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From: Jeff Mahon and Wolfgang Alschner
To: Prime Minister Mark Carney
Re: DELIVERING A SUCCESSFUL CHINA MISSION

Canada is at a turning point, embroiled in trade conflicts with our two largest trading partners, the United States and China.

These two conflicts are interconnected: How we solve one will have ramifications on the other.

Canada seeks an improved relationship with China as its market holds the potential to be an engine for trade growth and diversification. But the United States, whose market is critical for Canadian companies, has made clear in its National Security Strategy that it is looking for alignment from Canada and other partners on forcing China to “rebalance” its economy, by stemming its flow of exports. It is also seeking to curtail strategically significant Chinese investments in the Americas.

Canada shares many – but not all – of the US concerns about the economic security risks associated with unfettered engagement with China. In the past, Canada aligned with the United States on several restrictive trade and investment actions, including mirroring 100-percent tariffs on Chinese electric vehicles, which is at the heart of our current conflict with China. As with other attempts at addressing US concerns, this alignment with has not bought Canada any reprieve from Donald Trump’s tariff spree. But any reversal would complicate the upcoming CUSMA review and put US market access and the future of the integrated auto sector in greater jeopardy.

These circumstances have created a major public policy dilemma. Improving trade with China risks further complicating an already volatile relationship with the United States; conversely, aligning with Washington may limit such volatility and even help extend the CUSMA, but would entrench barriers we face in the world’s second-largest economy.

We believe, however, that there is a compromise solution that can rise above the current tensions and build a new foundation for Canada-China relations in a manner that does not jeopardize our relationship with the United States.

The successful implementation of this approach begins with strategic empathy: we need to understand the deeper sources of these conflicts and both Chinese and US concerns.

Low trust amongst all three countries resulted from adverse political and economic trends. Canada – and other liberal market democracies – were unprepared for implications of China’s meteoric rise over the past several decades, particularly its export-led strategies combined with barriers to accessing its own market, which shifted the global balance of benefits underpinning liberal internationalism. Yet, China’s \$13,000(US) GDP per capita remains dwarfed by Canada’s roughly \$54,000.

Understandably, China looks very suspiciously of any actions concerning trade, investments or technology that could constrain economic development. As both countries pursue their own perceived economic security concerns, the tit-for-tat nature of trade retaliation has resulted in a quagmire that makes both countries worse off.

Cutting through these tensions requires acknowledging that current approaches for managing how our unique systems interact is out of date. New principles are needed to manage engagement to solve the current dispute and build trust and slowly expand the zone of cooperation for the long-term.

This is not an easy task, nonetheless we believe that setting on such a course should be the focus of your visit with Chinese President Xi Jinping and Premier Li Qiang. The challenges facing our relationship, including current constraints that limit what Canada can do in terms of expanding engagement, including security concerns, must be addressed candidly. The goal should be to find a new consensus for improving relations and to operationalize that consensus over the coming months.

This new consensus should reflect three core principles .

First, both countries should shift public rhetoric and private communication away from confrontation and towards coordination. For Canada, this means the focal point should move away from criticizing Chinese non-market practices, which implies that we’re trying to coax China into converging on our political economy model, and instead focus on managing the frictions catalysed by the interaction of two very different systems.

Second, both countries should recognize that interdependency is the fundamental condition of the global economy. National self-reliance is a myth. For example, Canada’s close supply chain integration with the United States in certain sectors informs how we interact with third states. Acknowledging interdependency opens a path to compromise by recognizing and respectfully managing frictions in some areas while expanding engagement in other areas where such constraints are absent or risks can be mitigated.

Third, the identification of these opportunities and risks should be informed by disentangling economic and security risks in trade and investment relations. By compartmentalizing engagement, Canada and China can ensure that non-sensitive engagement is not sacrificed by restrictions meant to address economic security imperatives.

These principles can be translated into a tractable framework for economic engagement with China, one that will facilitate trade dispute de-escalation of the trade dispute currently plaguing Canadian canola and lobster exports, for example by placing Canadian policy on Chinese EV’s on a more principled footing. If the problem posed by imports of Chinese EVs is that they undermine domestic capacity and jobs, then Canada should manage this friction by shifting the market access focus by identifying non-sensitive segments of the EV supply chain and open up space for conditional investment.

Adopting these three measure could, importantly, show how to support future, trusted, and mutually beneficial commercial links aligned with both countries’ interests.

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