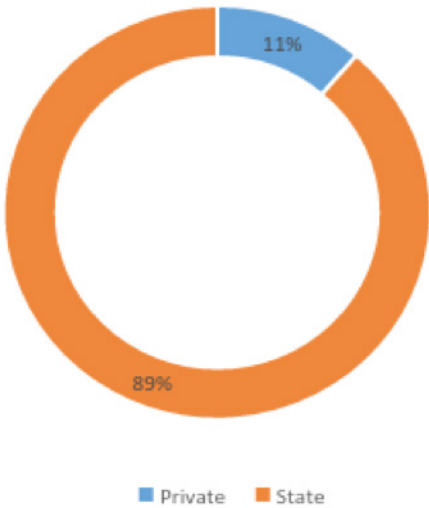
⁷ Ifeng.com (China), "The Gradual Reform of Chinese Energy SOEs Is Undergoing a Deep Change," May 12, 2016. Accessed August 9, 2017. http://finance.ifeng.com/a/20160512/14379844_0.shtml.

Figure 11: Chinese Energy Investment in Canada, by Province, 2007-2016



Source: China Institute, University of Alberta

Figure 12: Chinese Energy Investment in Canada, by Corporate Ownership, 2007-2016



Source: China Institute, University of Alberta

While capital outflow restrictions are important, economic factors also influence investment trends. After spending USD 35 billion in Canada's energy industry when oil and asset prices were high, Chinese energy companies in Canada, like others, lost significant profits as a result of the 2014 oil price crash, exacerbated by increasing production costs. China's sovereign wealth fund, China Investment Corp., invested heavily in Canada's energy and mining sector, yet shut down its Toronto office in December 2015 in response to these economic factors. The three big energy companies are also reeling from the interaction of lower prices and higher costs, and have reacted by cutting jobs and investment. Under such circumstances, Canada appears to have lost a measure of appeal as a top investment destination for new energy investment from China. While in recent months this concern may have diminished as a result of some investment returning or at least holding steady (some Chinese investors have proved steadier than others), logistics remain a significant challenge for Canadian firms. A former chief researcher at CNOOC argues that the most important reason behind the decline in Chinese investment in the Canadian energy sector is the lack of export infrastructure for Albertan oil and gas to enter external markets, such as East Asian countries.⁸ A medium- to longer-term perspective will be required to capitalize on these markets. Regardless of oil prices, the export of Albertan energy and energy-related products to China will likely be an avenue for the growth of the Canadian and Albertan economies in the future, and a needed path to customer diversification once Canada improves its ability to export and transport oil and gas.

Known for low political risk, a highly-skilled workforce, top oil and gas reserves, and advanced

exploitation and related technologies, Canada and Alberta are still among the most attractive and "safe" markets for international investors. Policymakers may want to consider relaxing foreign investment rules on Chinese SOEs in order to attract more capital from China in particular, and to spur further economic growth.⁹ It is possible, and perhaps even likely, that issues affecting Chinese investors in the oil sector will be among the "asks" by the Chinese side in FTA negotiations. These concerns may burden Canadian negotiators, but at the same time, and paradoxically, provide a measure of "leverage" in other sectors of the market or on other issues such as reciprocal and national treatment for Canadian investors in China: Canadians, like other foreign investors, currently face an uneven playing field in China, skewed in favour of SOEs, and reinforced by restrictions on incoming resource investments in China.

On the Chinese side, China's leaders are currently reshaping the oil and gas sector through ongoing SOE reforms that promote mixed-ownership and incorporate additional private assets. This reform, although viewed as moderate and quiet,¹⁰ involves all components in the supply chain, including upstream oil importing, middle-stream refining, and downstream marketing. Since 2014, Beijing has started to open up the tightly state-controlled sector: as of March 2017, eighteen private refineries were granted licenses for crude oil imports. Sinopec sold a 29.99% stake for 107 billion yuan (USD 15.5 billion) to a group of investors, including China Life Insurance Co. and billionaire Guo Guangchang's Fosun International Ltd. Chinese trade has become increasingly privatized, and this should be noted by Albertan companies and government for purposes of business strategy and planning.

⁸ Claudia Cattaneo, "Lack of Export Infrastructure Has Soured China on Oil Investment in Canada: CNOOC Official," *Financial Post* (Calgary), January 19, 2016. Accessed August 10, 2017. <http://business.financialpost.com/commodities/energy/lack-of-export-infrastructure-has-soured-china-on-oil-investment-in-canada-cnooc-official/wcm/8226cb07-1635-443c-b14d-084243d8193e>

⁹ Jeff Wingrove, "Canada Eyes Relaxing Rules to Attract Investment from China," *Bloomberg Markets*, August 21, 2016. Accessed August 10, 2017. <https://www.bloomberg.com/news/articles/2016-08-21/canada-eyes-relaxing-rules-to-attract-investment-from-china>

¹⁰ Aizhu Chen, and Meng Meng, "No Big Bang, but Quiet Reforms Reshaping China's Oil and Gas Sector," *Reuters*, May 11, 2016. Accessed August 10, 2017. <http://www.reuters.com/article/us-china-reform-energy-idUSKCN0Y22RH>.

4.2 AGRICULTURE AND AGRI-FOOD, FISHERY AND FORESTRY

China is expected to be the world's largest agricultural importer by 2020. It is crucial for Canada to seek more trade and investment opportunities in key Chinese industries where demand is currently rising, such as in agriculture, forestry, and fisheries. Canadian firms may be competitive in these industries, as they are well equipped to offer a higher value, higher quality, and more diverse range of products for China's rising middle class. Alberta now plays a key role in Canadian agricultural exports to the Chinese market, and China is Alberta's second largest market for agri-food exports, with a total value of CAD 1.6 billion in 2015, which accounts for nearly 30% of total Canadian agri-food exports.¹¹ Alberta dominates canola product exports and beef production, and is also active in the export of hides and skins (e.g., used in the production of leather goods), wheat, and barley.

The role of SOEs in China's agriculture sector is less prominent than in the energy sector: at the wholesale and retail level, the Chinese marketplace has begun to rapidly shift, for example, to direct-to-consumer platforms and hyper-markets (large retailers that combine grocery stores and department stores). This shift must be understood by Canadian and Albertan exporters in order to remain competitive. Nevertheless, with the Chinese government's preoccupation with "food security" and more recently food safety, state-owned firms are often tasked to help set industry standards, as well as implement policy priorities.

One of the largest agricultural companies is the state-owned China National Cereals, Oils, and Foodstuffs Corporation (COFCO). COFCO is China's largest food processor, manufacturer, and trader. The COFCO group and its subsidiaries have imported a wide range of Canada-origin agricultural and agri-food products, including canola seeds, canola oil, beef, wheat, barley, and hogs. COFCO is actively expanding its business in the North American market as a part of its global supply chain strategy. COFCO announced its plan to establish a trading office in Winnipeg in 2016 to promote international grain trade.

China National Agricultural Development Group Corporation (CNADC) is another key, central state-owned agricultural enterprise, with a business focus on pelagic fishing and agricultural resource exploitation; production of bio vaccines, veterinary medicine, and feed additives; and supplementary services. CNADC is also committed to international cooperation in agriculture and fisheries and has established offices in over eighty countries and regions.

The primary goal of Chinese agriculture and food SOEs is to assure China's food security and safety in line with the government's national strategy. As previously noted, SOEs' involvement in the pursuit of policy objectives, and their occasionally less-than-transparent or not-so-science-based approach on technical barriers to trade, could serve protectionist ends – or simply be used as leverage on unrelated issues. These barriers continue to frustrate foreign partners in bilateral trade and investment activities. However, this sector does have immense potential for Canadian firms: China's endeavors to meet the rising demand by the middle class for high quality and safe agricultural, processed, and fishery products could make agriculture and related sectors a key component in future FTA negotiations. As a reliable and safe supplier of quality agricultural and agri-food products and associated services, Canada will likely have considerable negotiation power in this sector.

Combined with Canada's capacity and competitiveness, we identify the following agricultural and agri-food products as the ones with great potential in future Canada-China trade and investment:

- Oilseeds, particularly canola seeds and oil
- Grains
- Animal meat, such as beef and pork
- Seafood
- Dairy products
- Wine
- Fertilizer

Forestry is also an important sector in developing the

¹¹ Alberta Economic Development and Trade, "China-Alberta Relations, Edmonton, Alberta: Government of Alberta," 2017. Accessed August 10, 2017. <http://economic.alberta.ca/documents/China-AB.pdf>.

Canada-China trade relationship – and one in which Alberta could participate to a greater degree in the future. While building codes and practices in construction remain biased toward concrete materials, China's demands for wood and wood products have grown in recent years, making China the second-largest consumer of timber and pulp/paper products in the world. The supply gap between China's forest resources and its industrial and residential demand is projected to be 180 million m³ in 2020. Canada is now sitting among China's top five forestry products importers, and China is the second largest export destination for Canada's softwood lumber. China's forestry sector has undergone a series of reforms since the 1980s. SOEs account for a diminishing proportion of total imports, though they are still important players in the industry. In fact, the leading importer of Canadian wood,

Zhejiang Material Industry Senhua Group, is owned by the Zhejiang Government and is ranked 339 in the 2015 global 500.

Given that the U.S.-Canada trade relationship is in a state of dispute, if not a virtual impasse, over softwood lumber, and with the future of NAFTA, particularly its dispute settlement provisions, in some jeopardy, the Chinese market may now be increasingly important for both policymakers and the softwood lumber industry. Trade in forestry products was reportedly brought up during the exploratory free-trade talks with China earlier this year. Alberta remains a key source of wood pulp imports into China, and can be an important player in the developing trade relationship with the Chinese wood product sector.

4.3 FINANCIAL SERVICES

Service exports to China from Canada, and Alberta in particular, are modest at present, yet opportunities for Canadian firms are growing in a number of key service sectors in addition to tourism and educational services.¹² Supply chain access for related service sectors are available through Chinese SOEs already engaged in Canada: for instance, in the oil and gas and mining sectors, access is available, but under-recognized and under-pursued. The next section of this paper will examine market access in terms of specific opportunities and capacities possessed by Canadian/Albertan companies.

The financial services sector stands out as a significant service import from China. Both Canada and Alberta host a growing number of Chinese financial institutions. Financial services also play a strategic role in the ability of Canadian firms to enter and establish in the Chinese

market and, with recently announced policy shifts that include greater access and transparency, will play a larger role in the attraction of FDI in an increasingly rapid pace. Furthermore, rising investment in financial services from Chinese investors in recent years reflects not only an effort to position in business activity in other sectors, but also the Chinese government's desire to more fully internationalize and modernize its financial system.

SOEs remain dominant in China's financial services sector. The key players include state-owned commercial banks, policy banks, share-holding (joint-stock) commercial banks, city commercial banks, county banks, Asset Management Corporations (AMCs) and other funds, trust, and investment corporations. The main state-owned banks and AMCs are shown in Table 3.

¹² Alberta's financial services sector is growing exponentially in the past few years, even though it is not a big sector compared to the energy and agriculture sector. The Government of Alberta recently highlighted the role of the financial service sector in Alberta economy in this document: http://www.albertacanada.com/files/albertacanada/SP-EH_highlightsABEconomyPresentation.pdf. On the other hand, China is gradually opening up its financial market and offer more opportunities for western countries (see documents released by the State Council http://www.gov.cn/zhengce/content/2017-01/17/content_5160624.htm, <https://www.bloomberg.com/news/articles/2017-11-10/china-to-allow-foreign-firms-to-own-51-of-securities-ventures>). For these reasons, there is a significant opportunity for Alberta to grow its financial service business in China.

Table 3: Key SOEs in China's Financial Services Sector

STATE-OWNED COMMERCIAL BANKS	STATE-OWNED ASSET MANAGEMENT CORPORATIONS
Bank of China	China Orient Asset Management
Industrial & Commercial Bank of China	China Cinda Asset Management
China Construction Bank	China Huarong Asset Management
Agricultural Bank of China	China Great Wall Asset Management

The combined assets of the big four state-owned commercial banks account for more than 35% of China's banking industry total. Profit growth of the big four slowed in 2015 and further flattened in 2016, weathered by the central bank interest cut and the slowdown of the country's economy.¹³

In general compliance with World Trade Organization (WTO) agreements and principles, China has gradually opened its financial service sector to increased foreign investor participation, albeit with continuing limits. In spite of these WTO-imposed requirements, as well as some external economic pressures, foreign participation in the financial services sector has remained constrained, despite previous growth. Indeed, the "golden decade" (since around 2005) for foreign banks in the Chinese financial market has come to an end, as the country's economy downshifts. Last year, the share of total assets of foreign banks was less than 2%, in contrast to 2.4% in 2007. Foreign banks face a series of challenges in competing with Chinese state-owned banks. For example, the difficulties of limited physical distribution channels, such as branches, represent a distinctive disadvantage compared with local Chinese rivals.

Another challenge is the policy and regulatory landscape confronted by foreign banks that operate in China. Restrictions are imposed on foreign banks in several areas, such as renminbi business, credit card business, and financial products. However, China's 13th Five Year Plan

(2016-2020) emphasizes the need for further reforms in China's financial services sector, and promises a further opening of China's financial markets to foreign issuers and investors. Likewise, China's State Council made an explicit statement early in 2017, known as "the twenty measures," which calls for the relaxation of financial sector restrictions, including in the banking, securities, and insurance industries.¹⁴ More "opening" is promised. This may provide new opportunities for foreign banks and investment corporations. While these measures can be seen as a step in the right direction, the move to negative (i.e., generally open, with explicit exceptions) lists rather than positive (i.e., proscribed) lists of what will be permitted, or implemented, should be closely monitored.

The coverage of such measures is likely to become a hotspot in negotiations with other trade partners, notably the United States and European Union, but also potentially with Canada. The China-Korea Free Trade Agreement (CKFTA) has a separate chapter for the financial services sector, and outlines how market access to the financial services sector can be improved. In the China-Australia Free Trade Agreement (ChAFTA), the two sides also agreed to deepen cooperation in the financial services sector. It will be important to ensure the negotiating priorities for Canada with China through the proposed FTA will similarly include improving financial services sector access, and that the objectives of China's state banks operating in Canada are well understood by Canadian policymakers.

¹³ Yuan Yang, "Profit Growth Flattens at China's Biggest Banks," *Financial Times*, March 30, 2016. Accessed August 10, 2017. <https://www.ft.com/content/31772348-f668-11e5-803c-d27c7117d132>.

¹⁴ The State Council, "Notice on Several Measures on Increasing of Openness to Foreign Investment and Active Use of Foreign Investment," Ministry of Commerce: People's Republic of China. Last modified January 12, 2017. Accessed August 10, 2017. http://www.gov.cn/zhengce/content/2017-01/17/content_5160624.htm.

4.4 OTHER SECTORS: MINING AND METALS, HEALTH, TOURISM, AND EDUCATION

Following the energy sector, Canada's mining and metals sector is ranked as the second-most important sector for Chinese investors, absorbing more than CAD 9 billion in investment since 2008, and accounting for around 14% of the total dollar value of Chinese direct investment in Canada. In Alberta, the mining and metals sector is ranked after the energy sector as the industry that attracted the largest amount of Chinese capital. However, mining and metals accounts for only 2% of the total dollar value, due to the dominance of the oil industry in Alberta economy. Canada has world-class reserves, as well as one of the most diverse natural resource endowments in the world. Canada is also recognized as a global leader in the production of potash, and sits among the top five global producers for gold, primary aluminum, cobalt, diamonds, nickel, platinum group metals, salt, tungsten, and uranium.

Beyond our reserves and production capacity, Canada's expertise and knowledge, technology advancement, and range of mining-related services across the resource value chain are also contribute to Canada's strong position as a leading commodity producer. China is Canada's third-most significant mineral importer, and second-most significant mineral exporter. China's continuous and fast-growing demand for metals and minerals to sustain its high rate of economic growth provides great opportunities for Canada's mining industry. Alberta's extensive coal deposits have already attracted Chinese SOE investment in Alberta coal companies: for example, in 2008, the Chinese state-owned Jinchuan Group Co. Ltd. bought out Calgary-based Tyler Resources Inc. for CAD 214 million.

Chinese investment in Canadian health sector demonstrates an upward trend in recent years, in contrast with the sharp post-2014 decline in Canadian

oil industry investment. China's fast-growing demand for improving life expectancy and quality care makes China a huge market for health-related products, technology and services. Since early 2016, Chinese companies have completed sixty-one M&A deals in the global healthcare sector, amounting to USD 5.8 billion. The major destinations of Chinese outflows are the United States, Europe, Asia, Israel, Australia, and Canada. This large and rapid investment is in part due to China's aging population: China's spending in health and old-age care is projected to reach USD 1 trillion in 2020.¹⁵ The competition for the share in Chinese healthcare market will be fierce between global suppliers. Canada also received significant Chinese investment in healthcare subsectors, such as biopharmaceuticals, nutrition supplements, and old-age care. The latter industry is somewhat controversial for Canadian constituents: in February 2017 the Trudeau government approved the sale of Retirement Concepts, a chain of old-age homes based in Vancouver, to Cedar Tree Investment Canada, the Canadian subsidiary of Chinese-owned Anbang.

Alberta's biotechnology companies have also shown great potential in capturing interest of Chinese investors. In 2014, three deals were closed by China's Shenzhen Hepalink Pharmaceutical Co Ltd.¹⁶ with Canada's Resverlogix Corp (Calgary), Quest PharmaTech Inc (Edmonton), and OncoQuest Inc (Edmonton). Most recently, Chinese Premier Li Keqiang signaled that the healthcare industry may turn into one of China's pillar industries. This suggests that China will remain a growing healthcare market for Canadian and Albertan companies.

While spending by Chinese travelers in Canada increased to CAD 993 million in 2015, the tourism industry in

¹⁵ Franck Le Deu, Rajesh Parekh, and Gaobo Zhou, "Healthcare in China: Entering Uncharted Waters," McKinsey and Company. Last modified November 2012. Accessed August 10, 2017. <http://www.mckinsey.com/industries/healthcare-systems-and-services/our-insights/health-care-in-china-entering-uncharted-waters>.

¹⁶ Shenzhen Hepalink Pharmaceutical Group, "About Hepalink." Accessed August 10, 2017. <http://www.hepalink.com/en/>.

Canada has so far failed to attract substantial interest from Chinese SOE or non-SOE investors. Policymakers should address this issue given this investment's potential to expand arrivals and related business activity further. Canada is already recognized as a world-class destination for tourists from all over the world: in 2015, Banff, Jasper, and Canmore contributed CAD 1.55 billion of visitor spending to Alberta's economy. Driven by a growing middle class, China's outbound tourism market continues to expand, and the country has remained the world's largest outbound tourism market since 2012 with around 100 million outbound tourists. According to the China Institute's China-Canada Investment Tracker database, Chinese tourism investment in Canada has focused on the purchase of hotels and resorts, wineries, restaurants, and other tourism-related services.

However, the growth of the Canadian tourism industry appears flat and continues losing its share of the international travel market. To combat this trend, efforts at the national level have been taken to further strengthen the relationship between Canada and China in tourism in the next decades. For example:

- A new Memorandum of Understanding (MOU) was signed during Chinese Premier Li Keqiang's visit in Canada in September 2016;
- Tourism was an essential element of Alberta Premier Rachel Notley's first trade mission to China. The main progress made in tourism cooperation includes agreements by Travel Alberta and CTrip.com to develop a tourism strategy and by Travel Alberta and Hainan Airlines to increase cooperation in Alberta;
- In December 2016, Alberta's Minister of Economic Development and Trade visited China on a trade mission to meet with potential Chinese investors, buyers, and government leaders, highlighting tourism as a key component in strengthening Alberta's economy; and
- Chinese tourism companies are actively exploring innovative models for overseas expansion recently, including M&A, greenfield investment, and service outsourcing with local tourism companies, in order to better serve China's growing outbound-tour market.

Although the majority of investments in the tourism sector are from private firms, SOEs are also key players in the competition, accounting for half of China's top 20 tourism corporations in 2016. To bring more Chinese visitors to Alberta, cooperating with Chinese tourism SOEs, such as Air China and the China National Travel Service (HK) Group (Hong Kong CTS), can boost Alberta's tourism. Hainan Airlines, a provincial-level SOE controlled by Hainan province, now operates a direct flight to Calgary. Analogous business such as a direct flight from China to Edmonton could also be considered.

There are also opportunities for local tourism companies to benefit from the global expansion of China's tourism companies, specifically in terms of both Chinese investment in foreign airlines, as well as the hospitality industry. In addition, in order to improve their global competitiveness, Canada and Alberta continue to increase capacity through providing adequate amenities, infrastructure, accommodation, transportation, and other services tailored to Chinese and other Asian markets. It is especially important to improve capacity for the delivery of tourism-related services in the Rocky Mountain communities.

Education also plays an essential role in China-Canada trade and investment relationship. Canada and Alberta have been among China's most important education destinations for decades for its academic excellence, affordability, and quality of life. Following Ontario and British Columbia, Alberta absorbed 5% of the total number of Chinese students in Canada during the 2004-2015 period.¹⁷ Education per se does not contribute a big share in China-Canada investment in either direction, yet it triggers investments and economic activity in many other industries such as tourism, real estate, financial services, transportation, and so on. According to the CTV, the top reason why Chinese buyers want to get into the Canadian housing market is related to education, not investment.¹⁸ Education, as a service sector, is currently not an identified priority in China's economic strategy or trade policy, and it is a sector with a lesser degree of direct SOE involvement. The education services sector is not an area likely to receive specific attention

¹⁷ "Chinese Students in Canada," *The Canadian Magazine of Immigration*, November 3, 2016. Accessed August 10, 2017. <http://canadaimmigrants.com/chinese-students-canada/>.

in any FTA negotiation; there are no known irritants to resolve, though accreditation of Canadian schools and/or curricula in China can be slow at times. Nevertheless, education's tight ties to other key industries, and its strategic people-to-people role in furthering business and government dealings, elevate its importance to the economic relationship between Canada/Alberta and China and to any strategy for expanding this relationship.

Table 4 below summarizes the Canada/Alberta-China sectors that may have potential to develop business links with SOEs and the issues we may encounter when engaging with SOEs under an FTA.

Table 4: Canada/Alberta-China Sectors, SOEs, and Issues Profile at a Glance

SECTOR	MODE OF ENGAGEMENT	CHINESE SOEs OF PRINCIPAL INTEREST TO ALBERTA	POSSIBLE FTA ISSUES (TO BE REFINED IN CONSULTATION WITH INDUSTRY)
ENERGY	<ul style="list-style-type: none"> · Alberta-to-China exports of crude oil; · China-to-Alberta investment, M&A with Albertan oil companies; · Labour 	<ul style="list-style-type: none"> · CNPC · Sinopec · CNOOC · China Investment Corp. · Shanxi Yanchang Petroleum (Group) Co. Ltd. 	<ul style="list-style-type: none"> · Access to cheap capital for subsidiaries · Chinese pressure to raise investment review threshold, to expand access to temporary workers
AGRICULTURE & AGRI-FOOD, AND FORESTRY	<ul style="list-style-type: none"> · Alberta-to-China exports e.g. Canola seeds and oil, wheat and barley, beef, wood products, and hides & skins · China-to-Alberta investment, M&A with Albertan food manufacturing or trading companies, or greenfield investment in Alberta; · Alberta-to-China investment, M&A with Chinese food manufacturing or trading companies, or greenfield investment in China 	<ul style="list-style-type: none"> · COFCO · CNADC 	<ul style="list-style-type: none"> · Non-tariff measures, including sanitary/phyto-sanitary (SPS) quality issues · Tariff escalation and tariff quota management on highly processed products · Equal or similar market access as granted to Australia by ChAFTA · Lumber building codes, standards to expand market for wood in housing structures
METALS & MINERALS	<ul style="list-style-type: none"> · Alberta-to-China exports, e.g. sulphur, nickel, coal & coke; · China-to-Canada investment, M&A with Alberta mining companies, or greenfield investment 	<ul style="list-style-type: none"> · Shenhua Group (coal) · Yancon Group (coal) · Sinochem Group (sulphur) 	
FINANCIAL SERVICES	<ul style="list-style-type: none"> · China-to-Alberta investment, e.g., Chinese financial institutions establish affiliates to facilitate Chinese investment 	<ul style="list-style-type: none"> · Bank of China · Industrial and Commercial Bank of China · China Construction Bank · Agricultural Bank of China 	<ul style="list-style-type: none"> · Improved access and operating flexibility for financial service providers; speedier approvals of bank branches/additional business line access · Chinese pressure to expand operations under Bank Act
OTHER BUSINESSES <ul style="list-style-type: none"> · business services · engineering services · education 	<ul style="list-style-type: none"> · Sales and service access · Investment in China 		<ul style="list-style-type: none"> · Affiliate establishment: national treatment; transparency, etc. · Access to professional certification or equivalent to operate in the market · Lawyers' licensing · Construction sector access for project bidding as per WTO GPA · Speedier accreditation of Canadian school and curricula in Chinese provinces
TOURISM	<ul style="list-style-type: none"> · China-to-Alberta investment; e.g., M&A with local hotels & resorts, open new flight routes, etc. · Cooperation with Alberta tourism firms in the fashion of service outsourcing 	<ul style="list-style-type: none"> · Hong Kong CTS · Hainan Airlines 	<ul style="list-style-type: none"> · Ease of access by Canadian travel agencies · Landing rights/frequencies etc. handled separately from FTA

¹⁸ "Education Key Driver of Chinese Investment in Canadian Real Estate: Study," CTV News, March 17, 2017. Accessed August 10, 2017. <http://kitchener.ctvnews.ca/education-key-driver-of-chinese-investment-in-canadian-real-estate-study-1.3314924>.

5. SELECTED SOE ISSUES AND POLICY IMPLICATION IN THE PROSPECTIVE TRADE NEGOTIATIONS

SOEs continue to play an important role in the domestic markets of many economies. With increasing SOE activity in the global market, particularly from emerging market SOEs, more attention will be paid to SOEs' roles as competitors for private businesses across borders. As outlined in the opening chapter, Chinese SOEs continue to be used by the Chinese government as vehicles, under certain circumstances, for the pursuit of national strategic objectives – and receive official support in doing so. Neither the subsidies nor other favors that generally benefit SOEs are available to Canadian or other foreign entrepreneurs in China or, for that matter, to domestic competitors operating in

Canada. At the same time, SOEs have lately become more commercially oriented in both domestic and international markets. Further consultations with Albertan and Canadian businesses on their experiences and priorities with respect to Chinese SOEs may be necessary to understand the specific competitive challenges that Canadian firms face. Favoritism for SOEs operating in China should not be overlooked, and will certainly become a topic of interest and even debate during any trade negotiations with China. The following is a list of issues related to SOEs that should be considered in any Canada-China trade negotiations.

5.1 MIXED MOTIVATIONS AND RISK ATTITUDES

The first issue relates to the motivations and risk attitudes of Chinese SOEs and their executive leadership. Most SOEs are wholly owned by the Chinese government, and often have complicated incentive structures. The motivations of Chinese SOEs extend beyond merely making a profit: political considerations, institutional pressures, policy compliance, and the personal political career development of executives may also greatly influence decision-making within SOEs.¹⁹ Political or at least “national policy” considerations guide much of the business strategy for SOEs, and this is particularly evident within China's national oil majors' global quest for energy resources, which can be interpreted as a direct response to the government's aim of achieving energy security.

During the first wave of Chinese firm internationalization in the 1980s, political considerations dominated the internalization of SOE decision-making, which was intertwined with state interests and priorities. In many cases these national-level strategic objectives have been retained within the business strategies of SOEs. In conjunction with government support measures, these national-level strategic objectives can, and often do, create ongoing market distortions – including trade effects. However, after the introduction of the “Go Global” policy, profitability has gradually become a more important factor in SOEs' overseas activities. Recently, directives and regulations by SASAC and NDRC indicate that

¹⁹ C. Zhang, “Business Negotiation between Westerners and Chinese State-Owned Enterprises,” *The International Lawyer* 42, no. 4 (Winter 2008): 1303-16.

profit will be included as a requirement for large-scale SOE overseas investment.²⁰ Jiang and Sinton conclude that the interests of Chinese national oil giants are not always in line with those of the Chinese government. In their study, Jiang et al. argue that national oil companies are owned, but not run, by the government. Under certain circumstances, the two parties may have divergent interests and the national oil companies can act in a more traditionally commercial sense, and are sometimes in overt competition with one another.

The degree to which an SOE accepts and manages commercial risk in operations is an example of how outside companies and governments can assess whether the SOE is highly commercially oriented. It has been demonstrated that SOEs have paradoxical risk attitudes, revealed in assessment and mitigation practices that vary somewhat from private firms.²¹ On the one hand, due to the separation of ownership and management, the overall responsibilities, and therefore accountabilities, of SOEs are weakened. Thus, SOEs tend to be more commercially risk-tolerant, or “patient,” in overseas expansion. On the other hand, SOEs are often risk-averse during internationalization: this is because the political careers and long-term career trajectories of SOE executives depend on the performance of the SOE. Such incentives are perhaps reinforced by the increased scrutiny of executives that are intent on leadership as part of President Xi’s anti-corruption campaign. Zhang argues that Chinese executives of SOEs are usually highly risk-averse, and therefore act more cautiously than their western counterparts.²² The complex motivations of SOE executives may result in negative outcomes for SOEs: 30% of SOE overseas investment incurs losses. One important reason for this is that the institutional influences on SOEs, for example, of government and Party, override their commercial interests and modify their commercial

behaviour. Sometimes, moreover, it can be speculated and occasionally observed that SOEs appear disinclined to move as quickly and flexibly as market dynamics may ideally require.

Given the new round of SOE reform and commitment to “market forces,” one could expect, assuming full implementation, that Chinese SOEs may develop greater incentives to become profitable – and market-oriented – in future international business activities, and may become more commercially risk-aware in making investment decisions. It is more difficult, however, to ascertain how this logic will play out in practice as, somewhat paradoxically, we have also seen of late a renewed determination by government to further regulate or exercise closer oversight of SOE investments in foreign markets.

It is crucial for China’s trade partners to understand the evolving and complex motivations and risk attitudes of SOEs. However, the motivations and operations of Chinese SOEs will vary significantly between sectors. For instance, SOEs in sectors that are less SOE-dominant and in which they compete with private sector entities, such as agriculture and food as well as most manufacturing and service industries, tend to act more like private enterprises themselves. In these circumstances, SOEs may be more reasonably treated as commercial entities by foreign partners and competitors, or by those in government that negotiate on behalf of these SOEs. Yet in the sectors that remain highly controlled by the government, such as oil and gas, utilities and power, and mines and metals, the Canadian business community should be aware of SOEs’ continuing involvement in both domestic and overseas business activities, as well as the influential policy role SOEs enjoy in some sectors, such as energy and finance.

²⁰ “Measures for the Supervision and Administration of Overseas Investments by Central Enterprises,” China Law Info: Laws and Regulations (中央企业境外投资监督管理办法). <http://www.lawinfochina.com/display.aspx?id=23099&lib=law&SearchKeyword=&SearchCKeyword>.

²¹ For example, Table 84.2 in Xiao-yang Zhu, “Chapter 84: Performance Evaluation of Stat-Owned Enterprises in China: A Case of Petroleum Industry” in *Proceedings of 2012 3rd International Asia Conference on Industrial and Management Innovation*, ed. Runliang Du (New York: Springer) assigns a weight of 26.53 out of 100 to evaluation of social and political goals within the three giant oil SOEs (17.33/100 is assigned to the energy security goal). Based on the author’s evaluating system, PetroChina is found to be the best among the three SOEs in terms of overall performance, and the ranking is “consistent with that of the micro-economic performance level.”

²² Zhang, “Business negotiations,” 1308.

In select sectors that used to be dominated by SOEs but now appear to be undergoing gradual reforms, such as financial services, it would be wise for Canadian and Albertan enterprises to proceed with due caution, and to study how best to take advantage of emerging opportunities associated with any further

“opening up” in the Chinese market, whether carried out unilaterally or as part of a process of bilateral negotiation. This would include opportunities involving difficult questions of how to seek greater “reciprocal treatment” of Canadian investors operating in China.

5.2 PREFERENTIAL POLICIES, PRACTICES, AND SUBSIDIZATION

The second issue, introduced briefly in the opening chapter and above is related to the preferential policies and favours enjoyed by SOEs, including direct or indirect subsidization by the Chinese government. SOEs benefit from a series of privileges granted by the central and local governments in order to protect and develop their businesses and/or the sectors these SOEs represent, especially if deemed high priority for China’s national objectives of the day. This favourable treatment includes non-financial (policy) support, as well as financial support and the facilitation of SOE activities and ventures through legal mechanisms. Favoritism occurs in traditional key sectors of SOE dominance: for example, in energy, infrastructure, or heavy industry, but also in “Strategic and Emerging Industry” (SEI) sectors highlighted by Five-Year Plans. Similar favours can be expected as part of the pursuit of capital construction projects associated with initiatives such as the Asian Infrastructure Investment Bank or the Belt and Road Initiative. In conjunction with other aspirational objectives, such as the “Made in China 2025” drive, these initiatives have a mercantilist dimension not entirely consistent with the spirit of the WTO.

Historically, preferential policies, practices, and subsidization contributed to building bigger and stronger national companies in the domestic and global

markets. SOEs are not the only corporations that benefit from these policies and practices: some private sector ‘national champions’ have benefited from high levels of protection, including tariff shelters, fiscal breaks, and financial support. These ‘national champions’ have also benefited from requirements that technology transfers take place in order for certain categories of imported products to be granted market access.²³ Critics abroad have suggested that these uneven competition policies, such as “performance requirements,” are questionable under international trade law and practice.

With government sanction and support, Chinese SOEs use their market position in China to negotiate technology transfer provisions with foreign partners. Likewise, it is not uncommon for foreign partners to be required to comply with joint venture requirements with a Chinese partner. SOEs operating in the energy, automotive, and green technology industries have also obtained technology transfers from foreign investors, as well as access to their global supply chains through these joint venture agreements.²⁴ These privileges are often the result of laws that control the extent of foreign equity participation in the Chinese market, or laws that grant preferential tax or regulatory treatment to Chinese SOEs.²⁵ Moreover, SOEs are favoured for access to key inputs such as energy, land, utilities, and raw materials,

²³ P. Nolan, *China and the Global Economy*. Hampshire, United Kingdom: Palgrave Macmillan, 2001, 18-19.

²⁴ United States Securities and Exchange Commission, “Annual Report Pursuant To Section 13 or 15(D) Of the Securities Exchange Act of 1934: Impco Technologies, Inc,” Government of the USA, 2002. Accessed June 30, 2017. <https://www.sec.gov/Archives/edgar/data/790708/000119312506071338/d10k.htm>

²⁵ In the automotive sector, for example, foreign investors in the complete automobile production sector are required to enter into a joint venture in which the Chinese partner owns at least 50%. *Automotive Industry Development Policy*, State Council Document Guo Han [2004] No. 30 (May 21, 2004) at Art. 48. In other sectors such as energy and infrastructure, SOE dominance is so widespread that foreign investors face few options to enter the market aside from joint ventures with SOE control.

and are the main beneficiary of government contracts.

Other than limits imposed on mining investors, which are indeed an irritant to Canadian firms, including those from Alberta, it is not clear whether, or how many, Albertan firms have been subject to technology transfer or joint venture requirements – or whether Albertan firms have been pressured to offer such arrangements. However, “technology partnering” arrangements can be designed as an effective market entry tool of mutual advantage in the knowledge intensive sectors, as has been the case for Bombardier. All of the foregoing is worthy of further research and sharing of experience with business. Nevertheless, as a bottom line, rules of engagement must be transparent.

Whether for domestic businesses or foreign ventures, SOEs have enjoyed low-cost bank financing, and preferential access to credit, including the right to issue trade equity and debt. SOEs also enjoy the right to establish their own finance companies, and the right to manage other state-owned firms within their enterprise group. These finance companies are exempt from the general prohibition on inter-company lending,²⁶ and are developed to provide a wide range of activities, including payments, insurance, and foreign exchange services to members, and underwrite the securities of member firms.²⁷ They benefit from preferential treatment regarding tax levies compared to private firms, are exempt from antitrust enforcement or bankruptcy rules, and are the recipients of over 80% of bank loans. All of the policies, measures, and practices listed here will arise or have already arisen as key areas of interest and contention for China’s international trade and finance dealings, and it is likely that these preferential practices will become even more contentious in the future, in trade negotiations involving major OECD

countries.

SOEs were the main beneficiary of the economic stimulus package created by the Chinese government in response to the 2008-2009 global financial crisis. A large proportion of the allocated funds were used to finance projects approved by the government and undertaken by SOEs.²⁸ From 1985 to 2005, the government spent over USD 300 billion to support SOEs through measures such as low cost financing, direct payments, and subsidized inputs. The automobile industry is one of the key sectors to benefit from government support, which is estimated to be USD 28 billion during the period of 2001-2011 and another USD 11 billion expected by 2020.²⁹

The principal instrument of government favour is a regulatory shelter effectively shielding SOEs from strong competition and from at least some measure of commercial risk, in order to protect SOEs (or other selected ‘national champions’) involved in a set of major industries seen as “strategic.” This shelter is often enhanced by financial support. In cases of what the government considers excessive competition among SOEs, the government will intervene to reduce the total number of firms, increasing the total market share of remaining SOEs.³⁰ This strategy prevents or limits the presence of non-state firms, including foreign firms, in these key industries. Failing SOEs are then absorbed by other state-owned companies. There are also other forms of subsidies, such as the exemption from paying full dividends to state shareholders, which help SOEs increase their capacity and production potential (quantity and quality) and sell at much lower prices than private firms. SOEs involved with international trade have also received support from the government through guarantees and concessional export credits.

²⁶ Daikuan Tongze, 贷款通则 [General Provisions on Lending], People’s Bank of China. Last modified June 28, 1996. Accessed August 11, 2017. <http://law.npc.gov.cn/FLFG/flfgByIDaction?txtid=4&flfgID=25801&showDetailType=QW>.

²⁷ Li-Wen Lin and Curtis J. Milhaupt, “We Are the (National) Champions: Understanding the of State Capitalism in China,” *Stanford Law Review* 65, no. 4 (May 2013): 665-97.

²⁸ “Report to Congress,” U.S.-China Economic and Security Review Commission, 2011.

²⁹ Usha Haley and George Haley, *Subsidies to Chinese Industry*, New York, NY: Oxford University Press, 2013.

³⁰ Derek Scissors, “The Importance of Chinese Subsidies,” Last modified December 11, 2013. Accessed August 10, 2017. <https://www.aei.org/publication/the-importance-of-chinese-subsidies/>.

In fact, after it launched the “Go Global” strategy in 2000, the Chinese government decided to gradually liberalize the OFDI regulatory regime. This process involved several measures, such as the decentralization of investment verification and approval at the provincial level, a relaxation of foreign exchange controls, simplification of application procedures and processing time, liberalization of restrictions on access to and use of foreign exchanges, and the creation of stimulus packages to ease the transition of Chinese SOEs into the international investment sphere.³¹ Since 2004, the number of stages that enterprises need to go through in order to get approval for outward investment projects has been considerably reduced.³²

It is difficult for policymakers and negotiators abroad to demonstrate many of these unfair subsidies and market distortions, particularly in the case of SOE operations in OECD countries like Canada.

The China Development Bank and the Export-Import Bank of China, typically focused mainly on developing countries, support Chinese enterprises with about USD 100 billion each year, largely provided to SOEs as export credits and guarantees. An example of preferential treatment are subsidies given to ZTE and SinoHydro in the form of government grants, export credits, and preferential tax treatment; these contributed considerably to the development of these companies in the global communications and hydropower markets.³³ It is clear that non-financial policy or legal support, as well as financial support of the central government, offers substantial advantages to SOEs by mitigating investment risk, and provides greater freedom and flexibility to SOEs when they undertake projects inside and outside China.

While China is not party to the OECD consensus arrangements on export credits, this issue has already

become contentious between China and several other major economies, including the United States and the European Union. Some modest progress has been made as a result of previous negotiations, however, which is significant for Canadian policymakers as Canada currently competes with Chinese entities, often SOEs, for contracts in third markets in Asia, Latin America, and Africa, especially in the professional services sector and notably for infrastructure and resource development.

It is important to note that the Chinese government began a process to remove preferential policies and financial support packages for SOEs following the country’s accession to WTO.³⁴ However, SOEs still receive the majority of the enterprise subsidies from the government. In 2015, seven out of the top ten listed companies that received state subsidies were state-owned. One major function of the subsidies is to motivate state firms to align with China’s national strategic objectives. For example, SOEs are committed to remaining dominant in vital industries and key fields, and also to fostering new sources of economic growth, as state subsidies help offset certain associated costs (e.g., clean energy and low carbon growth initiatives). Some of the favours involved in the promotion of “indigenous innovation” have already come to the attention of American and European Union trade policy officials as creating a less-than-even playing field in the knowledge-intensive sectors.

It would be misleading to simply regard state subsidization as a means to sustain loss-making SOEs or as intrinsically unfair competitive practices. Many national governments, including Canada, subsidize private firms in key industries. Likewise, crown corporations, operated by many OECD governments, including Canada, create what is seen by industry as an uneven playing field through market distortion. Nevertheless, it is true that some Chinese SOEs,

³¹ Cristelle Maurin, and Pichamon Yeophantong, “Going Global Responsibly? China’s Strategies towards ‘Sustainable’ Overseas Investments,” *Pacific Affairs*, 86, no. 2 (June 2013): 281-304.

³² “Decision of the State Council on Reforming the Investment System,” China Law Info: Laws and Regulations. Last modified July 16, 2004. <http://en.pkulaw.cn/display.aspx?cgid=54165&clib=law>.

³³ Terence P. Stewart, Elizabeth J. Drake, Philip A. Butler, Elizabeth A. Argenti, Ping Gong, and Jessica Wang, *China’s Support Programs for High-Technology Industries under the 12th Five-Year Plan* (Stewart and Stewart, 2011).

³⁴ G. Fan and N.C. Hope, “The Role of State-owned Enterprises in Chinese Economy,” *US-China Economic Relations in the Next Ten Years*, Chapter 16. Accessed in December 2016. <http://www.chinausfocus.com/2022/wp-content/uploads/Part+02-Chapter+16.pdf>.

colloquially known as “zombie firms,” operate at a profit-loss, and are kept afloat through government subsidies, which can put foreign firms operating in China at a significant disadvantage. China’s trading partners should pay particular attention to the subsidies provided to key profit-making SOEs, as they are often considered both potential partners and rivals, to foreign businesses. In particular, the government subsidies of these SOEs are often criticized as incredibly opaque to outsiders. It is crucial to prepare ahead of time for the issue of state subsidies in trade negotiations with China in order to ensure an outcome that will be seen as balanced by Canadian stakeholders. Indeed, any failure to address SOE subsidies and regulatory favours will impair and generally reduce the value of any tariff concessions that may be obtained.

Canada’s approach to market entry in China, or Canada’s efforts to enhance the conditions of such entry via trade or investment, should be informed by knowledge of China’s competition policies and practices. Due to the monopoly power or dominant position of SOEs in a number of sectors, Canadian businesses, as well as American and European businesses, may have reasonable concern about the antitrust regime in China, and in particular, the benefits this regime confers on SOEs. China’s Anti-Monopoly Law (AML) came into force in August 2008 and regulates SOEs as well as other types of enterprises by prohibiting monopoly agreements and the abuse of dominant positions, and

by controlling merger and acquisitions. China’s antitrust authorities, including the Ministry of Commerce (MOFCOM), the National Development and Reform Commission (NDRC), and the State Administration for Industry and Commerce (SAIC), are routinely criticized for weak enforcement of AML against Chinese SOEs, however.³⁵ AML provides a legislative framework that confines the expansion of SOEs’ monopoly powers and indeed a number of SOEs, mostly provincial-level ones, have been investigated due to price misconduct and inappropriate M&A in the past decade. Among the antitrust cases investigated by the three authorities since 2008, only a handful of antitrust investigations were aimed at SOEs. However, the investigations that were aimed against SOEs, especially central SOEs in vital industries, will remain a sensitive area for Chinese authorities in the near future.

This set of issues is perhaps a larger and more immediate concern for American or European multinational corporation negotiators. Indeed, and as noted below, it has appeared in other FTAs and bilateral investment treaty talks and was also covered in the text of the Trans-Pacific Partnership (TPP). Nevertheless, an awareness of the effect of the Chinese AML on SOEs and laterally on their trade and investment partners abroad is essential. Of special importance is AML’s “special” treatment of the monopolist activities of central SOEs, and also its occasional targeting of foreign multinationals on questionable grounds.

5.3 PRESSURE IMPOSED ON SOEs’ DECISION PROCESS

As noted earlier, the Chinese government recently announced its intention to tighten investment through central SOEs in response to a series of failures made by these entities in overseas mergers and acquisitions and concerns over massive capital flight and potential corruption. New regulations have been released by SASAC to further clarify SOEs’ investment strategies,

procedures, risk control, and accountability in domestic and overseas markets.³⁶

To clarify and ostensibly liberalize certain inbound FDI, the SASAC will also introduce a “negative list” approach in the supervision of investment projects. In theory, and hopefully in practice, a negative list is more transparent

³⁵ Hejing Chen and John Whalley, “The State-Owned Enterprises Issue in China’s Prospective Trade Negotiations,” Report no. 48. CIGI Papers: Center for International Governance Innovation, 2014.

on what investment will not be permitted and, provided the negative list is not too “big” or arbitrary, it is also less restrictive than the positive list of what is permitted that is now in place.

With respect to Chinese outbound investment, the new “negative list” details two categories of investment projects for 102 central SOEs governed by SASAC. The first category is projects labelled “forbidden to invest,” while the other category refers to projects which need “special regulations.” For projects that are not on the list, central SOEs may make investment decisions on their own. Chinese SOEs, especially central SOEs, will likely be more cautious and risk-averse about future activities in the global market, and will bargain heavily on cost and revenue-related items in bilateral negotiations.

Conversely, for Canadian investors opportunities can be envisioned under China’s recently released plans to further open up the Chinese market to foreign investment and build a more favorable business environment for overseas investors. Though perhaps not as completely or rapidly as the international businesses community would prefer, China will lower – and in many cases is lowering unilaterally– restrictions on some

foreign investment in the banking, securities, investment management, futures, and insurance, credit rating, and accounting sectors.³⁷ SOEs have traditionally held dominant positions in these sectors. Again, the Chinese government has suggested that a negative list approach will be introduced, although these changes have not yet taken place.

As one of the countries that has attracted the most Chinese overseas investment, Canada has high potential to enter the Chinese natural resource, agriculture, financial services, and technology, education, and tourism markets. Following the FIPA, policymakers should focus on the relaxation of restrictions for Canadian firms doing business in China to bring these restrictions closer to what Chinese businesses currently enjoy in Canada, and to what SOEs enjoy in China. This will be essential for Canada to build up a more successful business presence in China so that it can in turn ensure market access and long-term strategic positioning for Canadian firms in key Chinese sectors. Moreover, by further opening up goods and capital markets, more consumer goods, industrial materials, and capital from China may play an expanded role in Canada and Alberta's diversified economic growth and development.

5.4 GOVERNMENT PROCUREMENT AND SOES

One area where Canadian/Albertan firms can boast considerable professional excellence, and may have substantial competitive advantage, is in the engineering, construction, architectural, and project management services sector. China is only nominally a participant in WTO arrangements on government procurement at the local, national, and international levels, and is notoriously

closed to outside involvement. The main beneficiaries of opaque policies are national and provincial/local SOEs. Concerns over this lack of transparency are the subject of ongoing discussions at the WTO, and it is likely that some improved access to bidding may be possible through this institution, though how quickly or fully this reform may be is uncertain.

³⁶ State-owned Assets Supervision and Administration Commission of the State Council (SASAC), “The Supervision and Management Measures for Central SOES’ Investment (中央企业投资监督管理办法),” Order of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) No.34, Accessed August 11, 2017. <http://www.sasac.gov.cn/n2588035/n2588320/n2588335/c4258441/content.html>; State-owned Assets Supervision and Administration Commission of the State Council (SASAC), “The Supervision and Management Measures for Central SOES’ Overseas Investment (中央企业境外投资监督管理办法),” Order of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) No.35, Accessed August 11, 2017. <http://www.sasac.gov.cn/n2588035/n2588320/n2588335/c4258448/content.html>.

³⁷ Guo Fa, “The State Council on Expanding the Opening to the outside World,” Report no. 000014349 / 2017-00005, State Council, 2017, Accessed August 11, 2017. http://www.gov.cn/zhengce/content/2017-01/17/content_5160624.htm.

The area is especially important, as China is the largest infrastructure goods and services market in the world; a market driven by extensive urbanization needs as well as special projects associated with the Belt and Road Initiative. The Chinese-led Asian Infrastructure Investment Bank, which Canada recently joined, is another significant market opportunity, and one where procurement will supposedly be done on the basis of “international competitive bidding” carried out on a best practice and transparent basis. This is an objective

that will be closely monitored by its members, as well as by other international institutions.

Mindful of Alberta’s (perhaps limited) capacity to supply hardware, and the sensitivities there may be in having large-scale Chinese participation in public infrastructure be reciprocated in Canada, it is worth examining whether the services side of procurement should be explored by Canada, bilaterally, or in conjunction with likeminded allies.

5.5 PROVISIONS IN EXISTING FTAs RELATED TO SOEs AND THEIR POLICY IMPLICATIONS

The basic questions for policymakers regarding the SOE issues are the following: (a) do SOEs bring market distortion to the Canadian domestic market; (b) do Canadian companies/investors face anti-competitive market distortion due to SOEs in the Chinese market; and (c) how should Canada deal with potential or present market distortions? What are the remedies? To gain insight, we briefly review existing FTAs related to China or Canada in the hope that this could have future relevance.

At present, China has twelve completed FTAs, two partnership agreements, and eleven FTAs under negotiation.³⁸ The China-Australia FTA contains stipulations to screen inward investments, including the investments from SOEs – as Canada does already through legislation – and this could be used as a model or precedent for Canada. No other FTA contains issues specifically related to the activities of SOEs. However, the North American Free Trade Agreement (NAFTA) and the TPP text have explicit provisions related to SOEs and these can be good anchor points for Canada to negotiate with China under the prospective FTA. In its competition chapter, NAFTA addresses potential distortions created through trade with SOEs

and their designated monopolies. NAFTA argues that state enterprises with authorities mandated by the government should be obliged by the same obligations under the agreement as the government itself.³⁹

Likewise, TPP negotiating parties included robust language on SOEs. TPP provides three main criteria, or “tests,” to determine the commercial activities of SOEs: the activities must be meant to be profitable, the good or service is supplied in the “relevant market” in quantities determined by the SOE, and the SOE is also able to determine the price on its own.

The SOE TPP chapter also elaborates three main obligations of SOEs in commercial activities:

First, signatories are obliged to provide non-discriminatory treatment and commercial considerations. SOEs are required to act in accordance with commercial considerations in their purchases or sales of a good or service, except to fulfill any terms of their public service mandate. The non-discriminatory treatment clause is intended to prevent discrimination on the basis of nationality when an SOE sells and buys goods and services (Article 17.4).

³⁸ Ministry of Commerce, “FTA News Release,” China FTA Network. Last modified August 8, 2017, Accessed August 11, 2017. <http://fta.mofcom.gov.cn/english/index.shtml>.

³⁹ P. Kowalski, P. M. Büge, M. Sztajerowska, and M. Egeland, “State-Owned Enterprises: Trade Effects and Policy Implications,” Report no. 147. OECD Trade Publishing Paper: OECD Publishing, 2013.

Second, there is a non-commercial assistance obligation. This refers to the restriction of the provision of subsidies that are specific to SOEs. Non-commercial assistance is defined as assistance to an SOE by virtue of that SOE's government ownership or control, where "assistance" means direct transfers of funds or potential direct transfers of funds or liabilities, such as grants or debt forgiveness, loans, loan guarantees, or other types of financing on terms more favourable than those commercially available to that enterprise; equity capital inconsistent with the usual investment practice of private investors, including for the provisioning of risk capital; or goods or services other than general infrastructure on terms more favourable than those commercially available to that enterprise (Article 17.6).

Third, the TPP's SOE chapter includes extensive transparency rules. For instance, each party shall provide to the parties or otherwise make publicly available on an official website a list of its state-owned enterprises no later than six months after the date of entry into force of the Agreement, and thereafter shall update the list annually. Each party shall promptly notify the other parties or otherwise make publicly available on an official website the designation of a monopoly or expansion of the scope of an existing monopoly and the terms of its designation (Article 17.10).

Agreements such as TPP and ChAFTA contain in them coverage of SOEs which Canadian policymakers may wish to explore in an FTA with China. Including SOE provisions in an FTA would assure a greater flow of benefits, transparency, and reciprocity for Canada and Alberta in its future relationship with China, particularly with respect to subsidies, services trade, enhanced investor protection, and perhaps government procurement. Canada's objective should not be to imagine it can abolish China's SOEs, or even substantially reform them, but to mitigate harmful distortions and enhance access in areas of key interest to our firms. This is a reasonable, realistic, and results-oriented basis for the commencement of discussions.

6. CONCLUSION

As pointed out in the first chapter, multiple definitions of SOEs are applied across various trade agreements. Even within the dynamics of Chinese reforms, policymakers faced challenges in finding a uniform definition of SOEs that would fit all policy development scenarios. The task of understanding the evolution of modern Chinese SOEs and assessing the risks and benefits of engaging SOEs, either as business counterparts or as objects of “negotiation,” remains a significant challenge for Canadian policymakers. Future negotiations will be complicated by the common public image of SOEs and their descriptions in media, political discourse, and “the court of public opinion.” On one hand, exaggerated or otherwise, SOEs are viewed as the beneficiaries of unfair government benefits that may give them competitive advantages, and may limit or distort market entry and the achievement of business success on an equitable, transparent basis. On the other hand, Chinese SOEs remain national policy actors, and are part of the means by which the Chinese government pursues social responsibility. This role is not always made apparent, as SOEs now seek to present themselves as being more commercially-oriented, necessarily sensitive to market forces and profit lines.

Given their mixed private- and state-sector features, the decision-making processes of SOEs are rather complex and must be analyzed on a case-by-case basis. This is true whether policymakers want to assess how best to conduct business with SOEs by evaluating the merits of SOE investments abroad, including in Canada/Alberta, or gauge the measure of competitive unfairness in their operations in China or abroad.

While SOEs have become less dominant in China’s economy, SOEs continue to play major roles in

Chinese international trade and outbound investment in both Canada and Alberta – and SOEs hold dominant positions in some selected but critical sectors, such as energy, minerals and metals, and finance. SOEs must be a key part of any medium- to long-term strategy that Alberta develops with regard to Chinese markets and investment. Canadian firms will inevitably come into contact with SOEs as they navigate specific markets and supply chains that link Alberta and China.

It is important that the Canada-China FTA process address the full range of SOE-related issues, both in the current exploratory talks and as an actual negotiation gets under way. The priorities of policymakers with respect to SOEs must be informed by knowledge of individual sectors, and should be informed by issues of greatest priority to Canada/Alberta specifically – priorities which may differ from those of the United States and the European Union.

This report has assembled information on SOE stipulations in previous international trade agreements, and on industrial sectors that may favour Chinese SOEs and hence lead to economic distortions. Bearing in mind Canadian/Albertan priorities and objectives in building a medium- to long-term China strategy, policymakers should consider how best our businesses might navigate the evolving SOE reality to develop trade and investment partnerships, and how to approach SOE-related policy questions. Policymakers should aim not to eliminate the extent of state ownership, but to target and constrain the commercial advantages granted by the Chinese government and minimize the consequences of anti-competitive business settings.

Among the key specific takeaways:

- SOEs remain critical players in China's economy and society and in Canada/Alberta-China trade and investment, particularly in the key sectors of oil and gas, mining, and agri-food.
- Energy and petrochemical-based entities like CNOOC, CNPC, and SINOPEC are the key state-sector players of interest to Alberta. Together with China Investment Corporation, they are dominant investors in the province and, directly or otherwise, important customers.
- These SOEs are critical supply-chain players for downstream service-sector opportunities. These opportunities are often as important as sales of products, which in the case of oil and gas are dependent on overcoming logistical constraints.
- Other SOEs like COFCO and CNADC are important in the agriculture and agri-food sectors, though, in these areas, private sector direct-to-market platforms are growing in profile.
- SOEs in other sectors such as forest products, engineering and construction, telecommunications, transportation, healthcare, and tourism should figure into business strategies and planning as well as policy areas.

Key challenges:

1. The missions of SOEs are mixed; they typically receive substantial regulatory and sometimes financial favours from Chinese government authorities which are unavailable to their foreign competitors.
2. SOEs operate to a greater degree today as commercial entities, and this is true in particular of overseas subsidiaries. In relation to possible upcoming Canada-China FTA negotiations, issues raised by SOEs related to the competitive environment in Alberta and in China may be at least as consequential as market barriers at borders.
3. As with other non-tariff or institutional barriers that affect Canada-China commerce, objectives related to SOEs must be realistic. However, with preparation, learning from the experience of other agreements, and sound strategy, success can be achieved.
4. Getting to know key decision makers at different levels of SOEs, and becoming acquainted with

decision-making processes that affect investment and procurement, is important – not only in Beijing/Shanghai, but in the regions and among province and local level SOEs. Recruitment of on-the-ground professional advice is recommended to facilitate this engagement.

5. Favours granted to SOEs, financial or otherwise, imbalance playing fields – whether for the rising number of Canadian businesses operating in China, or even for SOEs who are operating in Canada and are now subject to stricter investment rules (e.g., in the energy sector). While the question of whether such subsidies constitute unique and unfair practices on the part of the central Chinese government is beyond the scope of this paper and would require detailed analysis of individual cases, it is certainly a concern of the general public and Canadian industry, and will therefore require thoughtful consideration from policymakers.

As the United States and the European Union have discovered, none of the issues surrounding SOE operations are easy, whether they relate to developing promotional strategies abroad or constructing trade/investment policy. Concerning the latter, limiting the preferential treatments that SOEs receive may be a desirable outcome of the prospective trade negotiations. In reality, however, quantifying these favours systematically would be very difficult. Reduction or even elimination of direct subsidies in specific sectors may be more easily negotiated, and concessions or reforms obtained – but even here progress will be incremental rather than transformational.

Nevertheless, SOEs and the SOE dimension must play an important role in both the development of business strategies for China by our firms and financial institutions, and in the preparations made and approaches taken in any forthcoming FTA talks with China in which Alberta has a major stake. Progress in these areas will test the ability of policymakers to deal as effectively as possible with the reality of economic and political systems that remain quite different. The central objective, a challenging one, is the development of sound approaches leading to meaningful, sustainable, and balanced outcomes for Canada/Alberta in all avenues of engagement with China.

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