

**Report of the Canada-Japan Joint Study  
on Benefits and Costs of Further Promotion of  
Bilateral Trade and Investment**

**October 2007**

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## **Chapter 1**

### **INTRODUCTION: AN ANALYSIS OF THE BILATERAL ECONOMIC RELATIONSHIP**

#### **1.1 Outline of the Joint Study**

##### **Background and Purpose**

At the Canada-Japan summit meeting held on January 19, 2005, the leaders of Canada and Japan issued a Joint Statement that set forth an initiative launching an innovative Canada-Japan Economic Framework (the Economic Framework).<sup>1</sup> As a practical means of promoting and revitalizing effective Canada-Japan economic ties in an integrated and coherent manner, the Prime Ministers of Canada and Japan signed an action-oriented and flexible Economic Framework in November 2005 on the margins of the Asia-Pacific Economic Cooperation (APEC) leaders meeting in Busan, Korea. Aimed at reinforcing existing bilateral economic ties and addressing new and emerging commercial challenges and opportunities, the Economic Framework reinvigorates the existing government-to-government dialogue, lays the groundwork for future cooperation on priority areas, and emphasizes the role of the private sector in guiding future initiatives. The Economic Framework includes a shared list of 15 priority areas of cooperation and the terms of reference of this Joint Study.

An important objective of the Economic Framework was the reinforcement of the Joint Economic Committee (JEC) as the central forum for regular, high-level dialogue between senior officials from both governments. Although the JEC was initially established under the 1976 Framework, Canada and Japan further clarified, in 2005, the JEC's role as a strategic oversight mechanism charged with monitoring the economic relationship, identifying opportunities for expanding trade and investment, and addressing remaining challenges limiting the growth of bilateral trade and investment. The co-chairs of the JEC, designated at the deputy minister level, meet regularly to discuss traditional issues such as trade and investment irritants, as well as new measures to promote commercial ties and to establish strategic directions for the bilateral relationship.

With a view to focusing on forward-looking strategic priorities, the Economic Framework identifies a number of "priority areas of cooperation" involving policy dialogue, facilitation and promotion of trade and investment, and the promotion of cooperation across a wide range of fields. Fifteen initial areas were identified at the time of the signing of the Economic Framework: social security, anticompetitive activities, food safety, customs, trade facilitation, transportation, investment, science and

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<sup>1</sup> Note that "Canada-Japan" and "Japan-Canada" are used interchangeably in this report.

technology, information and communication technology, e-commerce, e-government, energy and natural resources, climate change, tax convention, and tourism promotion.

At the same time, the two governments recognize the importance of ensuring that these areas remain current, effective and relevant to Canadian and Japanese business. To this end, the Economic Framework provides for a Cooperative Working Group, which reports to the reinvigorated JEC, to oversee progress on the priority areas and to update the priorities as new areas of mutual interest arise.

Moreover, this Joint Study is an integral element of the Economic Framework. A Joint Study Working Group was established to carry out the Joint Study and report the findings to the Prime Ministers upon its completion, within a 12-month time frame. In addition to examining the benefits and costs of the further promotion of trade and investment, the study includes an assessment of the implications of further bilateral trade and investment liberalization. With the recognition that bilateral commercial opportunities remain untapped, the Joint Study will be crucial in helping the two governments develop plans to ensure that the Canada-Japan economic relationship reaches its full potential.

The purpose of the Joint Study is stipulated in Attachment II of the Canada-Japan Economic Framework as follows:

- a. to examine the benefits and costs of the further promotion of trade and investment, as well as other cooperative issues between the two countries;
- b. to identify and describe the current status of the bilateral economic relationship, including the identification of areas for further development;
- c. to consider the possibility of pursuing various cooperative bilateral trade and economic initiatives to re-energize the relationship; and
- d. to give appropriate consideration to the interests of the private sector.

## **Structure**

The contents of each chapter are as follows:

**Chapter 1** is an introductory section.

**Chapter 2** provides the multilateral, regional and third-party context under which Canada-Japan bilateral economic relations will be evaluated in this study and identifies key areas in which the respective approaches of Japan and Canada converge and are complementary. In examining opportunities for further bilateral engagement on trade and investment issues of interest to both countries, it is first necessary to consider ways in which closer collaboration in existing international forums will help Canada and Japan attain their shared goals. Analysis of the impact of key economic developments that affect both Canada and Japan, including the rise of global value chains, energy and energy security issues, and ongoing bilateral trade and investment negotiations with third parties, will also highlight the value of close cooperation between Canada and Japan in the future.

**Chapter 3** provides an overview of the current status of the Canadian and Japanese economies. The chapter describes the past and current status of the bilateral economic relationship and also provides a focus on trends in trade and investment.

**Chapter 4** provides a qualitative review of Canada-Japan economic relations, including a description of key ongoing initiatives and priority sectors of interest to both countries. In order to examine ways to enhance the bilateral economic relationship, an evaluation of existing mechanisms for bilateral cooperation and of the views of the private sector will assist in determining where best to focus government attention for future collaboration. The analysis in this chapter of broad areas of key importance to both Canada and Japan, such as investment and science and technology, is complemented by further consideration of developments in specific commercial sectors, as well as the most recent developments under the Economic Framework. Many of these sectors continue to exhibit active collaboration and highlight the value of Canada-Japan cooperation in advancing mutual interests.

**Chapter 5** examines existing measures limiting the full potential of trade and investment. Recognizing the critical role of the private sector in identifying challenges to facilitating trade and investment, this chapter largely reflects comments received in the context of consultations with stakeholders.

**Chapter 6** examines the benefits and costs of the further promotion of bilateral trade and investment, as well as other cooperative issues between the countries, including an assessment of the implication of further trade and investment liberalization and related policy instruments.

**Chapter 7** summarizes the findings of the Joint Study.

Three meetings of the Joint Study Working Group were held between December 2005 and September 2006 in Canada and Japan (please see the attachment for the dates of these meetings and their participants). Through these three meetings, the Joint Study Working Group has deepened its recognition and understanding of the present Canada-Japan economic relationship, reaffirmed the cooperative relationship within the existing areas of cooperation, and examined ways to further strengthen the economic relationship.

## **1.2 The Canada-Japan Economic Relationship**

### **Steps in the Canada-Japan Economic Relationship**

While the signing of the Economic Framework in 2005 marked an important development in the Canada-Japan economic relationship, it is also worth recalling past initiatives that have contributed to the growth and strengthening of the bilateral economic relationship.

1. In 2004, Japan and Canada celebrated 75 years of diplomatic ties and 100 years of formal commercial relations. Their post-war commercial relationship was established in 1954 with the conclusion of the Agreement on Commerce. This bilateral commercial agreement, designed to strengthen the traditional bonds and friendship and to further develop existing commercial relations, contributed to the recovery of the post-war Japanese economy, as well as to the revitalization of the existing Canada-Japan trade relationship at that time.
2. In 1976, the Canada-Japan Framework for Economic Cooperation was established during a visit to Japan by then Canadian Prime Minister Pierre Trudeau. This framework was an expression of political intent to further strengthen the economic relationship between Canada and Japan. It contains provisions for further developing the bilateral relationship, including the establishment of the JEC, which meets once a year to review and promote the Canada-Japan economic relationship. Since then, JEC meetings have been held in both countries, with the 20th JEC meeting in 2006.
3. In 1999, then Canadian Prime Minister Jean Chrétien visited Japan with “Team Canada,” at which time “the Global Partnership for the 21st Century between Canada and Japan” was launched. The Global Partnership highlighted the need for expanded cooperation between Canada and Japan in addressing the global challenges of the new century and included a focus on regulatory cooperation, space development, official development assistance, and peace and security.
4. In addition to these joint initiatives, there exist many other structures between the two countries, including the 1955 Canada-Japan Agreement for Air Services, the 1976 Canada-Japan Cultural Agreement, the 1978 Canada-Japan Agreement on Fisheries, the 1959 Canada-Japan Atomic Energy Cooperation Agreement, the 1964/1986 Canada-Japan Tax Convention and the 1986 Canada-Japan Agreement on Cooperation in Science and Technology.
5. Furthermore, existing dialogues at the governmental level on Telecommunication Policy Consultations, Financial Consultations, the Canola Consultation and the Tourism Conference have continued for a long period of time. Important links have also developed in the private sector. For example, the Committee on Canada of the Japan Business Federation (Nippon Keidanren) and the Canadian Council of Chief Executives held consultations in 2004 and 2005. In addition, the Canada-Japan Forum, a non-governmental eminent persons group, has made significant contributions on economic and other issues through their four reports between 1992 and 2006.

## **Attachment**

### **Meetings of the Joint Study Working Group**

#### **1. First Meeting of the Joint Study Working Group**

Dates: December 13-14, 2005

Place: Ottawa, Canada

Participants:

*Canada:*

Department of Foreign Affairs and International Trade, the Canadian Embassy in Japan, Agriculture and Agri-Food Canada, Industry Canada and Natural Resources Canada

*Japan:*

Ministry of Foreign Affairs, Ministry of Agriculture, Forestry and Fisheries, Ministry of Economy, Trade and Industry, and the Japanese Embassy in Canada

#### **2. Second Meeting of the Joint Study Working Group**

Dates: April 5-7, 2006

Place: Tokyo, Japan

Participants:

*Canada:*

Department of Foreign Affairs and International Trade, Agriculture and Agri-Food Canada, Industry Canada and the Canadian Embassy in Japan

*Japan:*

Ministry of Foreign Affairs, Cabinet Office, Ministry of Internal Affairs and Communications, Ministry of Finance, Ministry of Agriculture, Forestry and Fisheries, Ministry of Economy, Trade and Industry, and the Japanese Embassy in Canada

*Private Sector Participants from Canada and Japan*

#### **3. Third Meeting of the Joint Study Working Group**

Dates: June 5-8, 2006

Place: Toronto and Ottawa, Canada

Participants:

*Canada:*

Department of Foreign Affairs and International Trade, Agriculture and Agri-Food Canada, Industry Canada and the Canadian Embassy in Japan

*Japan:*

Ministry of Foreign Affairs, Cabinet Office, Ministry of Agriculture, Forestry and Fisheries, Ministry of Economy, Trade and Industry, and the Japanese Embassy in Canada

*Private Sector Participants from Canada and Japan*

## **Chapter 2**

### **EXAMINING CANADA-JAPAN ECONOMIC RELATIONS IN THE CONTEXT OF BILATERAL, REGIONAL AND MULTILATERAL INITIATIVES**

#### **2.1 Introduction**

Today, regional economic integration and ongoing efforts toward further multilateral trade liberalization are key forces influencing the priorities and strategies of the world's top trading nations, notably many countries in East Asia and North America. As active players in these regions, Canada and Japan are directly affected by increasing regional economic integration and share a strong interest in continuing to collaborate in a broad array of international forums, including the World Trade Organization (WTO), the Asia-Pacific Economic Cooperation (APEC) forum, the Group of Eight (G8) and the Organisation for Economic Co-operation and Development (OECD). While both countries are firmly committed to multilateral and regional efforts to promote open and secure trade, Canada and Japan also recognize the important role that bilateral relationships can play in promoting the principles of free trade and in facilitating closer cooperation in multilateral and plurilateral settings.

#### **2.2 A Shared Commitment to Multilateralism**

Canada and Japan share a firm commitment to the rules-based multilateral trading system embodied in the WTO. As trading nations whose well-being depends on secure access to global markets, both countries believe that the WTO is the best forum in which to build a more open and equitable world trading system. The WTO also provides the best multilateral forum to advance commercial relationships with established and potential trading partners around the globe.

Both Canada and Japan remain committed to the WTO and to achieving an ambitious, balanced and comprehensive agreement on the Doha Development Agenda. Over the last few years, Canada and Japan have actively cooperated together across a number of areas in the negotiations in order to press for greater ambition. For example, both countries aim for an ambitious outcome in non-agricultural market access negotiations. Canada and Japan also share an interest in promoting an effective trade facilitation agreement, clarifying and improving WTO rules covering anti-dumping, subsidies and regional trade agreements, and cooperate in areas of mutual interest in the agriculture negotiations. On the services front, Canada and Japan cooperate within the "Quad" and the group of "Really Good Friends of Services," as well as in a number of sector-specific groups, in order to encourage further liberalization of trade in services.

As significant players in the Doha Development Agenda, ideas and proposals put forward by Canadian and Japanese representatives have been important in helping to build consensus across the negotiating groups. Canada and Japan will continue to work



together in the negotiations in order to ensure an ambitious, balanced and comprehensive outcome.

## **2.3 Close Collaboration in Other Forums**

Canada and Japan have also built strong ties through a variety of other forums. Dialogues in other international organizations and institutions support the work undertaken at the WTO, help build consensus on key issues and provide a platform for constructive debate on topics of interest to both countries.

### **Asia-Pacific Economic Cooperation (APEC)**

As the premier forum for trans-Pacific economic discussion and cooperation, APEC is an important vehicle for promoting the prosperity and security of the Asia-Pacific region. A shared vision of an economically integrated region, along the lines of APEC's long-term goal of free and open trade and investment, provides ample opportunities for Canada-Japan cooperation. The two partners work together on several issues of shared interest, including trade facilitation, structural reform, protection of intellectual property rights, secure trade and human security.

Trade facilitation has been an especially notable area of Canada-Japan cooperation in APEC in recent years, and APEC is specifically identified in the Canada-Japan Economic Framework as a forum in which the two countries will continue to work together to advance the work of the WTO Negotiating Group on Trade Facilitation. Through targeted, high-level statements, capacity building and its own program of individual and collective trade-facilitating actions in areas such as standards and conformance and business mobility, APEC has achieved concrete reductions in trade-related transaction costs in Asia Pacific. These reductions have direct benefits for the private sector in Canada, Japan and the rest of the region.

A further area of Canada-Japan cooperation in APEC has been structural reform. Japan drafted the APEC Leaders' Agenda to Implement Structural Reform (LAISR), adopted in 2004, in addition to the work plan toward LAISR 2010 in 2005. Canada, in turn, has emphasized the developmental benefits of certain types of structural reform by taking an active role with regard to public sector governance and by promoting a private sector development agenda for APEC.

Since the tragic events of September 11, 2001, Canada and Japan have supported the expansion of APEC's agenda to confront the full range of challenges facing the Asia-Pacific region, with particular emphasis on security threats. Under the aegis of the Secure Trade in the APEC Region (STAR) initiative, both countries have provided extensive capacity building to APEC's developing members and are planning further assistance in the future. Canada and Japan also support APEC's work on non-traditional security issues, such as health and human security. Both countries recognize that human security is a fundamental prerequisite for the economic prosperity and progress to which APEC is devoted.

Canada and Japan share common views on best practices in the negotiation of high-quality free trade agreements (FTAs), economic partnership agreements (EPAs) and regional trade agreements (RTAs) through “Best Practices for RTAs/FTAs in APEC.”<sup>2</sup> Both governments recognize that the success of any bilateral or regional trade agreement depends on the quality of the agreed provisions and the extent to which the agreement reflects the nature of the trade and investment relationship, while also recognizing areas of particular domestic sensitivity.

Beyond its natural role as a forum for regional discussions, APEC also presents excellent opportunities for individual economies to further their bilateral interests, as exemplified by the signing of the Canada-Japan Economic Framework and the launch of this Joint Study on the margins of the APEC leaders meeting in 2005.

### **Organisation for Economic Co-operation and Development (OECD)**

Canada and Japan share a deep commitment to democratic governance and a strong market economy, which are the central pillars of the OECD. As part of this commitment, both countries are actively engaged in various OECD committees that cover a broad array of subjects, including economic and social issues like macroeconomics, trade, investment, competition, education, development, and science and innovation. In addition, Canada and Japan are both active on energy issues through the 26-member International Energy Agency (IEA), an autonomous agency of the OECD wherein member countries share information, coordinate energy policies and develop energy programs.

Canada and Japan have worked together within the OECD to promote business and trade interests. Both countries have pushed for the OECD to increasingly engage with emerging global economic players. In addition, Japan has specifically expressed interest in collaborating with Canada in order to orient the Trade Committee’s 2007-08 Programme of Work and Budget toward a broader focus aimed at examining emerging issues and strengthening the multilateral trading system. Canada was very supportive of a horizontal project on services that was initially launched by Japan at the 2003 Ministerial (the conclusions of which were presented at the 2005 Ministerial). Japan consulted with Canada throughout the preparation of the detailed plan on this project, and Canada has been supportive of Japan’s efforts across the range of committees where this project was discussed.

As active members of the OECD, Canada and Japan are generally supportive of one another on broader institutional issues, including at the recent discussion at the 2007 Ministerial on OECD enlargement (five countries are to begin accession discussions) and enhanced engagement with global economic players, giving the OECD increased global relevance. Canada and Japan will continue to work closely together over the coming years on an agreement on financial reforms to ensure the OECD has a strong and sustainable financial foundation.

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<sup>2</sup> The document is available at:  
[www.apec.org/etc/medialib/apec\\_media\\_library/downloads/ministerial/annual/2004.Par.0004.File.tmp/04\\_amm\\_003.pdf](http://www.apec.org/etc/medialib/apec_media_library/downloads/ministerial/annual/2004.Par.0004.File.tmp/04_amm_003.pdf)

## **Working Together within the Group of Eight (G8)**

Canada and Japan have shared many common positions at G8 summits. Most recently, at the Heiligendamm Summit in 2007, leaders achieved a significant consensus in addressing the challenge of climate change. In particular, Canada's and Japan's decisions, which include at least a halving of global emissions by 2050, as well as those of the European Union (EU), are to be considered seriously for setting global goals. Canada and Japan voiced a common will to pursue commitments made toward Africa at previous G8 summits. Leaders also issued a declaration on growth and responsibility in the world economy, underlining, *inter alia*, the importance of:

- G8 agenda for global growth and stability;
- systemic stability and transparency of financial markets/hedge funds;
- freedom of investment, investment environment, and social responsibility;
- promoting innovation protecting innovation;
- climate change, energy efficiency and energy security;
- responsibility for raw materials transparency and sustainable growth;
- fighting against corruption; and
- trade.

One key result of the Summit was the launch of the Heiligendamm Process, wherein the G8, together with Brazil, China, India, Mexico and South Africa, will engage in a sustained dialogue on four tracks – innovation and intellectual property rights (IPR), investment and corporate social responsibility, development, especially with regard to Africa, and energy efficiency and technology cooperation.

Previously, Canada and Japan have reaffirmed the importance of strengthening individual and collective efforts to combat piracy and counterfeiting and to elaborate concrete actions to combat IPR infringements. In addition, Japan proposed a possible international legal framework on preventing proliferation of pirated goods and counterfeits at the G8 Summit at Gleneagles in 2005. Canada supported the proposal that G8 IPR experts continue to study the international legal framework in the long and medium terms.

In addition, Canada and Japan have worked together at the G8 on issues such as science and technology for sustainable development, and more efficient use of resources and materials. Furthermore, climate change, energy efficiency and energy security are areas of particular importance to both Canada and Japan and were key focal points identified for further work in 2007. Increasing transparency, predictability and stability of global energy markets, improving investment conditions in the environment and energy sector, diversifying the energy mix and enhancing energy efficiency and energy saving, including the development and promotion of energy-efficient technologies, will be the key areas for future cooperation.

## **Cooperation of G7 Finance Ministers**

Canada and Japan have an excellent working relationship in the G7 Finance Ministers process. Of note is that Canada became an official member of the G7 Finance Ministers group in 1986 at the Tokyo Summit. Since then, both countries have worked together, along with other G7 partners, on a number of important issues, including crisis prevention and resolution tools following the 1997 Asian crisis, various development-related projects for Africa and countless financial sector initiatives.

Most recently, Canada and Japan have been working together under the Canada-Japan financial sector dialogue and on International Monetary Fund (IMF) quota reform, which determines a member's voting power. Canada-Japan financial consultations occur every 18 to 24 months in Ottawa or Tokyo and allow for a broad discussion of current macroeconomic, financial sector and international financial issues. Meetings have proven to be a worthwhile means of keeping abreast of developments in our respective economies and providing a forum to discuss important bilateral financial sector issues, including financial services trade irritants.

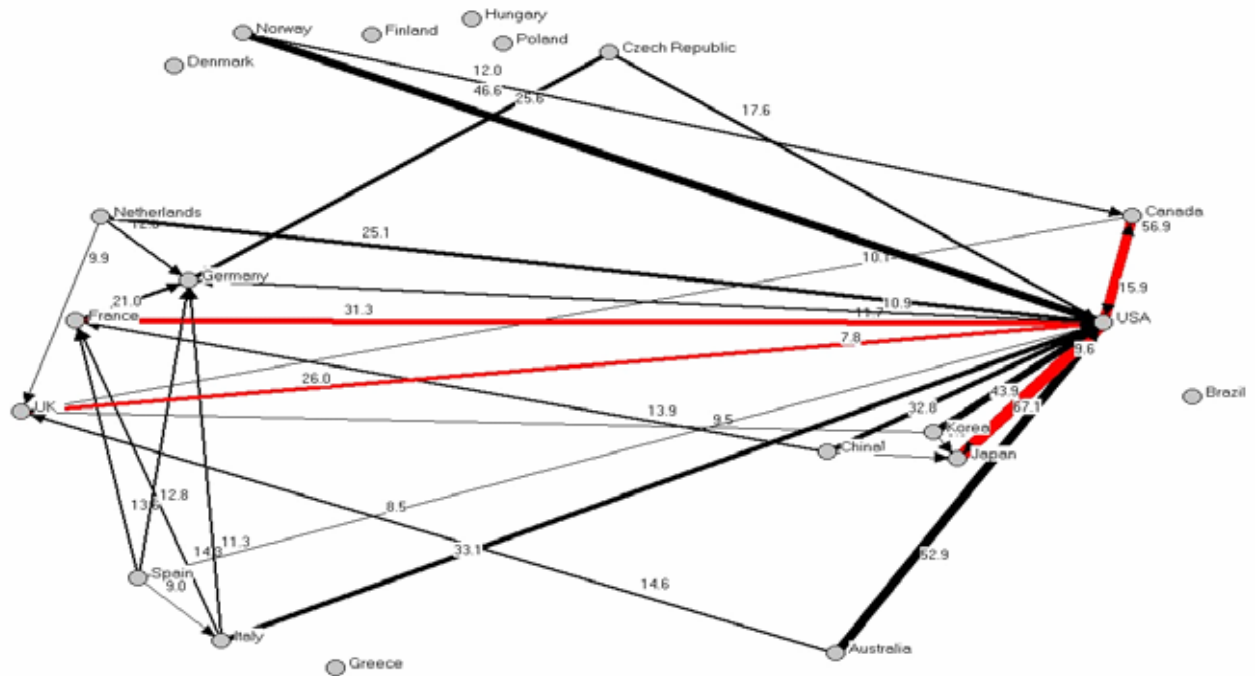
IMF quota reform is also of particular importance given that the rapid economic growth of emerging markets over the last two decades has meant that their quota shares are considerably out of line with their economic weights in the global economy. Canada and Japan are working closely on this issue of quota reform in order to ensure that quota shares, especially those of the most dynamic members, many of which are emerging markets, better reflect relative weights and roles in the global economy.

## **2.4 Regional Economic Integration**

As evidenced by their engagement in existing international organizations and institutions, both Canada and Japan are clearly committed to regional and multilateral cooperation as a means of increasing prosperity for their citizens and enhancing the overall security of global trade. While the multilateral trading system remains the centrepiece of the trade policy strategies of both countries, regional integration has become an important factor in setting priorities and identifying issues of interest to both Canada and Japan, such as the promotion of two-way investment and the negotiation of trade agreements and related initiatives with key strategic partners.

The diverse economies of East Asia and North America are leaders in international commerce, and interregional trade and investment between these two geographic epicentres continues to gather momentum. An increasingly important contributing factor is the overall globalization of production chains. Participation in such production networks can benefit partner countries by organizing trade links and providing access to technology flows. Global production networks are particularly complex for high-technology industries, which require a broad range of specialized inputs that can be sourced globally, either on an arm's-length or intrafirm basis. Figure 2.1, which depicts the global production network for the aerospace industry, provides a good example of this.

**Figure 2.1: A simplified production network for the aerospace industry, 1995**  
(flows in million USD)



Source: B. Wixted, N. Yamano and C. Webb (2006), "Input-Output Analysis in an Increasingly Globalised World: Applications of OECD's Harmonised International Tables," STI Working Paper 2006-07, Directorate for Science, Technology and Industry, OECD.

As can be seen from the above figure, in the aerospace industry in 1995 there was a significant trans-Pacific element to the global value chains, with Japan serving as a mini-hub that feeds primarily into the U.S. aerospace industry. Canada was also linked into the U.S. hub and served as a mini-hub for regional aircraft, drawing on inputs from the United States and Europe. The organization of these global value chains varies across industrial sectors and is evolving rapidly. Participation in global value chains, which is important in sustaining the engagement of Canadian and Japanese firms in globalized industrial sectors and deepening trans-Pacific trade links, serves to enhance the respective competitive positions of both countries.

In addition to regional integration, the trans-Pacific dimension is becoming increasingly important, particularly in higher-value and technology-intensive areas such as aerospace. Fostering deeper trans-Pacific connections by facilitating economic integration between Canada and Japan across the full spectrum of activities that are subject to globalization will provide Canadian and Japanese firms – including producers of goods and services as well as knowledge – with new competitive advantages in maintaining and expanding their participation in global production networks.

### East Asian Integration

In Asia, the implementation of regional production chains (or value chains) has been highly successful in large part due to the wide variation in the sophistication of

production among many economies in Asia. As a consequence, regional production chains have been a leading driver of Asia's economic growth and development and have attracted significant foreign direct investment from other areas of the world, including North America and Europe. Asian countries with a higher number of skilled workers and greater advancement in technology tend to enter the top of the value chain, providing the essential knowledge- and technology-intensive processes, such as research and development and advanced precision manufacturing. This type of contribution to the value chain is then complemented by production of more labour-intensive products by less developed countries. For example, while Japan provides much of the region's research and development and is home to many of the region's multinational enterprises, many other countries and regions, including Singapore, South Korea, Hong Kong and Malaysia, produce sophisticated inputs and are responsible for an increasing share of product design. Countries such as Indonesia and Vietnam also contribute to these value chains through the supply of an abundance of low-cost labour and their specialization in the final assembly of products.

While increasing Asia's regional integration, the global value chain phenomenon is also ensuring that Asia as a whole is more competitive globally. Overall, Asia's share of world imports has increased from 14.7% in 1980 to 28.8% in 2004. As Asia's largest economy, Japan is clearly a dominant player in global value chains. Japanese direct investment in its Asian neighbours and the proliferation of Japanese technology are central factors directing East Asian production and distribution networks. The vast majority (approximately 93% in 2004) of goods and services produced by Japanese affiliates in East Asia are traded within the region (50% to local markets, 22% to Japan and 21% to other countries in the region). In addition, these same Japanese affiliates source approximately 95% of their goods and services from the region.<sup>3</sup> China is also playing an increasingly influential role in all areas of Asian value chains, with more than two-thirds of Chinese imports currently being used as intermediate inputs in the production of exports. Most of these inputs come to China from its neighbours within the region and are then sent on to destinations outside of Asia, such as North America and Europe.

Given these developments, Asia's global value chains and Japan's role in the region are key considerations for Canadian business and government leaders. In addition to being a dominant force in global supply chains and Asia's largest economy, Japan is also a key export market and source of foreign direct investment (FDI) for Canada. In light of the high integration of Japanese companies and the concentration of Japanese direct investment throughout Asia, Japan has the potential to play a valuable role as an entry point to East Asia for Canadian trade and investment.

### **North American Integration**

From a business perspective, North America is one of the most highly integrated regions in the world. North Americans share increasingly integrated energy markets, serve the

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<sup>3</sup> Fukunari Kimura and Mitsuyo Ando, "The Economic Analysis of International Production/Distribution Networks in East Asia and Latin America: The Implication of Regional Trade Arrangements," Faculty of Economics, Keio University, Tokyo, May 2004, pp. 13-14.

same customers with an array of financial services, use the same roads and railroads to transport jointly made products to market, fly on the same integrated airline networks and increasingly meet the same or similar standards of professional practice. Canada and the United States have shared a similar political, economic, cultural and geographic heritage for the past two centuries, and this relationship continues to be reinforced through migration and immigration.

For the past 40 years, the two economies have become increasingly integrated, and the building of this integrated economy has been driven to a large degree by corporate perceptions of changes in global and national markets and environments. As Michael Hart indicates in a paper on Canada's relationship with the United States: "Economic integration is a natural process flowing from the impact of billions of discrete and seemingly unrelated decisions. Policy, however, can smooth or hinder this process."<sup>4</sup> The Canada-U.S. Free Trade Agreement, which entered into force in 1989, and the North American Free Trade Agreement (NAFTA) established a rules-based framework to smooth such integration.

When it came into force in 1994, the NAFTA created the world's largest free trade area, encompassing over 400 million people and almost \$8 trillion in yearly production. The NAFTA united the economic futures of Canada, the United States and Mexico with a rules-based framework for the conduct of business in the region. In 2006, Canada exported \$361 billion in goods to the United States and imported \$257 billion in return. Services exports totalled \$37 billion in 2006, with corresponding imports valued at \$47 billion. Almost 76% of Canadian exports of goods and services are to the United States. On the other side, about 19% of U.S. exports are bound for Canada, and 38 states have Canada as their primary trading partner. Trade with Mexico has also increased significantly. Bilateral trade had grown by more than 300% since NAFTA to reach \$20 billion in 2006. Mexico is Canada's fifth most important export market, and Canada is Mexico's second largest export market after the United States.

Like in Asia, improved market access has encouraged firms to rationalize production and become more specialized. Trade liberalization has resulted in a significant increase in intrafirm trade. It is estimated that over 34% of Canada-U.S. bilateral trade is intrafirm. In sectors ranging from beef to automobiles, products move back and forth across borders all along the value chain. Canada's automotive industry does not merely rely on access to the U.S. market for sales (85% of all vehicles produced being exported to that market); the United States is also the major source of parts for vehicle production as well as finished vehicles for sale. Parts cross the border many times as they are transformed and built into larger assemblies that are ultimately combined into finished vehicles. In the cattle and beef sectors, Mexico exports feeder calves to the U.S. market and Canada exports slaughter cattle, feeder calves and breeding stock. The United States ships feeders, slaughter cattle and breeding stock to Canada and breeding stock to Mexico. Canada and the United States ship beef to each other as well as to Mexico. Some multinational agri-food companies are taking advantage of economies of scale,

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<sup>4</sup> Michael Hart, "Canada, the United States and Deepening Economic Integration: Next Steps," *North American Linkages: Opportunities and Challenges for Canada* (Calgary: University of Calgary Press), 2003, p. 429.

specialization and input cost competitiveness by concentrating production for the hemispheric market in selected plant locations in Canada and the United States.

According to some independent analyses,<sup>5</sup> other Canadian manufacturing industries that are extensively integrated on a cross-border basis, and in which firms operate as if there were little or no border impediment to trade flows, are machinery manufacturing, computer and electronic product manufacturing, plastics and rubber product manufacturing, and electrical equipment, appliance and component manufacturing. Movements of direct and portfolio investment also clearly point to greater integration. U.S. direct investment in Canada increased to \$274 billion in 2006, while Canadian direct investment in the United States grew to \$224 billion in the same year. Canada is Mexico's fifth most important investor (1993-2004), with \$4.4 billion invested in 2006. Meanwhile, Mexican FDI to Canada reached \$277 million in 2006.

As active trading nations in two of the world's most highly integrated regions, Canada and Japan offer their trade and investment partners access to large and growing markets. Like Japan in Asia, Canada serves as an important access point to North America and, given its position as the largest trading partner of the United States, remains an unequalled point of entry into the world's largest market.

## **2.5 Bilateral Trade and Investment Policy Initiatives**

As a complement to examining ongoing collaboration in existing multilateral and regional forums, Canada and Japan recognize the importance of considering further their respective approaches to key bilateral trade and investment negotiations and discussions with third countries. This section highlights key innovative initiatives that Canada and Japan have developed with third countries, including Canada's free trade and investment protection agreements, Japan's economic partnership agreements and investment treaties, and other initiatives such as joint studies and exploratory talks. While Canada and Japan have also concluded and/or signed a number of bilateral agreements with each other, including an air services agreement, social security agreement, a tax convention and various cooperation agreements in areas such as investment, competition, science and technology, and regulatory cooperation, these initiatives are addressed in greater depth elsewhere in this report.

### **Canada's Strategy for Bilateral and Regional Trade Policy Initiatives**

As a trade-oriented and globally integrated economy, Canada benefits from an open, transparent and rules-based international trading system at the multilateral, regional and bilateral levels. Canada's regional and bilateral trade initiatives are a means to secure markets for Canadian business, encouraging companies to expand into these markets and create jobs in Canada. While the WTO is the centrepiece of Canada's trade policy, regional and bilateral initiatives are also important pillars. Bilateral trade agreements complement Canada's objectives to improve and strengthen global trade rules. These

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<sup>5</sup> Dr. Tim O'Neil, Chief Economist, Bank of Montreal, "North American Economic Integration and Its Applications to Canadian Banks," BMO Financial Group, Economics Department, 2002.



agreements serve to stimulate the economy, provide innovative solutions to difficult trade and investment issues, and strengthen economic reforms. Canada has concluded FTAs with the United States, Mexico, Israel, Chile and Costa Rica, and, most recently, has concluded negotiations for an FTA with the European Free Trade Association countries (Iceland, Norway, Switzerland and Liechtenstein). Canada continues to recognize the merits of pursuing FTAs and other targeted policy instruments with priority trade and investment partners.

Canada has ongoing FTA negotiations with Singapore, Korea, the Andean Community countries of Colombia and Peru, the Dominican Republic, the Caribbean Community (CARICOM), and a group of four Central American countries (El Salvador, Guatemala, Honduras and Nicaragua). Canada is also studying the feasibility of an FTA with Jordan. In addition to these initiatives, Canada established an Economic Framework with Japan to enhance bilateral economic relations and is working with the EU on a study to examine the costs and benefits of a closer economic partnership.

Canada's FTAs typically follow the NAFTA model, although provisions can vary from one agreement to another so as to reflect developments in international trade law and policy since the NAFTA's inception. For example, Canada has pursued a separate trade facilitation chapter in its most recent FTAs and in ongoing FTA negotiations. Such a chapter endeavours to promote enhanced transparency, predictability, due process, simplification, rapid release, a more efficient use of resources, and effective border control and enforcement – in part to help reduce business costs for all traders, an issue of particular interest to small and medium-sized enterprises.

The complete text of each of Canada's FTAs is publicly available,<sup>6</sup> including tariff elimination schedules, product-specific rules of origin, reservations, backgrounders and analytical pieces. Information, including statistics, relating to the examination of Canada's FTAs by the WTO Committee on Regional Trade Agreements can be found on the WTO website.<sup>7</sup>

### **Japan's Strategy for Bilateral and Regional Trade Policy Negotiations**

While Japan seeks to achieve economic growth by further strengthening the multilateral trading system as embodied in the WTO, Japan is taking the initiative in advancing economic partnerships with other countries in East Asia and other parts of the world as a means to complement the WTO multilateral trading system. Given the deep interdependence with its economic partners worldwide, Japan's bilateral or regional efforts are placed not only in the aspect of trade in goods or services but also in a wide range of areas – or in other words, “WTO plus” – including investment, movement of natural persons, intellectual property and competition policy as well as cooperation. In this light, the bilateral and regional agreements of Japan are called economic partnership agreements (EPAs) rather than free trade agreements (FTAs).

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<sup>6</sup> [www.dfait-maeci.gc.ca/tna-nac/reg-en.asp](http://www.dfait-maeci.gc.ca/tna-nac/reg-en.asp)

<sup>7</sup> [www.wto.org](http://www.wto.org)

In addition to the Economic Framework that Japan signed with Canada in 2005, Japan's bilateral and regional efforts have continued to evolve. Japan concluded EPAs with Singapore, Mexico, Malaysia and Chile, which took effect in November 2002, April 2005, July 2006 and September 2007 respectively, and signed EPAs with the Philippines, Thailand, Brunei and Indonesia in September 2006, April 2007, June 2007 and August 2007 respectively. EPAs with Vietnam, the Republic of Korea, India, Australia and Switzerland are under negotiation. In parallel with those bilateral efforts, Japan has been conducting negotiations of an EPA with the Association of Southeast Asian Nations (ASEAN) as a whole since April 2005 and an FTA covering trade in goods and services with Gulf Corporation Council (GCC) states since September 2006.

### **Canada's Approach to Investment Treaties**

While serving to reinforce Canada's bilateral relations, investment chapters in FTAs and international investment agreements are designed to assist Canadian firms in obtaining an optimum level of investment abroad, help lower their political risk, and reduce insurance and other attendant costs inherent in investing in emerging economies. The enhanced security that a Foreign Investment Promotion and Protection Agreement (FIPA)<sup>8</sup> provides also contributes to the overall viability of Canadian companies trading and investing abroad.

In this vein, Canada's FIPAs seek to ensure that Canadian investors abroad will not be treated any worse than similarly situated domestic investors or other foreign investors, will not have their investments expropriated without prompt and adequate compensation, and will not be subject to treatment lower than the minimum standard established in customary international law. In most circumstances, investors should also be free to invest capital and repatriate their investments and returns. Additionally, Canada's policy is to promote and protect investment through a transparent rules-based system in a manner that reaffirms the right of governments to regulate in the public interest.

A new Canadian FIPA model was developed and finalized in 2004 that builds on the experiences Canada has gained through the implementation and operation of the NAFTA investment chapter. The principal objectives of developing a new model FIPA were to enhance clarity in the substantive obligations, maximize openness and transparency, balance state sovereignty with investment protection and discipline, and improve efficiency in the dispute settlement procedures. Canada has concluded 25 FIPAs in 18 years, most recently with India and Jordan. Canada is currently negotiating an investment agreement with China, and is engaged in negotiations to revise FIPAs already in force with six new and acceding member states to the EU.

### **Japan's Approach to Bilateral Investment Treaties**

For Japanese companies that are planning to extend – or that have already extended – their business activities abroad, it is very important to ensure their protection and the protection of their assets, together with legal stability and transparency of the relevant

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<sup>8</sup> The FIPA is Canada's investment treaty model, which also forms the basis of Canada's FTA investment chapters.

laws and regulations of the host countries (investing countries) under a binding framework. This will contribute to the reduction or relaxation of institutional risks that Japanese companies face in foreign countries.

In this regard, investment chapters in EPAs or bilateral investment treaties will play important roles to helping to protect Japanese companies and their assets. Such investment rules incorporate several important elements, which the Canadian side has already stressed the importance of, including treatment not less favourable to local companies or other foreign companies, the clarification of important matters concerned with expropriation and compensation, and the free transfer of investment capital or repatriation of investments. In addition, the transparency of the relevant restrictive laws and regulations and the maintenance of the restriction level will be pursued to the greatest extent possible. Japan signed an investment agreement with Cambodia in June 2007, and negotiations for bilateral investment agreements with Saudi Arabia and Laos and a tripartite investment agreement with China and Korea are ongoing.

## Chapter 3

### PAST AND PRESENT TRENDS IN THE BILATERAL ECONOMIC RELATIONSHIP

Canada and Japan have long been important economic partners, with significant levels of two-way trade in goods and services, flows of direct and portfolio investment, flows of technology and ideas, and movement of people. Yet, for some time, the overall commercial relationship has underperformed and thus been overshadowed by dynamic growth in bilateral relations with other economic partners.

One contributing factor was the long period of slower growth in Japan following the bursting of the “bubble” economy in the early 1990s, which culminated in the recession of the late 1990s and the Asian economic and financial crisis. A second factor was the strength of the regional dynamic in both North America and East Asia. Intraregional trade and investment growth in these regions outpaced the expansion of trans-Pacific commerce, resulting in a relative decline in the weight of the latter.

Japan’s economic recovery is now strengthening. At the same time, Canada is seeking new opportunities to increase its prosperity by strengthening international linkages. The overall economic relationship between Canada and Japan is thus in a position to move forward more strongly than it has in the recent past.

#### 3.1 Overview of the Economies of Canada and Japan

Canada and Japan are both mature, industrialized economies that rank amongst the world’s largest. Japan’s economy was 3.4 times larger than Canada’s in 2006. This largely reflects different population sizes. Per capita income in Canada in 2006 was 2.1% lower than in Japan, measured in common currency at current market exchange rates. In terms of purchasing power parity, however, Canada’s per capita income was 6.7% higher than Japan’s per capita income in 2005, reflecting the fact that Japan’s prices were somewhat higher on average than Canada’s (See Table 3.1).

Japan’s gross domestic product (GDP) in 2006 was ¥507,693 billion (approximately \$4,952 billion), the second highest in the world after the United States. During that same year, Canada’s GDP registered \$1,439 billion (approximately ¥148,132 billion), placing it eighth in the world ranking. In both economies, services account for the largest share of GDP. Manufacturing and other industrial activity accounts for roughly one-quarter of GDP, while the primary sectors (agriculture, forestry, fishing, and mining and energy extraction) account for only a small share of overall economic activity. The primary sectors are relatively more important in Canada’s economy than in Japan’s.

Both economies are deeply engaged in the global economy; that being said, Canada's exports of goods and services as a share of GDP in 2006 stood at 36.4%, which is substantially higher than Japan's at 16.1%.

Both economies are in the midst of cyclical recoveries. In Japan's case, the economic expansion since 2002 represents the strongest sustained growth since the bursting of Japan's "bubble" economy at the beginning of the 1990s. In Canada's case, the economy recorded its 15th consecutive year of growth in 2006.

**Table 3.1: Summary Statistics on the Canadian and Japanese Economies**

|  | Canada     | Japan      |
|--|------------|------------|
| Gross domestic product, 2006   |            |            |
| In current USD billions at market exchange rates   | US\$1,269  | US\$4,365  |
| In CAD billions at market exchange rates   | \$1,439    | \$4,952    |
| In JPY billions at market exchange rates   | ¥148,132   | ¥507,693   |
| Population, 2006 (millions)  | 32.85      | 127.7      |
| Gross national income per capita, 2006 (current prices)  |            |            |
| In current USD at market exchange rates  | US\$38,440 | US\$35,137 |
| In CAD at market exchange rates  | \$43,595   | \$39,859   |
| In JPY at market exchange rates  | ¥4,469,907 | ¥4,088,000 |
| Per capita income at purchasing power parity, 2005 (Japan = 100)                                 | 106.7      | 100.0      |
| GDP growth, 2001-06 (average; constant prices)   | 2.5%       | 1.5%       |
| GDP shares (for Canada based on 2002 current dollars;<br>for Japan based on 2005 current prices) |            |            |
| Primary  | 7.2%       | 1.4%       |
| Secondary  | 25.1%      | 26.4%      |
| Tertiary   | 67.7%      | 72.2%      |
| Trade orientation, 2006 (current prices)   |            |            |
| Exports of goods and services as share of GDP  | 36.4%      | 16.1%      |
| Imports of goods and services as share of GDP  | 34.1%      | 14.9%      |

Sources: International Monetary Fund, *International Financial Statistics*, CD-ROM, for GDP, GNI, population and bilateral Yen/USD and CAD/USD exchange rates. Purchasing power parity data from the World Bank, *World Development Report 2006*, Table 1. Statistics Canada for trade data; trade data are on a balance of payments basis; Bank of Canada for the annual average exchange rate used to convert Canadian dollar data into Japanese yen data. The breakdown of GDP shares is based on the Canadian classification. (Japanese primary sectors include agriculture, forestry and fishing. Secondary sectors include mining, manufacturing and construction. The Tertiary is the rest.)

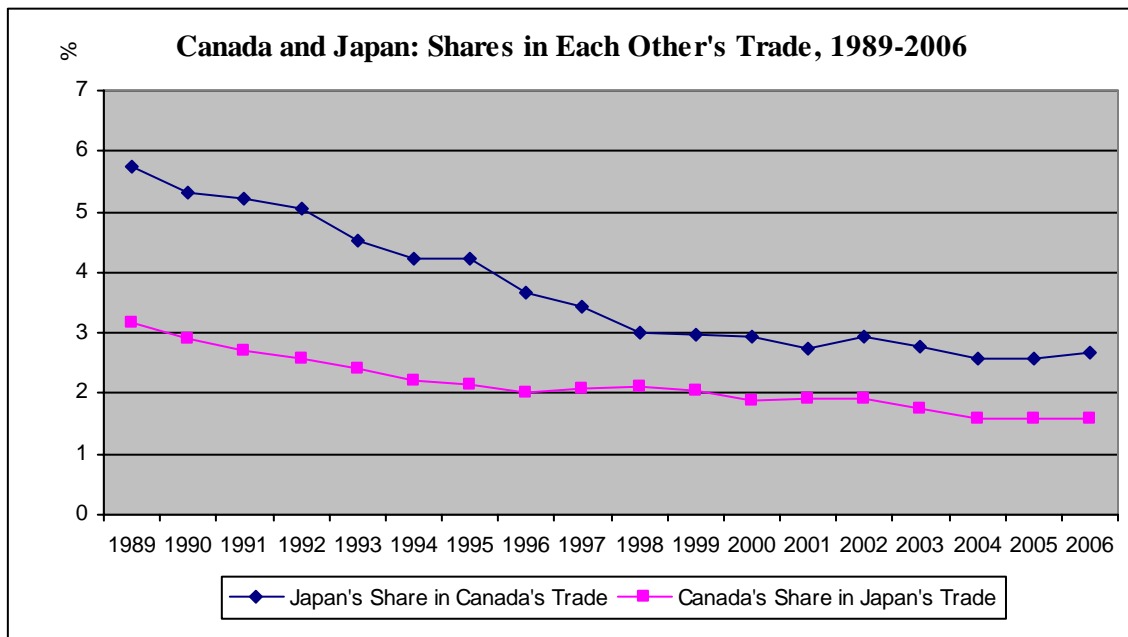
### 3.2 Trends in Bilateral Trade

The Canada-Japan trade relationship peaked in terms of relative importance in 1989; in that year, Japan accounted for 5.7% of Canada's two-way trade in goods and services, while Canada accounted for 3.2% of Japan's two-way trade in goods and services.

Since then, the value of two-way trade has grown but at a slow pace. According to Canadian statistics, two-way trade in goods and services grew from \$19.3 billion in 1989 to \$27 billion in 2006, a gain of 40.6%, or 2.0% per year. According to Japanese statistics, two-way trade has been flat at ¥2,122 billion in 1989 and ¥2,277 billion in 2006, fluctuating around ¥2,000 billion for the past 10 years. (Canada's and Japan's trade statistics have different standards, such as with respect to how to calculate shipments through third countries, which is reflected in the disparity in the data.)

In the 1990s, the relative importance of Canada-Japan bilateral trade fell more or less steadily, reflecting on the one hand the influence of economic slowdown and recession in Japan, and on the other hand the increase in the U.S. share of Canada's trade due to the Canada-U.S. Free Trade Agreement and its successor, the North American Free Trade Agreement (NAFTA). Since 2000, the relative importance of the trading relationship has continued to decline, but at a much slower pace. During this latter period, the main factor has been the rise in importance of China in both Canadian and Japanese trade.

**Figure 3.1: Canada's and Japan's Respective Shares in Each Other's Total Trade in Goods and Services**



Sources: Statistics Canada, "Balance of International Payments: Canada with Japan," CANSIM database; Ministry of Finance of Japan, "Trade Statistics."

In 2006, Canada was Japan's 15th largest trading partner in terms of two-way trade in goods and services (balance of payments basis). On the same basis, Japan was Canada's third largest trading partner in terms of two-way trade in goods and services.

### 3.2.1 Sectoral Trends in Merchandise Trade

Trade in goods between Canada and Japan appears to be largely complementary, with each specializing in products that the other does not intensively export (See Tables 3.2 and 3.3).

### Japan's Merchandise Imports from Canada

Canada is one of the world's leading exporters of primary goods (e.g. agricultural, forestry and fisheries products) and natural resources, such as energy, metal and mineral products. Recently, agricultural, forestry and fisheries products have accounted for about 44.6% of Japan's imports from Canada. However, Canada's trade with Japan is slowly evolving toward higher value-added products. For example, the share of Japanese imports from Canada accounted for by higher-technology products such as pharmaceuticals, aerospace, machinery and equipment, and consumer goods has risen from 4.5% in 1994 to 9.5% in 2006. The pattern of Canada-Japan trade is likely to continue to evolve in this direction in the future.

**Table 3.2: Top 10 Items Imported by Japan from Canada, 2006**

| HS                          | CAD<br>millions | JPY<br>millions | Share of<br>total (%) |
|-----------------------------|-----------------|-----------------|-----------------------|
| 44 Wood                     | 1,594           | 163,413         | 14.6                  |
| 26 Ores, slag, ash          | 1,434           | 146,994         | 13.1                  |
| 27 Mineral fuel, oil, etc.  | 1,194           | 122,440         | 11.0                  |
| 12 Misc. grain, seed, fruit | 974             | 99,821          | 8.9                   |
| 02 Meat                     | 848             | 86,961          | 7.8                   |
| 47 Wood pulp, etc.          | 544             | 55,811          | 5.0                   |
| 76 Aluminum                 | 475             | 48,706          | 4.4                   |
| 03 Fish & seafood           | 471             | 48,319          | 4.3                   |
| 10 Cereals                  | 431             | 44,179          | 4.0                   |
| 85 Electrical machinery     | 401             | 41,146          | 3.7                   |
| Total, all sectors          | 10,907          | 1,118,372       | 100                   |

Source: *World Trade Atlas*.

### Canada's Merchandise Imports from Japan

Manufactured goods dominate Canada's imports from Japan. Automobiles and automotive parts, machinery and machinery parts, and electrical machinery and electrical machinery parts accounted for 76.6% of the total value of Canadian imports from Japan in 2006.

**Table 3.3: Top 10 Items Imported by Canada from Japan, 2006**

| HS  | CAD<br>millions | JPY<br>millions | Share of<br>total (%) |
|---|-----------------|-----------------|-----------------------|
| 87 Motor vehicles, trailers, bicycles, motorcycles and other similar vehicles | 6,681           | 685,052         | 43.5                  |
| 84 Nuclear reactors, boilers, machinery and mechanical appliances             | 3,012           | 308,877         | 19.6                  |
| 85 Electrical or electronic machinery and equipment                           | 2,055           | 210,719         | 13.4                  |
| 90 Optical, medical, photographic, scientific and technical instruments       | 787             | 80,695          | 5.1                   |
| 88 Aircraft and spacecraft  | 445             | 45,636          | 2.9                   |
| 73 Iron/steel products  | 397             | 40,716          | 2.6                   |
| 40 Rubber   | 383             | 39,297          | 2.5                   |
| 30 Pharmaceutical products  | 139             | 14,241          | 0.9                   |

|    |                    |        |           |     |
|----|--------------------|--------|-----------|-----|
| 72 | Iron and steel     | 136    | 13,905    | 0.9 |
| 39 | Plastic            | 133    | 13,600    | 0.9 |
|    | Total, all sectors | 15,346 | 1,573,457 | 100 |

Source: *World Trade Atlas*.

### 3.2.2 Trade in Services

Trade in commercial services<sup>9</sup> between Canada and Japan is becoming an increasingly important part of the bilateral trading relationship. In 2006, two-way services trade amounted to ¥490 billion (\$4.8 billion), accounting for 17.6% of total bilateral trade in goods and services, compared with only 8.8% in 1990.

Travel services play an important role in Canada's cross-border services exports to Japan, comprising \$543 million in 2006 (compared with transportation services at \$512 million, commercial services at \$398 million and government services at \$34 million), according to Canada's statistics (See Table 3.4).

**Table 3.4: Bilateral Transactions in Services (million dollars)**

|      | Japan to Canada |                |            |            | Canada to Japan |                |            |            |
|------|-----------------|----------------|------------|------------|-----------------|----------------|------------|------------|
|      | Travel          | Transportation | Commercial | Government | Travel          | Transportation | Commercial | Government |
| 1999 | 153             | 388            | 1,226      | 43         | 619             | 441            | 416        | 31         |
| 2000 | 189             | 479            | 1,348      | 51         | 731             | 568            | 538        | 32         |
| 2001 | 204             | 448            | 1,426      | 47         | 678             | 593            | 615        | 31         |
| 2002 | 191             | 453            | 2,300      | 42         | 714             | 484            | 548        | 32         |
| 2003 | 202             | 506            | 1,975      | 39         | 398             | 369            | 430        | 32         |
| 2004 | 245             | 540            | 1,862      | 38         | 611             | 546            | 376        | 32         |
| 2005 | 231             | 582            | 1,518      | 36         | 605             | 551            | 325        | 32         |
| 2006 | 191             | 578            | 2,484      | 35         | 543             | 512            | 398        | 34         |

Source: Statistics Canada, "Balance of International Payments: Canada with Japan," CANSIM database.

In the area of commercial services, the largest segment of Canada's cross-border services exports to Japan is with respect to royalties and licence fees. However, computer and information services; professional services, such as engineering and architecture; advertising and related services; and other business services also represent a significant proportion of Canada's commercial services exports. Financial services also represent an important sector in Canada's services trade with Japan. However, the majority of Canada's financial services exports are transacted through commercial presence rather than on a cross-border basis and do not, therefore, figure prominently in cross-border trade statistics.

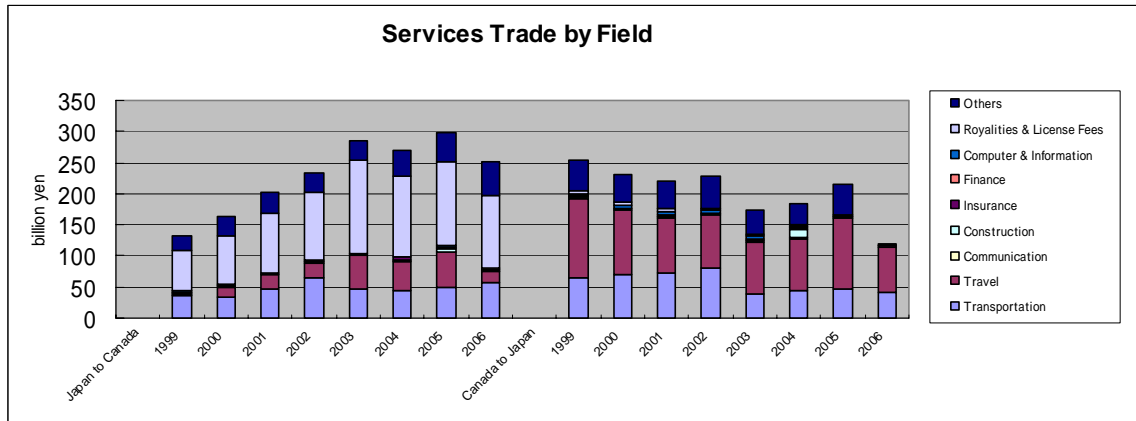
Commercial services also represent the largest segment of Japan's total cross-border services exports to Canada, comprising ¥251 billion in 2006. According to Japanese

<sup>9</sup> Statistics on trade in services often underestimate the total volume of services trade taking place, particularly since services statistics typically only measure cross-border services trade and do not take into account other modes of services supply, namely consumption abroad, commercial presence and temporary movement of natural persons. In some sectors, these other modes of services supply may comprise a much higher volume of total trade than cross-border supply. As a consequence, accurate measures of Canada's and Japan's respective trade performances in the area of services are often difficult to obtain, especially at the disaggregate level.



statistics, royalties and licence fees represent an extremely high proportion within this segment. Financial services, management services, audiovisual services and other business services represent other important sectors in the area of commercial services. Travel services represented ¥19 billion, transport services ¥56 billion and government services ¥1.0 billion in 2006 (See Figure 3.2).

**Figure 3.2: Services Trade by Field**



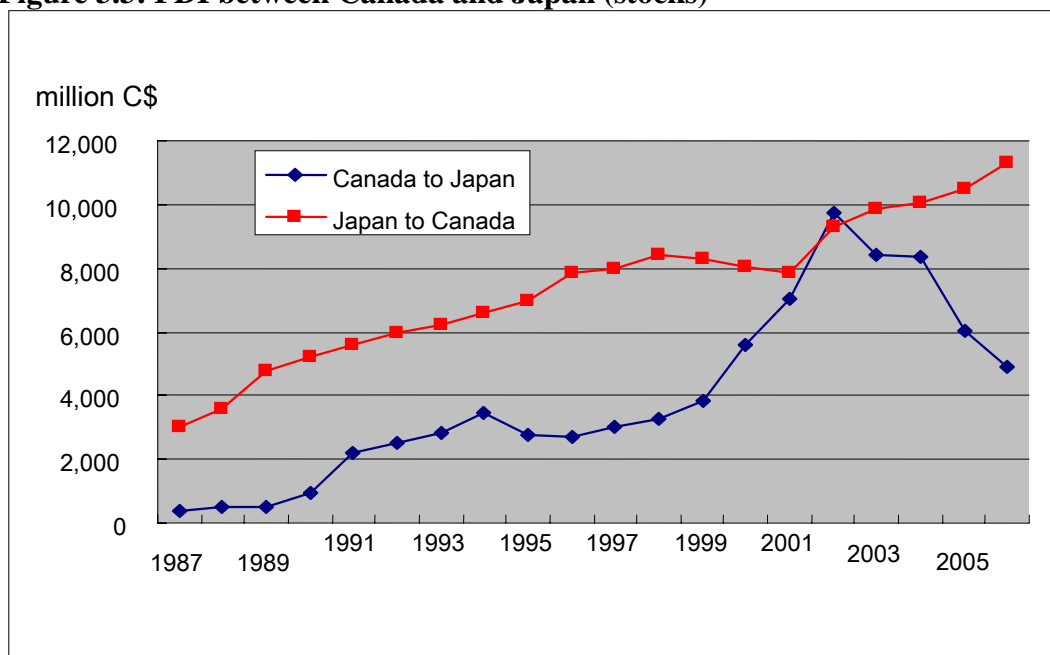
Source: Bank of Japan, "Balance of Payment."

### 3.3 Trends in Investment

#### 3.3.1 Overview

The value of foreign direct investment (FDI) has in the past been such that FDI flows and stocks from Japan to Canada have tended to be larger than investment in the other direction, although FDI stocks from Canada to Japan exceeded FDI stocks from Japan to Canada in 2002. While FDI stocks from Japan to Canada have been a growth trend recently, FDI stocks from Canada to Japan have been falling since 2002, when the FDI stocks were at their peak (See Figure 3.3).

**Figure 3.3: FDI between Canada and Japan (stocks)**



Source: Statistics Canada.

The compound annual growth rate in the value of direct investment (stocks) from Japan to other countries since 1996 has been 5.7%, while the growth rate in the value of direct investment from Japan to Canada has been 6.8%. On the other hand, whereas the growth rate in the value of direct investment (stocks) from foreign countries to Japan has been 13.7%, the average annual growth rate in the value of direct investment from Canada to Japan has been 15.1%.<sup>10</sup>

Direct investment from Japan to Canada in 2006 was US\$6,818 million (equivalent to approximately 1.5% of Japan's direct investment position abroad), while direct investment from Canada to Japan was US\$2,284 million (equivalent to approximately 2.1% of Japan's inward direct investment position). From Japan's perspective, although the total value of inward direct investment is low, Canada is an important source of investment in Japan. The scale of its investment is, however, by no means large (see Table 3.5).

<sup>10</sup> Source of the data for this paragraph: Japan External Trade Organization (JETRO).

**Table 3.5: Japan's International Investment Position by Region**

| <b>The Position of Foreign Direct Investment in Japan</b> |         |      |         |      |
|---|---------|------|---------|------|
| Million US\$  | 1996    |      | 2006    |      |
|   | Value   | %    | Value   | %    |
| All countries   | 29,942  |      | 107,663 |      |
| United States   | 15,394  | 51.4 | 41,989  | 39.0 |
| European Union  | 7,215   | 24.1 | 39,625  | 36.8 |
| Canada  | 562     | 1.9  | 2,284   | 2.1  |
| Rest of the world (ROW)                                   | 6,771   | 22.6 | 23,765  | 22.1 |
| <b>The Position of Japan's Direct Investment Abroad</b>   |         |      |         |      |
| All countries   | 258,653 |      | 449,680 |      |
| United States   | 94,336  | 36.5 | 156,411 | 34.8 |
| European Union  | 43,569  | 16.8 | 118,852 | 26.4 |
| Canada  | 3,545   | 1.4  | 6,818   | 1.5  |
| ROW   | 117,203 | 45.3 | 167,599 | 37.3 |

Source: Japan External Trade Organization (JETRO).

**Table 3.6: Canada's International Investment Position by Region**

| <b>The Position of Foreign Direct Investment in Canada</b> |         |      |         |      |
|--|---------|------|---------|------|
|  | 1990    |      | 2006    |      |
|  | Value   | %    | Value   | %    |
| All countries  | 130,932 |      | 448,858 |      |
| United States  | 84,089  | 64.2 | 273,705 | 61.0 |
| European Union   | 31,524  | 24.1 | 118,365 | 26.4 |
| Japan  | 5,222   | 4.0  | 11,309  | 2.5  |
| ROW  | 10,098  | 7.7  | 45,479  | 10.1 |
| <b>The Position of Canadian Direct Investment Abroad</b>   |         |      |         |      |
| All countries  | 98,402  |      | 523,260 |      |
| United States  | 60,049  | 61.0 | 223,623 | 42.8 |
| European Union   | 20,625  | 21.0 | 144,446 | 27.6 |
| Japan  | 917     | 0.9  | 4,919   | 0.9  |
| ROW  | 16,811  | 17.1 | 150,272 | 28.7 |

Source: Statistics Canada, "Canada's International Investment Position."

While the geographic distribution of FDI in Canada remained relatively stable over the past decade, with the United States dominating, there have been noticeable changes in the pattern of Canadian investment abroad. Canadians diversified their investment, making more investment in many parts of the world than in the traditional U.S. market. Between 1990 and 2006, the share of the United States in total Canadian investment abroad declined from 61.0% to 42.8%, while the corresponding shares for the "rest of the world" – mainly developing countries – increased from 17.1% to 28.7% over the same period (see Table 3.6).

According to Canadian statistics, Canada's direct investment position in Japan in 2006 was \$4.9 billion (equivalent to 0.9% of Canada's direct investment abroad, up from \$507 million or 0.6% of Canada's overall FDI in 1989). In 2006, Japan was Canada's 15th largest destination for direct investment.

On the other hand, Japan's direct investment position in Canada in 2006 was \$11.3 billion (equivalent to 2.5% of total direct investment in Canada from overseas), making Japan Canada's sixth largest source of direct investment. Looking at changes in Japan's investment position in Canada, the total stock has doubled since 1989, although Japan's share of total foreign investment in Canada has fallen from 4.0%.

Direct investment from Japan to Canada is directed primarily toward the manufacturing industries but also toward commerce and trade, and the financial and insurance industries. According to a survey by the Embassy and Consulates General of Japan in Canada, more than 600 subsidiaries and affiliates of Japanese companies were operating in Canada in 2006.

### **3.3.2 Investment in the Bilateral Economic Relationship**

More Japanese companies are starting to focus on Canada as an investment destination in order to gain access to the North American market, while taking advantage of factors such as lower operating costs in Canada compared to the United States. The growing number of mergers and acquisitions by Japanese companies is also certain to have an impact on investment in Canada. Similarly, Canadian companies often invest in Japan to gain access not only to Japan but to the whole Asian market through the incorporation of their products into exported Japanese goods and services.

The automotive sector in Canada is one with a particularly significant Japanese presence, with Toyota, Honda, Hino and Suzuki (CAMI GM-Suzuki) all producing vehicles in Canada. Toyota, Honda and Hino, along with several Japanese Tier 1 suppliers,<sup>11</sup> have recently announced new greenfield investments to increase their production in Canada. According to the Japan Automobile Manufacturers Association (JAMA), Japanese automotive companies in Canada employ over 62,000 people, directly and indirectly, in fields ranging from vehicle and parts manufacturing, to head offices and dealerships.

Japanese investment goes well beyond the automotive sector, with over 600 Japanese companies present in Canada. There has recently been renewed interest by Japanese companies in Canada's natural resources sector, as well as agri-food, and information and communications technologies. This is evidenced by recent investments by companies such as Itochu Canada Ltd. in coal mining, Nisshin Seifun Group's building of a second flour mill, and Cybird's investment into Montreal's Airborne Entertainment, a cellular phone content developer.

Over 100 Canadian companies have established a commercial presence in Japan. Nearly half of these are engaged in the information and communications technologies (ICT) sector, Celestica among them, often as Tier 2 and Tier 3 suppliers. Canadian service companies are also present in a number of sectors, including the transport and financial services sectors. Manulife Insurance, in particular, has significant investments in the financial sector. In the automotive sector, Canadian parts suppliers Magna and ABC

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<sup>11</sup> A Tier 1 supplier is a supplier under direct contract to manufacturers.

Group are expanding their operations and working closely with Japanese automobile manufacturers in order to supply parts to assembly plants located throughout the world.

Examples such as these show the crucial role that investment plays in the context of the economic relationship between Canada and Japan. Investment is responsible not only for creating a significant number of jobs, but also for enabling the large amount of trade between the two countries.

## **Chapter 4**

### **SUMMARY OF CURRENT AREAS OF BILATERAL ECONOMIC COLLABORATION**

#### **4.1 Introduction**

Recognizing the importance of establishing strong bilateral commercial relations over and above cooperation in multilateral and regional forums, the Canadian and Japanese governments have developed a myriad of intergovernmental institutions designed to facilitate bilateral trade and investment and lay the groundwork for a productive government-to-government dialogue. Reflecting the depth and breadth of the bilateral relationship, this has resulted over the years in a complex network of joint mechanisms.

At the same time, these interactions have been punctuated by efforts of the two governments to raise the level of coherence and coordination in the relationship. A notable early endeavour involved the conclusion in 1954 of the Canada-Japan Agreement on Commerce. Then, in 1976, the Canada-Japan Framework for Economic Cooperation was signed, creating the first major bilateral trade and investment mechanism established between the two countries, the Joint Economic Committee (JEC). Most recently, encouraged by the private sectors of both countries, Canada and Japan signed, in November 2005, a new strategic, forward-looking Canada-Japan Economic Framework.

However, despite some growth in bilateral investment, the overall trend in two-way trade has remained relatively sluggish, and both governments have identified a need to bring renewed energy and focus to ensuring that the relationship reaches its full potential. This Joint Study provides for a re-examination of Japan-Canada collaboration and consideration of ways to address new and emerging challenges and opportunities.

#### **4.2 Early Results under the Canada-Japan Economic Framework**

To reinforce existing bilateral economic ties and address new and emerging commercial challenges and opportunities, the Canada-Japan Economic Framework aims to reinvigorate the existing government-to-government dialogue, lay the groundwork for future cooperation on priority areas, and emphasize the role of the private sector in guiding future initiatives. The Economic Framework includes a list of 15 priority areas of cooperation: social security, anticompetitive activities, food safety, customs, trade facilitation, transportation, investment, science and technology, information and communication technology, e-commerce, e-government, energy and natural resources, climate change, tax convention, and tourism promotion.

Since the launch of the Canada-Japan Economic Framework in January 2005, significant progress has been achieved by the two countries in a number of the priority

areas of cooperation. Of key importance to the Canadian and Japanese governments and private sectors was the conclusion of an agreement on anticompetitive activities and an arrangement on customs cooperation, as well as the signing of an agreement on social security and a memorandum of understanding (MOU) on bilateral investment promotion between Canada's Department of Foreign Affairs and International Trade (DFAIT) and the Japan External Trade Organization (JETRO).<sup>12</sup> In addition to these early accomplishments, steps have been taken to enhance policy dialogue in other priority areas, such as cooperation in food safety.

### **Social Security Agreement**

Recognizing the potential to increase and facilitate two-way investment, Canada and Japan signed the Japan-Canada Social Security Agreement in February 2006, and both parties are taking the necessary steps to implement the Agreement. The successful signing of the Agreement represents the endeavours of the two governments to facilitate the creation of an enhanced environment investment in both countries. The Agreement is good news for Japanese companies operating in Canada and Canadian companies operating in Japan, which were previously paying significant pension contributions for workers sent to the other country. These workers will now be able to continue paying into their own country's pension plan while posted abroad, if the length of their assignment is expected to be less than five years. The Agreement will also help to protect the pension rights of nationals of both countries.

### **Cooperation on Anticompetitive Activities**

Facilitating cooperation between competition authorities is increasingly important, as reducing trade barriers accelerate the globalization of markets and raise the risk of anticompetitive business activity with transborder effects. Acknowledging that the sound and effective enforcement of the competition laws of each country is essential to the efficient functioning of their markets and trade between them, Canada and Japan signed a Cooperation Agreement on Anticompetitive Activities, which came into effect on October 6, 2005. Building on previous informal relations, enhanced cooperation will be essential in combatting anticompetitive business practices that could have negative impacts in the markets of both countries. The first formal bilateral meeting under the Agreement between the heads of the respective competition authorities took place in March 2006. Discussions focused on enforcement, policy and international matters of common interest.

### **Customs Cooperation Arrangement**

Reaffirming the importance of customs cooperation, especially its usefulness in combatting smuggling and enhancing the security and facilitation of the international trade supply chains, Canada and Japan entered into an enhanced bilateral customs cooperation arrangement in June 2005. Under the terms of this arrangement, both countries will assist each other to ensure proper application of customs laws, as well as

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<sup>12</sup> The Japan External Trade Organization (JETRO) is an incorporated administrative agency that works to promote trade and investment between Japan and the rest of the world.

to prevent, investigate and repress customs offences. The arrangement is an example of both countries' efforts to increase international cooperation and will provide more opportunities for Canada and Japan to maximize their contributions to the World Customs Organization.

### **4.3 Overview of Ongoing Collaboration**

Building on the basic structures that guide and manage the overall bilateral relationship, Canada and Japan have also developed, over the years, cooperative mechanisms in a wide range of areas to deal with specific areas of key importance. The two countries have focused on enhancing their mutual capacities in innovation and in knowledge-based industries through regulatory cooperation, science and technology cooperation, and investment promotion. This section provides an overview of key areas that form important building blocks of the bilateral cooperative relationship.

#### **Regulatory Cooperation**

As tariffs continue to be reduced, regulatory cooperation is becoming increasingly important in helping to ensure the efficient cross-border flow of goods and services. The Economic Framework outlined the importance both countries placed on regulatory cooperation in the context of facilitating commerce and reaffirmed this commitment, *inter alia*, in the context of our 1999 bilateral Regulatory Cooperation Arrangement in the Global Partnership for the 21st Century. The Economic Framework is expected to encourage Canadian and Japanese regulatory authorities to further promote the 1999 Arrangement's goals of closer cooperation and collaboration toward building mutual confidence between regulatory authorities.

Regulatory reform is important for both governments. In Japan, a Three-Year Plan for the Promotion of Regulatory Reform was established in March 2004, replacing an earlier program instituted under the Council for Regulatory Reform (Council). This body was further renewed as the Council for the Promotion of Regulatory Reform, and a new component, a ministerial-level headquarters for regulatory reform, was added. The Council consists of members of the private sector, academia and others. Its role is to consult publicly (including with international partners), debate various policy options and make recommendations to the Cabinet.

Through this Council, the Canadian Embassy in Tokyo, in close consultation with the Canadian Chamber of Commerce in Japan (CCCJ), has made regular annual submissions to the Japanese regulatory reform authorities, not only in areas of particular concern to Canada, such as telecommunications and financial services, and building standards, but also with respect to more cross-cutting structural issues related to the overall investment environment in Japan. The Council was reorganized in January 2007 in order to address critical issues such as the creation of an open and energetic economic society and works in close cooperation with the Headquarters for the Promotion of Regulatory Reform headed by the Prime Minister and made up of the full Cabinet. Then, the Government of Japan laid out a new three-year plan on regulatory reform on June 22,



2007, based on the results of the “Third Report on the Promotion of Regulatory Reform and the Opening Up of Government-driven Markets for Entry into the Private Sector” (published December 25, 2006) and the “First Report on the Promotion of Regulatory Reform” (published May 30, 2007).

Similarly, Japan has made submissions of its requests on regulatory issues to Canada through the Embassy and Consulates General of Japan in Ottawa, Toronto, Calgary, Vancouver and Montreal in close cooperation with its chambers of commerce in these regions. The Toronto Japanese Association of Commerce and Industry (Toronto Shokokai) actively works with the Japanese government in submitting recommendations for regulatory reform to Canada in broad areas of regulations such as taxation and investment issues.

Canada also recognizes the importance of regulatory reform and introduced in 2002 a government-wide initiative known as “Smart Regulation” aimed at improving the Government of Canada’s regulatory system. It strives for a better-coordinated, more transparent system that remains forward-looking and accountable to citizens. One of the key results of this initiative is the Government of Canada’s *Cabinet Directive on Streamlining Regulation*, which came into force on April 1, 2007. The new *Directive*, which replaces the previous *Regulatory Policy*, takes a life-cycle approach to regulating and introduces specific requirements for the development, implementation, evaluation and review of regulations. A number of other projects have been initiated to strengthen the policies, processes and tools needed to sustain high levels of regulatory performance and facilitate continuous improvement.

Regulatory cooperation between Canada and Japan continues to advance through a myriad of bilateral and multilateral avenues. Complementing the annual submissions to the respective regulatory bodies and dialogue that takes place at the JEC, bilateral regulatory cooperation mechanisms and dialogue exist in specific sectors – from forestry to financial services – which aim to promote better understanding of each other’s regulatory environment and to resolve issues where possible. As outlined in Chapter 2, Canada and Japan also work in concert multilaterally and regionally, such as in the APEC forum.

## **Science and Technology**

The 1986 Agreement on Cooperation in Science and Technology forms the foundation of the Canada-Japan science and technology (S&T) relationship. Since the signing of the agreement, collaboration between the Canadian and Japanese governments, as well as between universities and research institutions, has multiplied. These partnerships offer each country the opportunity to achieve more than it could independently, in terms of knowledge creation, innovation capacity and commercialization. The Ninth Joint Committee Meeting pursuant to the Agreement, held on October 12, 2005, noted the impressive array of bilateral cooperative projects being undertaken within and outside the framework of the Agreement with the participation of both the public and private sectors.

Significant complementarities between Canada and Japan in S&T exist in the areas of life sciences, information and communication technologies, earth sciences, environment, space, nanotechnology and renewable energy. A foundation has been laid for the promotion of research collaboration in many of these fields through the work of the Canada-Japan Joint Committee on Science and Technology Cooperation and its Joint Panels on Space Science, Earth Science and Environment, and Brain Science.

There have also been notable achievements in people-to-people exchanges, such as the Co-op Japan Program, in which Canadian undergraduate students in engineering, science and other disciplines pursue internships in Japanese companies. Through partnerships between the Canadian granting councils and the Japan Society for the Promotion of Science (JSPS), Canadian graduate students and postdoctoral researchers can conduct short-term research stays in Japan and receive an introduction to Japanese science policy and infrastructure. S&T personnel exchanges between agencies also allow for collaborative research opportunities, such as a recent exchange between the Japan Aerospace Exploration Agency (JAXA) and the Canadian Space Agency to work on the development of small satellites. Furthermore, Japan's Nanotechnology Research Institute (NRI) has signed an MOU with Canada's new National Institute of Nanotechnology (NINT) under which an NRI expert was seconded to NINT.

In addition, Canada and Japan continue to work together on the Women in Science, Engineering and Technology (WISSET) Exchange Lectureship Program co-administered by the Science Council of Japan and the Royal Society of Canada. The program provides an opportunity for outstanding female researchers from both countries to present lectures to a range of audiences highlighting the role of women in research. Integrating women more effectively into the S&T workforce is an important goal for both Canada and Japan.

In order to advance the commercialization of S&T, the two governments have held research and development (R&D) commercialization workshops, in collaboration with the private sector, to seek ways to cooperate more in this crucial area. In addition, both governments are involved in the promotion of industry-level cooperation between the Kingston Fuel Cell Centre and fuel cell work in the Mie Prefecture of Japan to expand bilateral alliances and potentially lead to increased investment partnerships and commercialization possibilities. There are similar instances of such joint commercialization efforts in the field of biotechnology involving the private sector and facilitated by government. Indeed, in recent years Canada has held a series of science seminars in Tokyo, including a Science/Biotech Week in 2006 that included presentations by experts from both countries on their respective experiences with commercialization of R&D.

### **Investment Enhancement**

The 21st century economy is characterized as one of competitiveness on a world scale, involving more intensive use of international networks of production and global value chains. Investment can clearly be key in both accessing and participating in these networks. Both governments assign importance to investment, in general terms and with

respect to each other specifically. However, as noted in Chapter 3, while the role of investment is becoming increasingly important in the context of the economic relationship between Canada and Japan, the scale of investment between the two countries has yet to realize its full potential.

As such, bilateral investment promotion was identified early on in the development of the Economic Framework as a significant component of this initiative. Recognizing the benefits of enhanced bilateral investment, in May 2005, DFAIT and JETRO signed an MOU on bilateral investment promotion cooperation designed to identify and advance key areas of cooperation in this regard. The MOU aims to lay the foundation for greater information exchange and cooperation in investment promotion activities in key industry sectors. Canada and Japan have since identified information and communications technology, biotechnology and services as areas for initial focus.

The two organizations have undertaken a series of bilateral investment promotion seminars in Toronto, Montreal and Vancouver. These seminars, which attracted more than 400 participants, were designed to help Canadian companies think about growing their markets in Japan and Asia, as well as to raise Japanese companies' awareness of the comparative advantages to be gained by expanding existing operations in Canada. Similarly, a series of sector-specific investment seminars have been organized by the Canadian Embassy and Consulates in Tokyo, Osaka and Nagoya on a variety of sectors including natural resources, agri-food, transportation, and information and communications technology.

With a view to advancing commitments undertaken in the MOU, DFAIT and JETRO are making efforts to develop the program of joint investment events, in particular to tailor such outreach to more closely suit specific investment prospects in the various regions of Canada and Japan. The two organizations are also focusing efforts on examining the road ahead in terms of possible joint initiatives to increase awareness of the respective advantages of establishing investment partnerships in both countries.

In addition to these promotional efforts, investment facilitation is a key factor in increasing bilateral investment. Some results of efforts on this front are represented by recently signed instruments, such as the Social Security Agreement and the Cooperation Agreement on Anticompetitive Activities, which will help create an enabling environment to enhance conditions for the Canadian and Japanese private sectors to invest further in each other's country.

### **Tax Convention**

Canada and Japan concluded their existing tax convention in 1986 and amended it in 1999, in order to address the issues of double taxation and fiscal evasion with respect to taxes on income. Since then, both countries have recognized the importance of a continuing dialogue on tax-related issues and an exchange of views on improving the tax convention so that it responds to current business trends.

## **Air Services**

The efficient flow of people, goods and services between Canada and Japan has a significant impact on the bilateral trade and investment relationship. Canada and Japan have had a long-standing air services agreement in place since 1955 and have worked closely over the years to ensure the efficient operation of this agreement. The most recent consultations, which took place in early 2007, have resulted in a range of improvements, such as the replacement of a complex formula of capacity unit co-efficient to a simplified method of determining capacity entitlements, the removal of prescriptions on the use of certain aircraft types, and the modernization of other aspects of the agreement that benefit both sides. Delegations have decided to meet again in early 2008. Such development is consistent with the main thrust of the Economic Framework, which supports continuing the existing dialogue between Canadian and Japanese aeronautical authorities to support people-to-people, commercial and cultural exchanges between the two countries.

## **Intellectual Property**

As the importance of intellectual property is increasing rapidly, Canada and Japan are discussing possible areas of cooperation in the field of intellectual property, including patent examination. For example, the Japan Patent Office and the Canadian Intellectual Property Office are consulting on (1) establishing mechanisms that allow a patent applicant to obtain a foreign patent expeditiously by providing the foreign patent office with the search and examination results of the domestic patent office (Patent Prosecution Highway), (2) establishing a new legal framework for patent filing and examination that allows a patent applicant to obtain a foreign patent at a low cost by providing the foreign patent office with the search and examination results of the domestic patent office (New Route), and (3) establishing information infrastructures and systems to make patent prosecution history available for patent offices through the Internet. Canada and Japan also work together on intellectual property issues in a number of international forums, including the G8, the Asia-Pacific Economic Cooperation Forum (APEC) and the Organisation for Economic Co-operation and Development (OECD).

## **4.4 Sectoral Initiatives**

Canada and Japan have a long history of positive commercial relations that span the full spectrum of economic activity. In a number of sectors, this has led to the creation of public and private sector mechanisms to improve efficiencies, address issues and develop understanding and cooperation. This section provides a selective overview of sectors where active cooperation, in particular between the governments of Canada and Japan, plays an important role in facilitating trade, investment, and science and technology links between our two countries.

## **Agriculture and Food**

Japan is the largest net importer of agricultural products in the world, while Canada is a leading supplier to Japan of a number of products of key agricultural interest, such as meat, grains, oilseeds and seafood. Moreover, the agriculture and food sector is an area of strong partnership between Canada and Japan that serves the needs of producers and consumers.

The broad partnership has led to collaboration on issues of market access between Agriculture and Agri-Food Canada (AAFC) and the Canadian Food Inspection Agency, together with the Japanese Ministry of Agriculture, Forestry and Fisheries, the Ministry of Health, Labour and Welfare, and the Food Safety Commission. There have been ad hoc discussions on an ongoing basis, both directly and through our respective embassies. As a result of our constructive relationship, a number of trade irritants have been successfully resolved in a mutually beneficial manner, including most notably the progress achieved in 2005 addressing problems associated with access for Canadian and Japanese beef in each other's markets.

Food safety, which has seen tremendous cooperation over the last two years, is one of the priority areas under the Economic Framework. Given the increase in global food trade, new inspection technologies and new risks, there are many challenges that both countries share in this area. Under the terms of the Economic Framework, the two governments determined specifically to cooperate and share experiences to respond to these challenges through enhanced dialogue and a joint work plan between the relevant Canadian and Japanese authorities. This work plan was finalized in July 2006 and builds upon existing cooperation and dialogue that has achieved important results. For example, past food safety seminars in Japan provided a useful means for exchanging information and experiences on ways to communicate risk to the public.

Canola is an area of long-standing close relations between Canada and Japan, given the mutually dependent nature of our markets in this sector. Japan is Canada's largest market for canola, while Canada is the main supplier of Japan's imports of canola and rapeseed. Since 1976, the Canada-Japan Canola Consultations and Pre-consultations have been an important semi-annual event involving government and industry participants. This 30-year history has fostered mutually beneficial consultations, where issues of concern to the Canadian canola industry and the Japanese importing and crushing industry are discussed, and approaches for addressing these concerns are explored.

With respect to the promotion of agriculture and food trade, Canada and Japan have a long history of cooperation in helping to develop mutually beneficial business opportunities. AAFC, the Canadian Trade Commissioner Service and JETRO play an important role in promoting bilateral trade and investment in the agriculture and food sector by building strong networks and partnership opportunities between Canadian and Japanese firms.

In addition, while agricultural scientific cooperation between Canada and Japan at the institutional level remains relatively modest, exchanges between AAFC and the Japanese private sector have been enhanced through a number of joint science and trade initiatives. For instance, AAFC and a major Japanese international trading company signed an MOU under which a collaborative scientific cooperation project is providing value-added to commodities suited for the Japanese market. Furthermore, AAFC and the Canadian Embassy in Tokyo have been working closely over the last few years to build a stronger Canada-Japan relationship in the agri-food sector and position Canada as a serious scientific and commercial partner. To date, this partnership has proven highly successful given the significant commercialization opportunities resulting from investment into Canadian scientific research.

### **Forestry and Building Products**

The relationship between Canada and Japan in forestry dates back to the first shipment of Douglas fir lumber from Canada to Japan in 1903, and the years since have been punctuated by significant events. For instance, after the Great Kanto Earthquake of 1923, large Canadian forest companies shipped lumber to Japan to help with reconstruction. In the early 1960s, as the cost of domestic harvesting rose in Japan, Canada became one of Japan's largest suppliers – a trend that continues today. Then in the late 1960s, during a housing shortage, and at a time when the Japanese government was actively looking for new housing technology, a new era of collaboration in forestry and building products between our governments and private sectors arose.

Collaboration and technical exchanges between our governments and private sectors have continued and contributed to many improvements in housing technology and regulations. One key example is in respect of premium-grade softwood lumber and related building products. In the early stages, the sawmill industry in British Columbia worked with Japanese lumber importers and home-building companies to produce premium-grade softwood for Japan, resulting in the special “J” grade, as it is known today. In 1973, the Canadian Council of Forest Industries committed to an aggressive market development program in Japan with the support of the Canadian federal and provincial governments and industry. Such efforts, combined with the cooperation of the Japanese government, which was seeking to increase housing options for its citizens, led to the formal approval in 1974 of lumber grading standards and a building code for wooden prefabricated two-by-four structures, the construction of which was not previously possible in Japan. In May 2004, Canada-Japan collaboration led to Japan's recognition and acceptance of large-scale four-storey two-by-four wooden structures in previously restricted zones or urban areas. Subsequently, in October 2006, post-and-beam structures also received Japanese ministerial approval, now on par with two-by-four and other fire-resistant structures. In conjunction with the September 2006 Japanese certification of the strength properties of Canada's new kiln-dried hemlock grade (E120-F330), these technical achievements mark an important step in regaining ground in the Japanese lumber market.

More broadly, the Canadian and Japanese governments have established close relations at the officials' level through the formation of a number of regular bilateral

mechanisms (or trilateral with the United States), which are intended to facilitate the exchange of knowledge and address issues of mutual concern. These mechanisms include the Building Experts Committee/Japan Agricultural Standards Technical Committee (BEC/JASTC) Meeting, Canada-Japan Housing Committee (CJHC) and Canada-Japan Housing Research and Development Workshop. The BEC/JASTC is a process launched by Japan with the objective of exchanging views and information, as well as promoting mutual understanding, and involves annual meetings between the Japanese, Canadian and U.S. governments and industry. The CJHC is a biannual policy conference between the Canada Mortgage and Housing Corporation and the Japanese Ministry of Land, Infrastructure and Transport. The Housing R&D Workshop is a science and technology bilateral mechanism that enables Canadian and Japanese researchers to share and exchange recent advances in the area of housing research and technology development.

### **Information and Communications Technologies (ICT)**

Canada and Japan are global leaders at the forefront of innovation in the field of ICT. The two governments place great importance on this sector and recognize the potential to enhance our respective objectives through collaboration, not only at the multilateral level (e.g. International Telecommunications Union), but also bilaterally. In addition, Canada and Japan are actively endeavouring to strengthen cooperation among research centres, universities and the private sector.

The key bilateral forum for cooperation in this area is the Canada-Japan Telecommunications Policy Consultations, which were established in 1984. These consultations provide an opportunity to share perspectives on key policy developments, to exchange a wide range of opinions on appropriate regulatory decisions and cooperation concerning ICT in Canada and Japan, as well as to identify and advance mutual collaboration in research and development. In 2006, Industry Canada, the Japanese Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry signed a joint statement in the field of anti-spam.

Collaboration between various Canadian government departments and JETRO is also ongoing and productive. JETRO has supported Canada's efforts to enhance ICT partnerships by sending information technology (IT) missions to Canada and by providing Canadian IT companies with information and advice about the Japanese market. In April 2003, JETRO and Industry Canada signed an MOU intended to increase levels of data sharing and technical cooperation and to improve electronic access for both Canadian and Japanese firms.

With a view to facilitating business-to-business cooperation in this sector, Industry Canada and DFAIT have worked with JETRO to organize a number of partnering initiatives for ICT companies in Canada, Japan and third countries. For example, partnering initiatives at the Technology Bizmatch at the 2005 Combined Exhibition of Advanced Technologies<sup>13</sup> in Japan, as well as the Technology Bizmatch at the 2006

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<sup>13</sup> The largest international exhibition in Asia for the technology and electronics sectors.

Cellular Telecommunications and Internet Association exhibition in the United States, provided an opportunity for Japanese and Canadian ICT companies to meet with potential partners to explore possible areas of cooperation.

In addition, Canada's Communications Research Centre (CRC) and Japan's National Institute of Information and Communications Technology (NICT) have worked together for a number of years, focusing mainly on wireless optical networking, satellite communications and high-definition video conferencing. Past projects include the first-ever demonstration of telemedicine using high-definition television technology. In October 2003, these two national research centres signed an MOU to further solidify the cooperative relationship, promoting exchange opportunities for Canadian and Japanese researchers as well as an ongoing sharing of information and expertise. The collaboration between CRC and NICT has led to an advancement in innovation and knowledge, and to technologies and applications that have tangible social and economic benefits.

### **Trade in Services**

Trade in services is playing a leading role in the transformation to knowledge-based economies in Canada and Japan, where global electronic networks facilitate the delivery of those services to previously inaccessible markets. Trade in services, significantly, represents the fastest-growing component of bilateral trade, and the two countries continue to work together through the WTO to further enhance the conditions for services trade. In certain areas, such as tourism and financial services, Canada and Japan have developed bilateral cooperation mechanisms that promote dialogue and address mutual areas of concern.

For over two decades, Japanese visitors to Canada have had a significant positive effect on the Canadian tourism industry. More recently, Canadian visitors to Japan have been steadily increasing. The Canadian Tourism Commission and the Japanese Ministry of Land, Infrastructure and Transport continue to cooperate through the Canada-Japan Tourism Conference to identify ways and opportunities to help facilitate increased bilateral tourism flows. Tourism promotion was highlighted as one of the areas of cooperation under the Economic Framework, and both governments have committed to make their best efforts to increase, by 2010, the volume of tourist flows between the two countries to one million (800,000 Japanese tourists to Canada and 200,000 Canadian tourists to Japan).

In the area of financial services, bilateral financial consultations have been a very useful forum for advancing mutual interests on a range of financial services trade and investment-related issues, as well as reinforcing the basis for further cooperation and information sharing on financial sector issues. The Canada-Japan Financial Consultations occur every 18 to 24 months, involving the Ministry of Finance and the Financial Services Agency on the Japanese side, and the Department of Finance, the Office of the Superintendent of Financial Institutions, and the Bank of Canada on the Canadian side. Most recently, in June 2005, Canadian and Japanese authorities met in Ottawa to discuss a range of financial sector policy and international financial



cooperation issues, including Asian economic cooperation, the G7 process, and the WTO Doha Round negotiations regarding financial services.

## **Energy**

Commercial activity between Canadian and Japanese firms in the field of energy has been growing steadily over the past few years. This burgeoning relationship includes a wide variety of energy ties, including with regard to coal, uranium, nuclear energy services, oil sands, petroleum and gas, and alternative energies (e.g. wind, solar and fuel cell technology). Canada has a long-standing record as a reliable supplier of uranium to Japan's electrical utilities. Japanese commercial interests have invested directly in Canadian uranium, oil sands and coal production capacity, with Japan supplying oil sands technology, heavy equipment and pipeline pipe, for example. Given the breadth of this sector, the role of government in the domain of bilateral energy ties to date could be characterized as somewhat limited. With the emergence of energy and energy security issues, consideration should be given to enhancing bilateral relations on energy. On the Canadian side, the federal, provincial and territorial governments have been active in facilitating and promoting investment and trade in energy resources and technologies between Canadian and Japanese firms.

One example where bilateral cooperation is rather developed is in nuclear energy, dating back to an agreement signed in 1959 for cooperation in the peaceful use of atomic energy. Since then, there have been extensive exchanges regarding matters affecting nuclear safety and radiation protection, fuel storage and transportation, as well as technical cooperation on the development of products such as pumping seals for application in nuclear power installations in both Canada and Japan. Cooperation also exists at various levels within the nuclear industry, nuclear power regulatory bodies, utilities and research agencies. Collaboration has even extended to third markets, such as the joint cooperation on the construction of two CANDU<sup>14</sup> reactors in China, in addition to joint efforts to develop an advanced CANDU reactor.

Another example of bilateral cooperation that is starting to develop in this sector is the partnership for onshore natural gas hydrate production research. Japan Oil, Gas and Metals National Corporation (JOGMEC) and Natural Resources Canada (NRCan) have been conducting joint gas hydrate research since the late 1990s. In 1998, the two organizations drilled the first gas hydrate well in the Northwest Territories, Canada, to study the properties of this resource. This was followed by the world's first production test in the same field in 2002 (together with a consortium of international partners), with encouraging results. Currently, JOGMEC and NRCan have negotiated an agreement to conduct a longer-term test of production feasibility in the Mackenzie Delta. The first winter drilling season has been completed and show encouraging results. These tests are an integral part of both countries' strategy to develop the technology for commercial production of natural gas from gas hydrates by 2016.

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<sup>14</sup> CANDU stands for CANada Deuterium Uranium.

## **4.5 Role of the Private Sector and Other Key Stakeholders**

For over a century, and even before the establishment of formal diplomatic relations between Canada and Japan, the Canadian and Japanese private sectors have been at the forefront of building mutually rewarding trade relations. The nature of these interactions has covered the full spectrum of activity, with many groups constituting broad membership across the Canadian and Japanese private sectors, while others remain sector-focused. Regardless of the composition of these business associations, the Canadian and Japanese private sectors have been responsible for creating numerous bilateral trade and investment links and driving innovative initiatives that have contributed significantly to the overall economic relationship. Although the latter half of the 1990s saw the end of some formal business mechanisms, such as the Canada-Japan Business Council, other mechanisms have remained strong, and these have led the push for renewal of the bilateral commercial relationship.

From the very beginning, the Canadian and Japanese private sectors have worked to identify areas in the economic relationship that have been underperforming and to highlight opportunities for greater ambition in furthering the bilateral relationship. Most recently, the Canadian Council of Chief Executives (CCCE)<sup>15</sup> and the Nippon Keidanren<sup>16</sup> were key players in leading efforts to revitalize the bilateral economic relationship and examine options for further enhancing trade and investment between the two countries. While private sector leaders have been the traditional focus of stakeholder consultations undertaken by both governments, non-governmental organizations such as the Canada-Japan Forum have also been important in providing strategic advice and recommendations to both Canada and Japan on ways to enhance the bilateral relationship.

### **Canada-Japan Forum**

Recognizing the challenges facing the bilateral relationship, the Prime Ministers of Canada and Japan established the Canada-Japan Forum in 1991 to serve as a non-governmental “eminent persons” group mandated to develop recommendations for a stronger and more effective bilateral partnership. Forum members are selected to represent the business, media, academic and arts communities from each country and serve the unique objective of ensuring ongoing, high-level input by Canadian and Japanese citizens into the bilateral relationship. The recent co-chairs of the Forum were

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<sup>15</sup> Founded in 1976, the CCCE is devoted to strengthening Canada’s economy and society through the development of sound public policy in Canada, North America and the world. Its member chief executive officers represent all sectors of the Canadian economy. Key members of the CCCE have been constant supporters of the Canada-Japan economic relationship, working closely with government and private sector organizations in Canada and Japan to further promote trade and investment between the two countries.

<sup>16</sup> Nippon Keidanren (Japan Business Federation) is a comprehensive economic organization created in May 2002 by the amalgamation of Keidanren (Japan Federation of Economic Organizations) and Nikkeiren (Japan Federation of Employers’ Associations). In 2005, their membership comprised 1,329 companies, including 130 industrial associations and 47 regional economic organizations. Keidanren, notably through its Committee on Canada, has been active in promoting measures to improve the business environment in both countries by making representations to the governments of both countries.

Don Campbell, Executive Vice-President of CAE Inc. (and former Canadian Ambassador to Japan), and Peter Yoshiyasu Sato, Advisor, Tokyo Electric Power Company (and former Japanese Ambassador to the People's Republic of China).

The Forum produced reports in 1992, 1995, 2000 and 2006. On the economic front, Forum reports have made recommendations on bilateral trade and investment between Canada and Japan, NAFTA's impact on Canada-Japan trade, the value of open bilateral economic cooperation (including the promotion of joint investment and cooperation at APEC), improvement of access to the Japanese market, a potential Canada-Japan free trade agreement, and the establishment of a multilateral trade organization, which was eventually realized in the WTO.

The most recent report, which was presented to the Prime Ministers of Canada and Japan on June 28, 2006, suggested that Canada and Japan should intensify their efforts to deepen the bilateral economic relationship, with emphasis on, *inter alia*, the promotion of trade and investment (including a free trade agreement as the ultimate objective of this Joint Study, addressing challenges of small and medium-sized enterprises), the promotion of tourism, and joint research on environmental and energy issues.

### **CCCE and Nippon Keidanren: A Long History of Cooperation**

The CCCE and Nippon Keidanren have worked together for more than two decades on the Canada-Japan economic relationship and have been central in the development and conclusion of the Economic Framework. Following a meeting between the CCCE and Nippon Keidanren in 2004, both organizations called for strengthened bilateral economic ties and pressed for the creation of a framework agreement between the two governments. This call for action expedited the decision by the two governments to move ahead with plans for a new economic framework that had been under joint consideration. Shortly thereafter, in January 2005, the Canadian and Japanese Prime Ministers launched the development of the Canada-Japan Economic Framework. At their last meeting in Canada, in November 2005, CCCE and Nippon Keidanren business leaders issued a joint statement urging the Canadian and Japanese governments to move swiftly toward a discussion of opportunities to enhance the bilateral relationship (the joint statement is available at [www.ceocouncil.ca](http://www.ceocouncil.ca) or [www.keidanren.or.jp](http://www.keidanren.or.jp)).

### **Canadian Chamber of Commerce in Japan (CCCJ)**

The CCCJ has been working since 1975 to promote the interests of Canadian business in Japan and encourage the development of commerce between the two countries. Its members represent a broad cross-section of business leaders and entrepreneurs from Canada, Japan and other countries. Over the years, the CCCJ and the Embassy of Canada in Tokyo have forged a close working relationship through joint efforts to promote Canadian products in the Japanese market and through the work of the CCCJ's Committee on Trade Policy.

## **Japanese Chambers of Commerce**

The Japanese chambers of commerce in Toronto, Calgary, Vancouver and Montreal have been working to promote friendly relations between Canada and Japan through economic, commercial and industrial activities by members, as well as to develop and maintain good relations with the community at large. In particular, the Toronto Japanese Association of Commerce and Industry (the Toronto Shokokai), which began its activities in 1957, represents many Japanese companies doing business in Canada. The Consulate General of Japan in Toronto has been cooperating closely with the Toronto Shokokai to promote business between Canada and Japan.

## **4.6 Conclusion**

The Economic Framework has galvanized a mutually beneficial history of bilateral cooperation and provided a foundation for re-energizing the relationship. The aim is to give further impetus to the broad array of sectoral and other forms of cooperation that have evolved over the decades of partnership.

Canada and Japan clearly enjoy a rich and prosperous relationship involving a myriad of actors in both the public and private sectors. The existing panoply of multilateral and bilateral policy and private sector mechanisms provides a solid basis upon which to build more vigorous economic relations in the periods ahead. The challenge will be to improve the breadth and variety of mechanisms for collaboration with a higher degree of dynamism, energy and direction so that they play the most effective role possible in generating increased economic activity and prosperity for Canada and Japan. To assess how best to achieve that aim, it is necessary to move beyond an assessment of existing mechanisms – the focus of this chapter – to an analysis of remaining challenges to the further expansion of bilateral trade and investment, which is the focus of the next chapter.

## **Chapter 5**

### **EXAMINATION OF THE EXISTING MEASURES LIMITING THE FULL POTENTIAL OF TRADE AND INVESTMENT**

#### **5.1 Introduction**

Canada and Japan share a long history of mutually beneficial trade and investment. Although this relationship remains healthy and largely problem-free, our ability to fully exploit the potential of the bilateral trade and investment relationship can often be limited by existing measures, as well as informal constraints to trade such as foreign business customs. However, in order to overcome these limitations, it is first necessary to identify and understand them. Drawing from input received from the Canadian and Japanese private sectors during roundtable consultations, held in Tokyo and Toronto in April and June 2006 respectively, as well as other sources, this chapter examines existing measures in both Canada and Japan that are seen to limit the full potential of trade and investment between the two countries.

In order to guide the work of the Joint Study Working Group, Canada and Japan conducted consultations with the private sector, in line with the Japan-Canada Economic Framework. The representatives and experts of various sectors were invited to express their views on existing measures of the two countries that may hinder the full development of potential trade and investment, and any other views that would enhance the existing economic relationship. Based on requests from some of the speakers and to preserve confidentiality, this report will not attribute remarks to specific groups or individuals.

Domestic consultations with the private sector have played a vital role in the development of this Joint Study. The valuable input of the private sector and other key stakeholders in both Canada and Japan also helps ensure that this Joint Study is both comprehensive and meaningful.

The following section is based on the views of the private sector in Canada and Japan and does not necessarily reflect either government's positions.

#### **5.2 Consultations at the Second Session of the Joint Study Working Group (in Tokyo)**

##### **5.2.1 Participation from the Private Sector**

Consultations with the private sector were conducted on April 6 and 7, 2006, on the occasion of the second session of the Japan-Canada Joint Study Working Group, which was held in Tokyo from April 5 to 7, 2006. Two groups from industrial sectors, two

trade/business organizations, one expert on international trade and one expert on food economics and environmental economics participated in these consultations.

## **5.2.2 Views of the Japanese Private Sector**

### **(1) On a Free Trade Agreement (FTA)/Economic Partnership Agreement (EPA)**

#### **(i) Group A**

This group recommended that the governments and private sector continue to discuss the possibility of the establishment of an FTA or EPA for the time being while urging that the Joint Study also consider, as matters of high priority, issues such as an investment agreement (including the liberalization of trade in services), dialogue on regulatory reform, the mutual recognition of standards and the promotion of other cooperative issues. This group stated that consideration should be given to Japan's sensitive products, such as agriculture, forestry and fisheries products, and called for multi-level efforts to create a foundation for free economic activity through comprehensive EPAs with countries and regions important to Japan, although concern was expressed about Canadian FTAs and negotiations that could lower the competitiveness of Japanese exports to Canada. The group also pointed to Article XXIV of the General Agreement on Tariffs and Trade (GATT), stipulating that the parties to an FTA or EPA must ensure trade liberalization by eliminating tariffs with respect to "substantially all the trade." It further explained that tariff elimination or reduction should be considered in conjunction with the progress in the WTO Doha Development Agenda negotiations.

The group also explained that if there was a change in *status quo* of the international environment surrounding Japan and Canada, such as Canada signing FTAs with other countries, thus reducing the competitiveness of Japanese goods exported to Canada, an FTA or EPA would be, on the whole, greatly advantageous for both Japan and Canada. In such a case, it was recommended that the two sides should begin consultations on an FTA or EPA. Particular concern was, in fact, expressed that the Japanese business community must keep in mind the progress of ongoing negotiations between Canada and other countries as they pursue FTAs or EPAs, with strong concern noted especially over the progress on a Canada-South Korea EPA/FTA.

#### **(ii) Group B**

Another group mentioned that Japan is by far a net exporter of industrial goods and the world's largest net importer of agricultural products. It explained that in such a situation, EPAs would not benefit each sector in an equal manner and that Japan should not pursue trade expansion in industrial sectors at the expense of its agricultural sector. The group also stressed the importance of domestic agricultural production in terms of food security and maintenance of the multifunctionality of agriculture, which they felt serves to prevent floods, to secure water resources and to maintain landscapes and food safety, estimating the impact to be 8 trillion yen per year. The group indicated that EPAs should include necessary exceptional measures for sensitive products in each country. It further pointed out the large gap in agricultural production conditions between Japan and Canada and that the negative impacts of tariff elimination would be unbearably large to Japan. The group concluded that a negotiation with Canada, which would include tariff

elimination on agricultural, forestry and fisheries products would be impossible, especially when these products made up 57% of total imports from Canada in 2004, a significant amount of which are products sensitive to Japan. Such an agreement could not be qualified as an FTA (under Article XXIV of the GATT, which defines free trade agreements as covering “substantially all the trade”) if these products were excluded. This group mentioned that Canada was a major exporter of agricultural products sensitive to Japanese agriculture and contended that tariff elimination for these products would have negative effects on ongoing domestic agricultural policy reforms. It also explained that liberalization exclusively with Canada would create imbalances with other exporting countries, which may arouse serious opposition from countries not having similar preferential arrangements with Japan.

### **(iii) Group C**

The third group shared the results of their survey conducted with Japanese companies operating in Canada on their expectations regarding an FTA. Asked to rank the most beneficial future FTA and cite the expected benefits, 103 companies expressed their wish for a Japan-Canada FTA, and 68 companies among 103 ranked it as the most beneficial. Seventy-nine companies explained that an FTA would improve market access, and 29 companies replied that it would improve the business environment, such as through amendments of laws related to labour and other areas. In this context, this group summarized that there was a high expectation for a Japan-Canada FTA among the Japanese companies in Canada.

### **(iv) A Canadian Group**

A Canadian group identified the conclusion of a Canada-Japan FTA as one of its top three priorities, the others being the Social Security Agreement and the Tax Treaty. The group argued that consumers in the two countries would benefit greatly through lower prices, better services, more choices and better use of tax money. An FTA would promote entrepreneurship, innovation and job creation among small and mid-sized companies. The group felt that an FTA would open markets to new goods and services, promote competition (e.g. by reducing costs through tariff savings), promote innovation and increase flows of people between the two countries. It would also help bring about increased transparency in public procurement and bidding practices, along with better pricing of services such as banking and insurance products. The group also emphasized Canada as an FTA partner, including Canada’s dynamic markets in labour and capital, its very efficient and strong economy, and a politically stable environment backed by a well-developed financial system.

### **(v) Japanese Expert A**

An economist suggested that, while in the past the WTO played a central role in liberalizing world trade, the WTO function to harmonize world trade rules has come to its limit, and in the future this role would shift to bilateral or regional FTAs where countries share common interests and have a mutual understanding of the nature of liberalization between them. Concerning agricultural products, he indicated that in many cases it is difficult to show Japanese farmers the merits of liberalization because they usually do not have a comparative advantage. He concluded that, in those cases, the feasibility of an FTA would depend on whether it would be possible to exclude those

sensitive products from tariff elimination. He raised a number of such examples from the world's existing FTAs.<sup>17</sup> He suggested that rice, wheat and barley, dairy products, sugar and pork are some of Japan's important and sensitive items, and these import restrictions were mostly changed to Tariff Quota items in the GATT Round, and he explained that the elimination of tariffs on those products through FTAs with the U.S., Australia and New Zealand would surely result in the destruction of Japanese agriculture. Finally, he stressed the importance of the role of agriculture and small-scale farming in rural areas, explaining the concept of multifunctionality of agriculture. He also addressed the importance of understanding Japan's efforts to reform its agriculture as well as the anxiety of Japanese people, who depend on foreign countries for 60% of their food.

#### **(vi) Japanese Expert B**

Another economist argued the importance and significance of East Asian economic integration, describing it as an immediate "economic need" due to Japan's long-term commitment to the region and the existence of international production and distribution networks. He further stated his views by introducing the fragmentation theory, which enables cost reduction in production blocks and low-cost service links that connect production blocks. Based on this theory, he explained the present political and geopolitical situation surrounding Japan and Asia. He expressed his concern about whether Japan can be comfortable under a China-dominated East Asia. He also stressed that although East Asian economic integration makes sense, it was too early to think of an "East Asian community" in the European sense. But he explained that there was a possible development of plurilateral FTAs among industrialized countries in Asia Pacific that would counterbalance China. Finally, he raised the question as to whether an "Economic Framework" without an FTA could be attractive enough in this era of regionalism, while also arguing that trade protection on agriculture was the only major obstacle for Japanese economic diplomacy.<sup>18</sup> He concluded that to have a certain degree of freedom in economic diplomacy in Asia Pacific, policy reform in the agricultural sector was urgently needed from Japan.

### **(2) On Tariff Elimination and Reduction**

#### **(i) Group A**

Regarding actual bilateral tariff elimination and reduction, this group explained that the Japanese companies' responses to the questionnaire revealed that tariff items and rates impeded business operations. The group listed major Canadian tariffs, such as those on automobiles and trucks (6.1%), wheels for railway rolling stock (9.5%), photographic film for exposure in cinematographic cameras (6.5%) and electrical insulators of ceramics (3.0%). On the Japanese side, tariffs on spruce-pine-fir products (4.8%), oriented strand board (6.0%) and beef (38.5%) were mentioned.

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<sup>17</sup> This economist gave the following examples of exemptions of tariff lines: (1) NAFTA with Canada and Mexico on dairy products, sugar, etc. Canada had 78 items, and Mexico had 87 items exempted. (2) In the EU-Mexico FTA, the EU postponed negotiation on beef, pork, etc., and Mexico postponed on rice, wheat, pork, chicken, etc. (3) Korea-Chile postponed negotiation on beef, chicken, mandarin, etc.

<sup>18</sup> This economist explained that major Japanese imports from Canada are agricultural, forestry and fishery products. He further explained that although the proportion is high, the number of sensitive items is limited.



**(ii) Group C**

The third group introduced the interviews it conducted with Japanese companies in Canada on tariffs. It revealed that Japanese companies felt Canadian tariffs on automobiles were high 6.1%.

**(3) On Regulatory Issues**

**(i) Group C**

This group conducted interviews with Japanese companies in Canada regarding potential Canadian regulatory issues. It revealed five areas of concern. First were the visa issuance procedures. It said that issuance delays occurred with highly skilled workers that they believed to be valuable to Canada. Second was the area of mutual recognition of safety standards. The companies urged the necessity for a simpler recognition process to facilitate business. Third was the protection of intellectual property. The group pointed out that counterfeits and pirated copies of Japanese goods were easily accessible and sold in some shopping malls, though no specific example was provided. Fourth was the area of tax investigations and application procedures. The group suggested that accelerated, simpler and more accurate procedures were needed, explaining that in some cases transfer pricing investigation could take up to five years. Fifth was an appeal for better coordination between the federal and provincial governments of Canada. One example given was a case that was repealed by the federal government after being approved by a provincial government.

**(ii) Group A**

This group explained that improving the business environment and promoting regulatory reform in both countries should be priority areas. The questionnaire conducted by this group revealed that 46.7% of respondents requested regulatory reforms, focusing primarily on the need to eliminate requirements in Canadian corporate law regarding the nationality of executive officers and the avoidance of double taxation between Japan and Canada. The group claimed that resolving these issues would benefit Japan's business community as a whole and would also spur investment in Canada.

This group also identified the liberalization of investment and trade in services as a major priority. This was especially focused on regulations governing foreign investment in financial and insurance services.

The group further requested the establishment of a framework for mutual domestic regulatory reform to develop the business environment, drawing inspiration from other regulatory reform dialogues among industrialized countries.

The group suggested that the Finance Ministers of both countries establish a framework for regular dialogue on tax reform with a view to implementing rapid and practical tax reform measures. It also suggested that they should begin without delay and work toward the conclusion of such an agreement.

The group also listed the following areas of regulatory reform to improve Canada's business environment:

- i) Harmonization of federal and provincial regulations and elimination of trade and investment regulations that the group viewed as unnecessary. The group stated that the duplication of regulations by both federal and provincial levels created complication in applying permits and licences. In some cases, provincial regulations were stricter than the federal ones.
- ii) Liberalization of investment-stage operations and facilitation of business operations to ensure continuity:  
Priority should be on removing requirements in corporate law regarding the nationality of executive officers and liberalizing insurance services. The group further claimed that an investment agreement with Canada should ensure that corporate laws be changed to eliminate nationality requirements, following the example of such clauses in Japan's investment agreements with other countries. They stressed that the abolition of nationality requirements was one of the most important regulatory reform issues for the business community and called for swift resolution on this issue.
- iii) Harmonization of standards and certification, and facilitation of the movement of natural persons:  
It was recommended that the two countries study the harmonization of standards and recognition of professional licences (such as engineering licences). It also stressed the importance of visa issuance procedures being simplified and made more efficient, as well as having the visa validity periods extended.
- iv) Investment promotion and measures to reduce the cost of doing business:  
The group addressed the importance of tax reforms to promoting investment and reducing business operating costs, including the elimination of capital tax and elimination of duplication whereby unemployment insurance premiums must be paid in both countries.

#### **(4) Specific Areas for Cooperation**

One group suggested that the conclusion of a Japan-Canada investment agreement would effectively and efficiently spur regulatory reforms in Canada and the liberalization of Canada's trade and services. The agreement should be comprehensive and advanced, fitting the two countries' developed status. The group stressed the importance of ensuring that the Canadian federal and provincial governments grant most-favoured-nation treatment and national treatment, and stressed that they should prohibit the application of performance requirements, obligating the maintenance of current investment conditions and protecting investment assets.

Besides these areas, the group also introduced the responses of the questionnaires on the following areas of interest:

#### ***Energy and natural resources***

The group introduced the need for better infrastructure to promote more trade in natural resources with Japan and other Asian countries by constructing a large crude oil export terminal on Canada's west coast, constructing a pipeline to supply the terminal, and

supporting investment to promote further development of the oil sands and subsidiary industries.

### ***Tourism promotion***

It requested enhancing advertising campaigns to promote tourism and cooperation in developing tourism-related products and also suggested campaigns to attract tourists to Vancouver for the 2010 Winter Olympics.

### ***Investment***

Seminars sponsored by JETRO and International Trade Canada were appreciated. It suggested that this type of activity be continued and expanded.

### ***Transportation***

It claimed that rail freight fares were high in Canada because of the monopoly of local transport. This should be overcome to boost the transportation of energy and other resources.

### ***Information technology***

Recognizing that Canada's electronics industry was highly developed, some companies expressed their hope to absorb know-how and to secure human resources in Canada. For these purposes, the group suggested periodic technical exchange sessions, training of promising engineers and promotion of personnel exchanges.

### ***Food safety***

A large part of Japan's imports from Canada is food-related products, and there was a request for cooperation with Canada to ensure food safety. In one example, a respondent mentioned the need to collaborate on issues involving residual pesticides and mould poisons in wheat.

## **(5) Others**

### **(i) Group B**

A group emphasized the specific features and multifunctionality of agriculture in Japan and its decreasing domestic production, causing a decline in its self-sufficiency ratio of food (40%) and a high amount of food imports. The group suggested that, instead of pursuing an FTA that includes tariff elimination in agricultural products, Japan and Canada should rather pursue ways to enhance their economic relations through an exchange of views on agricultural matters, the maintenance of favourable and stable trade relations in agricultural products, and the negotiation of agreements for a stable supply of natural resources and the promotion of investments.

### **ii) Group C**

Another group introduced the problems Japanese companies face on infrastructure. It introduced concerns by Japanese affiliates that the Port of Vancouver was reaching its capacity limit (short of port workers and space at bulk terminals), resulting in extra stays at the port. It also introduced concerns by the Japanese affiliates that there was an unstable supply of electricity, causing "brownouts," which forces factories to stop machines and affects product quality. This group also explained its role to increase

investment between Japan and Canada in both directions. For this purpose, the group spoke of the various seminars and workshops they organized in Japan and Canada. It also explained that it had arranged a number of missions from Canada's automobile parts industry to Japan, as well as dispatching Japanese missions to Canada.

### **iii) A Canadian Group in Japan**

The group expressed appreciation for the signing of the Social Security Agreement between Canada and Japan, a measure they had strongly advocated over the last decade. It took the opportunity to urge for the swift implementation of the Agreement, which would lead to easier staff transfers and increased investment for years to come.

With respect to the tax treaty, the group explained that the renegotiation of the existing bilateral tax treaty was needed. A renewed and improved agreement, the group argued, would provide greater certainty to taxpayers and avoid discriminatory taxation. It explained that the costs of existing taxation measures were mostly concentrated in royalties, dividends and interest payments that were subject to withholding taxes of 5%-15%.

## **5.3 Consultations Held in Canada**

In Canada, in order to ensure that this study adequately reflects the views and priorities of the private sector, the Government of Canada undertook a domestic consultations process designed to solicit diverse opinions and views from Canadian stakeholders, as well as provincial and territorial governments. This included a notice in the *Canada Gazette* (the "official newspaper" of the Government of Canada), letters sent by the Minister of International Trade to key stakeholders, and an article in *CanadExport* (the official trade newsletter of the Department of Foreign Affairs and International Trade).

To complement this process, Canada and Japan also undertook a second set of joint consultations, similar to those held in Tokyo in April 2006, in Toronto from June 5-6 with key stakeholders on the margins of the third session of the Canada-Japan Joint Study Working Group.<sup>19</sup> These consultations proved useful in continuing to inform both governments of the challenges faced by the business community and options for dealing with them. Comments received both through the *Gazette* process and through the public consultations are detailed below.

### **5.3.1 Summary of Trade and Investment Barriers and Other Issues in Japan**

Canadian stakeholders generally see Japan as an important trade and investment partner, and while the commercial relationship is largely problem-free, there is a strong view that the relationship is underperforming. Stakeholders have welcomed the Joint Study process as a key opportunity to explore ways of re-energizing the relationship, but have clearly stressed the need for substantial outcomes and not more dialogue or processes. In order to move forward toward increased economic cooperation, many stakeholders

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<sup>19</sup> The Joint Study Working Group meetings were then held in Ottawa on June 8, 2006.

recommended that the joint study lead to the negotiation of a high-quality FTA that provides guaranteed market access, as well as provisions for dispute settlement in a fair and transparent manner. Some argued for models of economic integration that would go even beyond an FTA, with one stakeholder calling for a comprehensive Japan-Canada Economic Integration and Partnership Agreement (EIPA) that would include most, if not all, aspects of Japan-Canada economic activity. This approach would include all of the traditional elements of a comprehensive FTA, but also incorporate additional elements to reflect new global realities. Adopting a forward-looking vision of deeper economic integration by means of an EIPA, it was argued, could include a dialogue on capital markets and exchange rates, greater cooperation on energy matters and climate change, improvements to the tax convention, as well as the promotion of institutional cooperation in areas including intellectual property rights, security and trade matters, standards and certification, and possibly information technology security. Another stakeholder, who also called for an ambitious trade and investment agreement including trade liberalization, noted that Canada and Japan are, among major world economies, two countries that stand to lose the most from missed opportunities to bolster the international trading system, be it multilaterally or bilaterally.

In terms of specific barriers, stakeholders raised a number of tariff and tariff-related issues, services and investment restrictions, and non-tariff barriers that could potentially be addressed effectively in an FTA (or economic partnership agreement). Such an approach would also mitigate concerns of Canadian business about the potential negative effects of Japan's preferential agreements with other countries. There was recognition of various sensitivities in both Canada and Japan in this regard, but some stakeholders were of the view that only a small portion of total trade is truly sensitive and that these concerns could be overcome - either by a better understanding of the nature of the market or through provisions in a prospective agreement.

In addition to the prospect of an FTA, many stakeholders saw value in increasing promotional efforts between the two countries to facilitate greater awareness about the significant opportunities in each country. Moreover, updating the current air services and tax treaties was seen as a key priority.

### ***Tariffs and Related Issues***

Tariffs are one of the traditional trade policy tools used to restrict or limit trade in particular products for a variety of reasons. Generally, Japanese tariffs on industrial goods are low, though some concerns have been expressed in areas such as the forestry sector. High tariffs in Japan do exist in the agricultural sector and can be, in some cases, prohibitive to market participation. In 2004, Japan's overall average applied most-favoured-nation (MFN) tariff was 6.3%; for agricultural products it averaged 16.1%, compared with 3.8% for non-agricultural products. In addition to the tariffs themselves, some concerns have also been raised in respect of related issues, such as escalating tariffs for value-added products, tariff parity, tariff rate quotas and subsidies. A number of these issues are outlined below.

While the Japanese tariff on beef is not prohibitive per se, Canadian beef exporters have indicated that they face a number of tariff and related barriers in Japan that restrict their market access. Canadian beef exports currently face an applied tariff of 38.5% (though the WTO bound rate is 50%). Japan also maintains an emergency tariff measure, allowing the tariff to return to the bound rate of 50% in the event that beef imports exceed a certain level (i.e. when quarterly imports increase by more than 17%). According to Canadian industry, this is particularly problematic at a time when Japan has partially lifted its ban on Canadian beef products (closed in 2003 due to the detection of BSE in Canada) and Canadian beef imports would be merely returning to previous levels of trade (prior to the ban, Canada had traditionally been Japan's third largest supplier of beef).

Similar concerns have been raised by Canadian pork exporters regarding the emergency tariff measure on pork. Japan is the world's largest importer of pork, and Canada has been increasingly filling the demand. However, Canadian pork exporters commented on the emergency tariff measure on pork, which snapbacks the gate price to the bound level whenever total imports in a given quarter are 19% higher than the previous three-year average from the start of the Japanese fiscal year to the end of quarter, raising the minimum import price by approximately 25%. As currently administered, this measure creates considerable market fluctuations for Canadian suppliers.

Canadian stakeholders have expressed concern that Japan's import tariff regime on processed vegetable oil products (e.g. canola/rapeseed and soybean) restricts Canadian exports of these products to Japan. Japan's tariffs on imported cooking oils are applied on a specific rate basis (i.e. yen per tonne) and the rate for canola and soybean oil (10.9 yen/kg) is higher than for other similar vegetable oils (e.g. corn oil at 5 yen/kg and sunflower oil at 8.5 yen/kg).

The Canadian cereal grain industry has expressed concern regarding the restrictiveness of Japanese tariff quotas on wheat and barley. Although the in-quota duties are free, Japan maintains extremely high over-quota tariffs for wheat and barley at 55yen/kg and 39yen/kg, respectively (WTO bound). Wheat flour is also subject to high tariff quota rates, with an in-quota tariff of 25% and an over-quota tariff of 90yen/kg. Stakeholder concerns were also raised regarding restrictive tariff rate quotas facing Canadian pulses and special crops (e.g. peas, beans), as well as on the tariffs for processed products.

Canadian stakeholders have expressed concern regarding other agricultural products facing high tariffs, including refined sugar, wherein Japan has the highest refined sugar tariff protection in the world. Food products that contain sugar are also subject to high tariffs, in the range of 20%-30%. In some cases, specific tariffs apply, raising similar concerns as with vegetable oil products.

Japan has liberalized its fish and seafood import regime over the years. Although Japan's average tariff rate on fishery products is low (4%), Canadian stakeholders noted the higher rates on a few key products including salted herring roe (8.4%), frozen scallops (10%) and sea urchins (7%), and the import quota on scallops.

Canadian stakeholders have expressed concern regarding tariffs on spruce-pine-fir (SPF) lumber and panel products. Japan's system of tariff classification distinguishes between the species and dimensions of lumber irrespective of end use. Therefore, Canadian SPF lumber imports are subject to a duty of 4.8%, whereas other species imported for the same purpose enter duty-free. The 6% tariff on softwood plywood and oriented strand board is also considered to significantly limit Canadian exports.

Tariff escalation and tariff parity issues have also been common concerns. Tariff escalation is the practice of charging lower tariffs on unprocessed goods and high tariffs on their semi-processed or processed end products. For example, while Japan has a 0% tariff on import of unprocessed mustard seed, the tariff rates for mustard flour range from 7.5% to 9%. Another example is on value-added beef products, where the tariff increases at the bound level of 50%, which has a prohibitive effect. In addition, concern has been raised across a number of different products, including oils and wood products, concerning the disparity between tariffs applied to like products within the group. For example, canola and soybean oils face tariffs of 10.9 yen/kg for crude oil and 13.2 yen/kg for refined oil, while other oils enjoy lower or, in some cases, no tariffs.

In the shipbuilding sector, although the shipbuilding industries of Canada and Japan are quite different, in terms of both size and the types of vessels manufactured, the Canadian industry is concerned that trade liberalization in this sector and the removal of the 25% Canadian tariff would likely have a detrimental impact on the industry. The industry representative indicated that they were not opposed, in principle, to trade liberalization with Japan, but highlighted the need to have in place a domestic transformative policy before tariffs are eliminated. The industry noted that over the past 20 years, the Canadian shipbuilding industry has been under increasing pressure in the face of highly subsidized international competition.

Tariff issues also go both ways in the context of Canada's consultations. A Japanese group in Canada pointed out that Canada is committed to reducing custom tariffs as part of its APEC action program. Areas of special concern are automobiles and trucks, wheels for railway rolling stock, photographic films for exposure in cinematography, and electrical insulators of ceramics.

### ***Aerospace and Defence Industry***

Canada has significant defence and aerospace sector capabilities in both peacekeeping and conventional defence, and stakeholders are keen to enhance industrial cooperation with Japan. Canadian industry stakeholders identified two issues that they believe require attention: the need for Canada to address restrictions on the export of Canadian automatic firearms to Japan; and the need for a mechanism to facilitate the issuance of industrial security clearances.

Also, Canadian industry stakeholders highlighted private business practices that they feel limit their participation in the Japanese market, such as buyer-seller networks and the requirement to show prior experience in Japan.

### ***Tax Convention***

Various stakeholders urged Canada and Japan to update their current agreement on the avoidance of double taxation (Double Taxation Agreement DTA). The purpose of the DTA is to prevent double taxation and to provide a level of certainty about the tax rules that will apply to particular cross-border transactions. Ensuring relief from double taxation is desirable because of the negative effects double taxation can have on the expansion of trade and the movement of capital and labour between countries. Canada and Japan agreed in 1999 to a protocol amending the 1986 Canada-Japan DTA. However, the Canadian and Japanese business communities have expressed the need to renegotiate the existing DTA to take into account more recent DTAs negotiated between major trading partners, as well as the need to reflect current trade and investment trends. A Japanese group in Canada emphasized the amendment of the Japan-Canada tax treaty so that the Canadian subsidiaries of Japanese firms can be exempted, as are U.S. corporations.

### ***Investment***

In terms of foreign direct investment (FDI), Japan remains the largest recipient of Canadian direct investment in Asia. The number of Canadian companies investing in Japan continues to increase at a modest rate, with few reports of formal barriers preventing investment. However, key Canadian investors, including the aerospace industry, have flagged some barriers related to investment in Japan, including restrictive processes for making regulations and the lack of transparency in the area of industry standards development and product certifications. Other barriers experienced by Canadian companies investing in Japan are informal, tending to be related to issues such as language and culture, as well as differences in business practices. Many Canadian stakeholders also noted, in particular, the potential value of greater promotional efforts about the valuable investment opportunities in both countries. Some Japanese firms based in Canada noted that lowering the residency requirements for corporate directors in Canada, as well as eliminating the duplicate employment insurance payments, would be beneficial, especially for smaller companies.

### ***Services***

Trade in services between Canada and Japan has been growing rapidly over the past few years. In part, this reflects the fact that there are few formal barriers restricting trade in services in Japan. In general, Canadian service suppliers indicate that they enjoy a high level of access to the Japanese services market. Nevertheless, improvements could be made in certain areas that would promote trade in services between our two countries. With respect to the cross-border supply of professional services such as legal, accounting and engineering services, Japan often maintains commercial presence requirements and Mode 4 (movement of natural persons) restrictions in the General Agreement on Trade in Services. Canadian service suppliers have also identified an interest in promoting greater transparency with respect to domestic regulations in Japan related to licensing requirements and procedures, qualifications requirements, and



standards. In the financial services sector, a few issues have been raised, including the strict firewall provisions that prohibit the efficient use of shared infrastructure, as well as the new Corporation Act (Law No. 86), which appears to prohibit the activity of Japanese branches of foreign companies that are incorporated offshore.

Canadian stakeholders also highlighted the key role played by air services in promoting the bilateral trade relationship between Canada and Japan. They have expressed an interest in strengthening the air services relationship through regular bilateral channels.

### ***Regulatory Environment, Transparency and Other Issues***

Technical regulations, industrial standards, and sanitary and phyto-sanitary (SPS) requirements play an important role in facilitating the trade in goods and protecting public health and safety and animal and plant health, but they vary from country to country and may impose unnecessary restrictions on trade. Just as tariffs can have a limiting effect on trade, non-tariff barriers can be just as effective in restricting trade. For example, having too many different standards complicates business transactions for producers and exporters. Lack of access in a timely fashion to changes in laws and regulations can also be problematic.

On the agricultural side, concerns have been expressed that Japanese SPS measures should be more transparent and be based on internationally accepted standards. A key example relates to the beef sector and the BSE-related Japanese import ban on certain Canadian beef products. While noting the actions taken to date in Japan in this regard, stakeholders expressed concern that Japan is still applying a more restrictive SPS barrier against Canadian beef than permitted under the internationally agreed standard established by the World Organization for Animal Health (OIE). Other interests have also been expressed in cooperating on regulations so as to facilitate trade, such as in organic products. In addition, some Canadian stakeholders also raised concerns about subsidies in the Japanese agricultural sector as a barrier to trade. For example, Japanese government subsidies in the form of taxes on imports are believed to subsidize wheat production in Japan, leading to a distorting effect on trade.

On the industrial side, many raised issues related to the forestry and building products sector. Over the years, Canada and Japan have developed mechanisms with a view to dealing with many regulatory and standards issues in an efficient manner. However, there are still some outstanding measures that are limiting trade in this sector. Of particular importance is the Building Standards Law (BSL). Some stakeholders indicated that test methods, criteria and related restrictions do not fully recognize internationally accepted practices.

Several members of the Canadian automobile sector expressed concerns about the closed nature of the Japanese market to Canadian-made vehicles, given that, among major OECD auto-producing nations, Japan had an import penetration rate of 4.7%, compared to the OECD average of 48.2%. Vehicles and related parts represent the largest sector of two-way trade between Canada and Japan annually. However, the trade in automotive products is overwhelmingly one-way, with Japan enjoying a \$5.5 billion

surplus in automotive products in 2005. Despite duty-free access for automobiles and efforts to increase market share, Canadian stakeholders indicated that Canadian automobiles and parts remain largely shut out of the Japanese market. Given the unbalanced nature of trade in automotive products, Canadian vehicle manufacturers are of the view that any policy option (e.g. FTA) needs to put in place mechanisms that can help ensure that the trade imbalance is eliminated on a permanent basis. Some other members of the Canadian automotive sector were of the view that multilateral trade liberalization was the preferred approach since bilateral agreements can create imbalance among members. There were also some concerns about a perceived lack of common standards that complicates the certification process.

In the building products sector, there are concerns over how standards are developed and the lack of transparency and consultations in the standards-setting process. Regulatory and transparency issues are not limited to trade in goods. Concerns have also been expressed in relation to services and investment, as noted above.

In addition to the various sectoral and technical issues (e.g. tariffs and regulations) raised by many stakeholders, it was also mentioned by some stakeholders that there are non-formal barriers that act to hinder the relationship. Broadly speaking, there can sometimes be a perception of “friendly indifference” that can act as an invisible barrier. Some observed that despite a good level of cultural exchanges between Canada and Japan, business interest does not always appear to follow. From a government perspective, it was noted that there was a need to raise the level of political interaction (e.g. in the form of increased ministerial visits). In that vein, it was also suggested that an FTA would send a strong signal that each country is “open for business.” Language and cultural differences were also highlighted as key challenges for both Canadian and Japanese firms.

A Japanese group in Canada pointed out that Canada is alone amongst its G7 contemporaries in its residency requirements, as stipulated in the Canada Business Corporation Act. They also expressed concerns over the visa issuance process for skilled workers and tourism-related workers and asked for clarification of the policies on granting visas. With regard to the Social Security Agreement, the group appreciated that the duplicated pension contribution was solved, but further requested exemption from the requirement to participate in the payment of employment insurance premiums. Also, they asked for a review of Liquor Control Board of Ontario policies to reduce complexity and increase clarity and flexibility, to smooth the flow of liquor.

### ***Japan’s FTAs/EPAs with Other Countries***

Free trade agreements (FTAs) are trade policy instruments that aim to liberalize and remove barriers in trade and investment between member trading partners. However, they may also have the effect of diverting trade away from other countries that are not party to the FTA. In recent years, Japan has been engaging in an increasing number of FTAs that could negatively affect and limit trade with Canada. A range of issues have been expressed by stakeholders in this regard and include, for example, concern about the potential impacts of Japan’s EPAs in sectors such as beef, pork, seafood and wheat,

among others. Japan's conclusion of EPAs with countries other than Canada will lead to a destabilizing effect on bilateral trade, as trade diverts to countries granted preferential access under an FTA.

## Chapter 6

# ANALYSIS OF THE IMPLICATIONS OF FURTHER PROMOTION AND LIBERALIZATION OF BILATERAL TRADE AND INVESTMENT

### 6.1 Overview

The previous chapters examined past and current trends of Canada-Japan economic relations from bilateral, regional and multilateral perspectives. This chapter examines the benefits and costs of the further promotion of bilateral trade and investment, including economic modelling on the potential impact of trade and investment liberalization. Key to this chapter are the views and comments received from the private sectors of the two countries. The representatives of the business communities suggested that, though both countries have favourable relations, some existing measures hinder the full potential of trade and investment, and requested that the governments address these measures to further invigorate bilateral economic relations. Based on these consultations, as well as the analysis of previous chapters and the economic modelling, this chapter also indicates possible policy options both countries should consider for enhancing their future bilateral economic relations.

### 6.2 Economic Analysis of Trade Liberalization between Canada and Japan

This section examines the economic impacts of the further promotion of trade and investment between Canada and Japan to provide a comprehensive assessment of trade liberalization and facilitation, drawing on a range of quantitative economic models.<sup>20</sup>

The economic modeling analysis suggests the following: (1) elimination of all tariffs between Canada and Japan would benefit both countries in terms of income and production, (2) the impacts of liberalization would vary across sectors in terms of increases and decreases, and (3) preferential trade liberalization between Canada and Japan may have adverse trade diversion effects on the economies of third countries, such as the United States, while trade between Canada and Japan would increase.

While these results generally conform with expectations, given the opportunities for gains to be made through liberalized trade between Canada and Japan, caution is required with regard to the interpretation of specific estimates generated in this simulation.

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<sup>20</sup> It should be noted that economic models are a simplification of reality and rely on various assumptions. Therefore, modelling results should be used only to infer the probable effect of bilateral trade liberalization between Canada and Japan and the magnitude and direction of such impacts.

First, the scope of the modelling exercise is restricted to the elimination of tariffs on goods. Yet, modern FTAs also contain other provisions such as on trade in services, investment, customs cooperation and other areas of cooperation as well as trade facilitation, that address non-tariff barriers to trade that would yield benefits for business. These various measures can work to expand bilateral commerce in various ways. For example, complementarities between investment and services liberalization in the context of an FTA and goods trade can lead to a stronger response of goods trade to an agreement than tariff considerations alone would indicate. However, these types of provisions are not captured by the economic modelling analysis.

Second, computable general equilibrium (CGE) models may underestimate expansion of two-way trade in differentiated products and firm-level export gains even in sectors in which a country experiences net import gains, as these models do not capture certain types of gains that come from the expansion of the range of products traded as a response to trade liberalization, as well as new trade and business enthusiasm spurred by the announcement of an FTA. Furthermore, the greater certainty about market access by setting disciplines on non-tariff barriers to trade in goods and services, investment, the movement of business persons and others would reduce the perceived risk and encourage investment and trade. An FTA would also have the effect of encouraging firms to deepen the bilateral economic relationship to take advantage of the greater potential derived from the agreement.

Third, the results can be quite sensitive to the model's structure, level of aggregation of sectors and regions, omitted factors, estimates of key parameters, and the assumptions implicit in the design of the simulation. There are a number of important caveats that should be borne in mind when considering the results reported in this study. For example, the level of aggregation for some of the data used in the model combines products that would not be expected to undergo similar economic adjustments from trade liberalization, which may result in either understatements or overstatements of the sectoral trade impacts. As well, the 2001 base year of the model does not account for the rapid changes in global trade patterns and tariffs in recent years, such as China's accession to the WTO, so the estimates may not be consistent with actual protection levels subject to elimination by a Canada-Japan agreement. Another concern is that the model does not account for the high degree of integration in North American commodity markets, which prevents significant differences in pricing between Canadian and U.S.-produced commodities. As such, any gains to the terms of trade will generate a production response from North America, rather than just Canada, which will tend to overstate the production impacts in Canada while understating the positive impacts in the United States.

Taking these various considerations into account, the macroeconomic impacts reported below should be considered as broadly indicative of the potential for significant economic benefits for both Canada and Japan. However, the composition of those gains should be treated more cautiously since they are subject to greater uncertainty. At the same time, the sectoral impacts reported below must similarly be interpreted with considerable caution, as regards both the structure of sectoral impacts and the sources of sectoral gains in terms of volume versus prices.

## 6.2.1 The Impacts of Merchandise Trade Liberalization

This subsection provides a quantitative economic analysis of the impacts of merchandise trade liberalization between Canada and Japan. It is assumed that the two countries would remove trade barriers in a preferential manner once and for all.

Following the conventional approach of estimating the impacts of trade liberalization, a CGE model of global trade is employed. CGE models are designed to assess the effects of policy change on the equilibrium structure of the economy, detailing the changes in resource allocation, production and trade across sectors, and the resulting overall impacts on national economic welfare and output.

The particular CGE model used for the simulations in this study is the Global Trade Analysis Project (GTAP) model, version 6. While this model is primarily designed to assess the static effects on resource allocation, certain dynamic aspects are incorporated: (a) a dynamic capital formation mechanism and (b) productivity improvement effects. The database for this model corresponds to the global economy in 2001.

### 6.2.1(a) Macroeconomic Impacts

Trade liberalization stimulates trade by lowering the prices of tradable goods. Exporting sectors gain increased access to the market of trading partners, while domestic consumers gain access to lower-priced imported goods. As production in a liberalizing country adjusts in line with its comparative advantage, domestic production resources, land, capital, labour, and intermediate inputs, are used more efficiently. These combined effects, one from access to foreign markets and the other from adjustment in the domestic market, are expected to result in an overall expansion of production and an increase in economic welfare. In addition to these “static” efficiency gains, economic benefits would be expanded dynamically through increased incentives for capital formation and productivity improvements stimulated by the increased competition generated by trade liberalization.

The simulation outcomes on the macroeconomic impact of trade liberalization between Canada and Japan are shown in Table 6.1.

**Table 6.1: Macroeconomic Effects**

|                      |                         | Japan | Canada |
|----------------------|-------------------------|-------|--------|
| Real GDP             | (%)                     | 0.17  | 0.32   |
| GDP Deflator         | (%)                     | -0.17 | 0.76   |
| Utility              | (%)                     | 0.17  | 0.59   |
| Equivalent Variation | (millions U.S. dollars) | 6,176 | 3,809  |
| Exports              | (%)                     | 0.42  | 0.43   |
| Exports to Canada    | (%)                     | 18.22 | -      |
| Exports to Japan     | (%)                     | -     | 120.40 |
| Imports              | (%)                     | 0.56  | 1.00   |
| Trade Balance        | (millions U.S. dollars) | -583  | 353    |

Both Canada and Japan would obtain benefits in terms of gains in income and production. These gains are significantly larger for Canada in percentage terms compared with those for Japan: Canada's GDP expands by 0.32% in real terms compared with 0.17% for Japan. The difference in size of impact is mainly a reflection of the relative sizes of the two economies: Japan's GDP in the reference year was approximately five times larger than that of Canada. In addition, Japan's share in Canada's two-way trade, which is around 3%, is higher than that of Canada's share in Japan's two-way trade, which is around 1.5%.

Japanese macroeconomic gains measured in terms of change in utility, a key indicator of welfare improvements in a CGE model analysis that may be understood as a proxy for real consumption, would amount to 0.17%. Canada's gains in terms of increased utility would be proportionately greater: Canadian utility would increase by 0.59%. However, because Japan's economy is larger than that of Canada, in terms of absolute changes, Japanese gains would be larger than those in Canada. Looking at welfare improvements, measured by changes in equivalent variation, which is defined as the lump sum payment to households required in the pre-FTA scenario to leave them as well off as in the post-FTA scenario, Japan's economic benefits would amount to almost US\$6.2 billion (in 2001 dollars) compared with Canada's US\$3.8 billion. Moreover, breaking down the welfare gains, measured in terms of changes in the equivalent variation, indicates that the impact of trade liberalization by Japan would be significantly larger than that by Canada for both the Canadian and the Japanese economies. Japan's gains would come primarily from more efficient resource allocation. In contrast, Canada's gains would be derived to a greater extent from improvements in its terms of trade.

Japanese export volume is estimated to increase by 0.42% and import volume by 0.56%. Meanwhile, bilateral trade would be significantly boosted. Japanese exports to Canada would expand by 18.2%. However, largely because of the deterioration in terms of trade, the Japanese trade balance would decline. Canadian export and import volumes are estimated to increase by 0.43% and 1.00% respectively. These rates of change are similar to those in Japan. One notable difference is that exports to Japan are estimated to expand by 120.4%. In addition, the Canadian trade balance would increase.

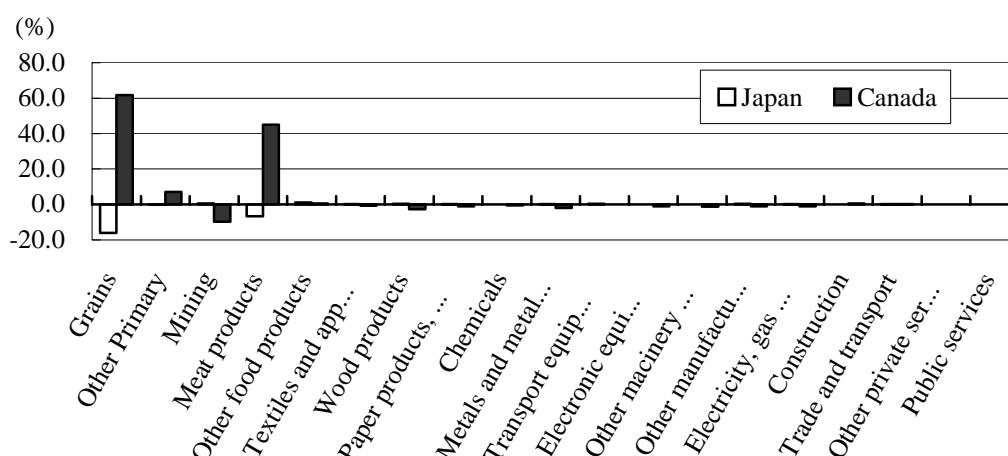
### **6.2.1(b) Impacts by Sector**

As noted above, the impact of bilateral trade liberalization at the sectoral level is largely determined by trade structures and protection levels prior to trade liberalization. The higher the initial tariffs, the larger the impact on trade flows and the greater the adjustment of production across sectors, in line with the comparative advantage of the trading partners.

In the context of liberalization of both agricultural and industrial goods trade, the CGE model estimates that Japanese exports would increase in most manufacturing sectors, led by the increase of those exports to Canada due to the removal of trade protection. On the other hand, Canadian exports would increase in grains and meat products due to import liberalization by Japan. Changes in the production structures in both countries

would correspond to the trade impacts. In Japan, production in the manufacturing and services sectors would increase, but that of grains and meat products would decrease. In Canada, production in the agricultural and food sectors would increase, but that of most manufacturing sectors would decrease, although to a lesser extent. The changes in sectoral production in Canada and Japan in the simulation depicting full liberalization of agricultural and industrial goods trade are shown in Chart 6.1.

**Chart 6.1 Impacts on Sectoral production**



Source: Author's simulation using the GTAP model

It is likely that the production impacts in the grains and meat products sectors are overstated due to a combination of aggregation bias, failure to take account of producer price supports in Japan's agricultural sectors that would not be part of a bilateral negotiation, and the limitations on price increases for Canadian producers due to the integrated nature of North American commodity markets.<sup>21</sup> To the extent that the impact on agriculture is overstated, the results concerning production in the other sectors of the economy would also be moderated as the realignment of productive resources, such as labour and capital, would not be as extensive.

In general, the changes to be expected in sectoral trade and production will vary according to the models employed and, more importantly, the simplifying assumptions on which they are predicated. However, one can infer the probable effects of bilateral trade liberalization between Canada and Japan, and the direction, if not the magnitude, of the model simulations above are broadly in line with the expectations guided by the comparative advantages of the countries.

### 6.2.1(c) Impacts on Third Country Economies

The bilateral trade liberalization between Canada and Japan would also have an impact on third country economies. Assisted by the more efficient resource allocation resulting from bilateral trade liberalization, Japanese exports are expected to increase to both

<sup>21</sup> For example, a simulation of the model where rice is disaggregated from the rest of grains suggests growth of Canadian grain production to be about 7% compared with over 60%. Similarly, a much smaller impact for meats could be expected for Canada.



Canada and the rest of the world. Improvement in the terms of trade is expected to increase Canadian exports to Japan; however, Canadian exports to the rest of the world would decline as some trade is diverted to Japanese markets (see Table 6.2).

Similarly, both Canada and Japan are expected to increase their imports from each other. The expected growth in Canada from trade liberalization will contribute to increasing imports from the rest of the world as well. In the case of Japan, imports from the rest of the world are expected to decline as some trade is diverted to Canadian suppliers.

**Table 6.2: Changes in Japanese and Canadian Trade Flows**

| <b>Change in Japanese Trade Flows (2001 US\$ millions)</b> |        |                   |       |
|--|--------|-------------------|-------|
|  | Canada | Rest of the World | Total |
| Exports  | 1,701  | 158               | 1,859 |
| Imports  | 10,416 | -7,963            | 2,453 |
| <b>Change in Canadian Trade Flows (2001 US\$ millions)</b> |        |                   |       |
|  | Japan  | Rest of the World | Total |
| Exports  | 9,947  | -7,195            | 2,752 |
| Imports  | 1,754  | 646               | 2,400 |

### 6.2.2 Dynamic Adjustment Path

The GTAP model used to evaluate the impacts of merchandise trade liberalization between Canada and Japan does not explicitly take into account the adjustment path between the pre-FTA economic equilibrium and the post-FTA equilibrium. It is conventionally assumed in the model that the post-liberalization equilibrium will be achieved in approximate 10-15 years following liberalization.

To study the adjustment paths of the Canadian and Japanese economies to trade liberalization, a “fully” dynamic model developed by Canada’s Department of Foreign Affairs and International Trade (DFAIT) has been used. In this model, savings and investment behaviour by households and firms responds to the changes in economic incentives induced by trade liberalization. The model directly incorporates time as the savings and investment responses are derived by an inter-temporal decision-making process which assumes that economic agents are rational and take into consideration both past and future variables in making savings and investment decisions.<sup>22</sup>

The dynamic model used in the context of the Canada-Japan Joint Study uses the GTAP 6 database and has been aggregated to provide maximum sectoral consistency with the sectoral aggregation scheme in Section 6.2.1. However, due to the computational complexities encountered in dynamic models, the regional aggregation consists of four regions: Canada, Japan, the United States, and the rest of the world.

The model results indicate that 80% of the adjustment takes place within the first 20 years following liberalization. The precise adjustment path will depend on the type of economic indicator and the circumstances particular to individual countries.

<sup>22</sup> For a description of the DFAIT CGE dynamic model, see E. Papadaki, M. Mérette, Y. Lan, and J. Hernández, “The International Trade Canada Trade Model, Version 2.0,” *Trade Policy Research* 2005.

### **6.2.2(a) Canada's Adjustment Path**

Trade liberalization is expected to increase household income. As households adjust their consumption spending accordingly, 40% of the total increase in Canadian real consumer spending is expected to occur in the first 10 years post-liberalization. By the end of the second 10-year period, 80% of the long-term adjustment will have been completed.

Similarly, responding to the expectation of increased economic growth, firms respond to trade liberalization by increasing investment. Indeed, in the initial 10-year period, investment overshoots its longer-run equilibrium response, leading to a rapid adjustment of the overall capital stock to the new long equilibrium.

Canadian imports adjust faster than exports; in fact, imports overshoot their longer-run equilibrium in the first period. Imports changes depend on changes in aggregate domestic demand. As Canadian households expect an increase in their real income following an FTA, they increase consumption, and in particular, consumption of imported goods, immediately through inter-temporal substitution. Although there is an increased demand for Canadian exports, and in particular exports of Canadian agricultural goods, extra capital needs to be allocated in this sector. However, capital requires time to be built, which explains the slower adjustment in Canada's exports. Consequently, about 40% of the increase in Canada's total exports will occur in the first 10-year period.

Reflecting the pattern of change in domestic demand and trade, Canadian output adjusts gradually, with approximately 40% of the gains registered in the first 10-year period post-liberalization and 80% by the end of the second 10-year period.

### **6.2.2(b) Japan's Adjustment Path**

Japan's economy would adjust faster to its long-term equilibrium than Canada's, according to the model simulations; this reflects in good measure the fact that there is less overall structural adjustment in Japan's larger economy than in Canada's relatively smaller economy in response to a bilateral trade agreement. In Canada, the increase in output involves a significant reallocation of resources across productive sectors (mostly to the benefit of the agricultural sector). This is not the case in Japan, which explains why 95% of the output gains are achieved within the first 10-year period, post-liberalization.

In terms of real consumer spending, more than 70% of the rise in real consumption in Japan takes place in the first 10 years. Real investment in Japan adjusts more slowly, rising by 40% within the first 10-year period. In the subsequent periods investment will adjust gradually following the pattern of capital stock accumulation.

Japan's exports adjust to their new long-term equilibrium in the first 10-year period. The same is true for imports, which also complete their adjustment in the first period.

## **6.3 Policy Options**

### **6.3.1 Cross/Multi-Sectoral Approach: For a Better Business, Trade and Investment Environment**

Canada and Japan enjoy a firm and favourable economic relationship, which was confirmed by the private sectors of both countries. However, additional action can further contribute to the promotion of the bilateral relationship. Options in this regard are divided into cross-sectoral and individual approaches. The cross-sectoral approach focuses on specific issues that tend to impact on a wide range of sectors, while the individual approaches focus on specific issues in sectors or areas. Both approaches will have positive impacts on both economies and deepen bilateral cooperation.

#### **6.3.1.1 Potential Canada-Japan Free Trade Agreement**

While the multilateral trading system, embodied in the WTO, remains the foundation of Canadian and Japanese trade policies, both countries recognize that the reduction of trade and investment barriers with appropriate partners bilaterally and regionally can create beneficial commercial opportunities for the respective partners. By ensuring that bilateral and regional trade agreements are consistent with WTO rules and, where possible, go beyond the WTO, such initiatives can also help support and advance the multilateral trading system. As such, Canada and Japan have concluded a number of bilateral and regional agreements with other trading partners, and have a number of new initiatives under way.

As noted earlier in the Joint Study, regional and bilateral trade agreements are designed to reflect the interests and priorities of participating members and to maximize mutual benefit through more open and liberalized trade and investment. FTAs and EPAs, as well as other measures such as regulatory cooperation, are intended to respond to particular needs to harmonize, facilitate or regulate commercial transactions that arise naturally between countries and companies. In many areas, such as trade in goods, investment and competition policy, Canada and Japan share common views on best practices in the negotiation of high-quality agreements and cooperation, while understanding that each country has certain sensitive sectors.

Consultations were conducted pursuant to this Joint Study with the Canadian and Japanese private sectors, as outlined in Chapter 5. There was a call for strengthening a framework for investment, reducing tariffs in a number of areas, and addressing other types of impediments such as non-tariff barriers or the movement of business persons. At the same time, some concerns were raised on both sides (e.g. the potential impact on Japan's agricultural, forestry and fisheries sectors, as well as on the automotive and shipbuilding sectors in Canada).

The modelling in this chapter explores the possible benefits and costs of an FTA between Canada and Japan through the lens of economic modelling, and its results

support the suggestion that a Canada-Japan FTA could yield economic benefits for both countries as a whole. However, economic modelling cannot provide a definitive measurement of the effects of trade policy reform, as it has limitations (e.g. there are various factors that cannot be measured in the market). Still, it serves as a useful indicator. The modelling shows benefits in terms of gains in income and production, with GDP expanding by 0.32% for Canada compared with 0.17% for Japan. Japan's economic benefits would amount to almost US\$6.2 billion, compared with Canada's US\$3.8 billion. Japan's total exports of goods would increase by about US\$2.4 billion and Canada's total exports of goods would increase by about US\$2.7 billion (both figures in 2001 dollars). Japanese exports would increase in most manufacturing sectors, and Canadian exports would increase in grains and meat, in addition to wood products, textiles and apparel, and certain machinery and equipment.

The positive qualitative and quantitative assessment of the modelling above, coupled with the long history of cooperation between Canada and Japan, suggests potential value in a bilateral free trade initiative. While agreement could not be reached at this time, due to Japan's concerns on possible impacts on its agriculture, forestry and fisheries sectors (related to the fact that these sectors account for such a large part of Japan's imports from Canada), Canada and Japan decided to revisit the possibility of an FTA to follow up the Joint Study report, through appropriate channels such as the next Joint Economic Committee (JEC).

### **6.3.1.2 Regulatory Reform Dialogue**

Regulations can influence trade and other commercial activities in a number of ways. Addressing regulatory issues and making efforts to solve them with a cross-sectoral approach will contribute to the promotion of bilateral trade. The Canada-Japan Economic Framework document identifies regulatory cooperation as a key area in Section 5. One of the measures to address this issue is to initiate a regulatory dialogue, to advance regulatory cooperation between both countries, along with the Economic Framework and the JEC.

The need for establishing such a framework between Canada and Japan was expressed from both Canadian and Japanese sides at the hearings of the private sector. In addition, the importance of improving the business environment and promoting regulatory reforms in both countries was also stressed. Some of the issues identified for improvement are visa issuance, mutual recognition, intellectual property, removal of regulatory barriers in the trade of goods, and regulations governing investment in services.

Canada and Japan share the view that improving regulatory issues will contribute to strengthening economic relations between the two countries. Though Canada and Japan have submitted their regulatory requests to each other through several channels, there are no functional frameworks to pursue these issues effectively. Establishment of a framework for dialogue will be helpful to stakeholders in both countries in order to bring out every potential of both economies. Therefore, a regulatory dialogue is a suitable starting point, with a view to identifying priority sectors for additional

cooperation and possibly establishing a more formalized mechanism for addressing these issues in the future.

Such a framework should be designed carefully to be results-oriented, and issues should be determined in a timely way, considering effectiveness and efficiency and reflecting the status of the economic relations between the two countries. The framework for dialogue should include the following components: (1) areas and issues to be addressed will be coordinated carefully in advance with a view to promoting trade and investment between the two countries, responding to the needs of the private sectors, (2) the framework will not intervene with or duplicate areas and issues discussed in the existing forums, and (3) regulatory cooperation will receive elevated prominence within the existing JEC structure, such as through an annual agenda item. Officials will present recommendations as to the framework for consideration at the next JEC.

### **6.3.1.3 Investment**

The economic relationship between Canada and Japan has been progressing steadily and favourably so far. As developed nations, both countries have stable economies and mature political systems and both take pride in the high quality of their labour forces and their advanced technology. Japan's location in Asia and Canada's closeness to the United States, combined with their attractiveness as safe investment destinations, have allowed each country to become a foothold in the Asian and North American markets respectively. In addition, the emerging BRICs economies will expose Canada and Japan to increased international competition, potentially affecting both the Canadian and Japanese economies. It is therefore important to enhance cooperation on trade and investment between Canada and Japan.

As global supply chains have become a necessity for companies to thrive in today's business world, investment has also become a part of trade, and it is important that we facilitate existing investments in order to enable Canadian and Japanese companies alike to take full advantage of the complementary strengths offered by both countries. As such, Canada and Japan should cooperate on initiatives that assist in facilitating investment. An existing example of such cooperation is the new Social Security Agreement; in terms of new work, the negotiation of an updated taxation agreement would be beneficial.

Both countries' private sectors are interested in strengthening the promotion of investment relations between Canada and Japan. One way to invigorate investment is through various promotional measures, such as seminars targeting key industry sectors in both countries. In May 2005, the Japan External Trade Organization (JETRO) and the Department of Foreign Affairs and International Trade (DFAIT) signed an MOU on bilateral investment promotion cooperation designed to identify and advance key areas of cooperation. The two organizations have undertaken a series of bilateral investment promotion seminars to enhance mutual understanding of the business environment. This kind of positive activity should be continued and extended in both countries. Increasing the scope of promotion will lead to the expansion of investment opportunities. The continuation of promotional activities by these and other organizations in both countries

will serve to increase the awareness of capabilities and complementarities that exist in both countries, leading to new investments, which will in turn create new business opportunities for companies both in Canada and in Japan.

#### **6.3.1.4 Updating the Tax Treaty**

The current Canada-Japan double taxation agreement (“tax treaty”) was signed in 1986. While an amending protocol was signed in 1999, it was very limited in scope. As a result, the current tax treaty does not respond to a number of concerns consistently voiced by the Canadian and Japanese business communities.

Over the past few years, the finance departments of Canada and Japan have held several informal discussions, seeking to identify the areas of the tax treaty that could be improved to reflect current business trends. In light of this exchange, a number of worthwhile changes have been identified that could be made to the existing Canada-Japan tax treaty, including: reducing, and in certain instances exempting from withholding taxes, certain cross-border payments; exempting from source taxation gains on shares of corporations resident in the other country to further promote cross-border investment; including a limitation of benefits provision to deter treaty-shopping; adopting the revised OECD provision on exchange of information that deals with banking secrecy; and including specific provisions to reduce double tax with respect to pension and trust income. Such amendments would be consistent with Canada’s and Japan’s current tax treaty policies and, more importantly, would further eliminate tax barriers to trade and investment between the two countries.

Against this backdrop, the negotiation of an updated and improved tax treaty would provide the governments of Canada and Japan with the opportunity to address concerns with the current tax treaty as expressed by the Canadian and Japanese business community. An improved tax treaty would, therefore, yield clear benefits for Canadian and Japanese business groups by further facilitating trade and investment between the two countries.

Finance Ministers at their bilateral meeting on April 4, 2007, in Tokyo agreed that officials from both sides will work together to bridge the few remaining differences, having substantive discussions following the signature of the new Protocol to the Canada-U.S. Tax Convention, with a view to initiating formal negotiations on the revision of the treaty once such differences have been reasonably narrowed.

#### **6.3.1.5 Asia-Pacific Gateways**

Success in international commerce is driven by the timely and efficient movement of goods and people in global supply chains. It requires new approaches from governments and it means giving businesses the tools to adapt. Initiatives related to national gateways are being developed in Canada and Japan to promote economic growth and strengthen ties with trading partners. Canada’s billion-dollar Asia-Pacific Gateway and Corridor Initiative aligns the multibillion-dollar investments by the provinces and private sector to enhance transportation logistics between Asia Pacific and North America through

significant increases in the capacity, reliability and efficiency of Canada's ports, railways, roads and airports. Japan is advocating the Asian Gateway Initiative and aims to play a key role in connecting Asia and the rest of the world in terms of the flow of people, goods, capital, information and culture. Japan's Initiative presents a comprehensive strategy for ensuring Japan's stable economic and social growth and encompasses wide-ranging issues. While maintaining focus on trade and commerce, Japan's Initiative attaches much importance to other areas such as restructuring policies for international students, promoting Japan's creative industries and publicizing its attractiveness overseas. The two gateway initiative concepts are different but related and do coincide in a timely manner. There is considerable scope for sharing information and for cooperation as both countries seek to become improved gateways to their respective regions.

### **6.3.2 Individual Approach: Cooperative Issues**

Chapter 4 described recent developments in bilateral cooperation, including the priority areas of the Canada-Japan Economic Framework. This section contains a number of these areas and others.

#### **6.3.2.1 Food Safety**

The relationship between the Canadian Food Inspection Agency (CFIA) and Japanese regulatory agencies has strengthened over the last several years. On complex and sensitive issues, the relationship is one of mutual trust, collaboration and transparency.

The CFIA and Health Canada and Japan's food safety authorities finalized an informal document in July 2006 for cooperation on food safety issues. The cooperation focuses on three areas: risk communications, risk assessment and international cooperation. Under the responsibility of the CFIA, Health Canada and the Food Safety Commission of Japan, initial cooperation in these areas will be carried forward in line with the content of the framework document. It would be constructive for authorities in both countries, as mutually decided, to coordinate cooperation between the Canadian and Japanese relevant authorities, which would enhance professional contacts at all levels and enhance the exchange of information.

The initial step of cooperation on food safety will be a touchstone for next steps. It is envisioned that the scope of the cooperation may be extended to include the areas of risk management, laboratory cooperation in the field of food safety, as contemplated by the existing food safety cooperation document, and further to include animal health and plant health. Given the increase in international trade in food, animals and plant products, as well as new inspection technologies and risks, such initiatives would foster better communication and understanding between Canadian and Japanese authorities and help minimize the potential impacts of regulatory differences.

#### **6.3.2.2 Energy Cooperation**

Given the convergence of the global energy situation and environmental concerns, cooperation on energy between Canada and Japan has evolved over the past decade. As such, promoting the development of energy technologies and diversification of energy sources has become a theme of strategic importance to Canada and Japan, with commensurate emphasis on expanding cooperation and commercial alliances across a range of traditional and non-traditional energy forms.

Japan has long-standing investment in oil sands partnerships in Canada, and Japanese companies have expressed interest in expanding information sharing with Canada on associated oil sands infrastructure, including technical exchanges. With a view to promoting diversification of energy resources and markets, it is important for Canada and Japan to encourage and support collaboration in this area.

Canada and Japan are among the global leaders in the area of hydrogen fuel cell development, including stationary, micro and automotive/mobile applications. Furthermore, there are a number of Canadian firms actively engaged in fuel cell activity in Japan. Both countries already cooperated under the framework of the International Partnership for the Hydrogen Economy (IPHE) by coordinating and implementing the research, development and demonstration of hydrogen fuel cell technology. As both countries will benefit from information sharing and increased collaboration, which will facilitate efficiency in research and development programs, international partnerships should be continued and enhanced.

Novel energy sources such as gas hydrates represent another area for bilateral cooperation. A new proposed \$40-\$50 million extended production test at the Mallik gas hydrate site in the Mackenzie Delta in Canada would represent a significant advance in determining the commercial potential of gas hydrates and would verify appropriate technologies for production.

Other significant areas regarded as holding long-term cooperation potential between Canada and Japan, albeit at preliminary development levels, include coal (clean coal, liquified coal), CO<sub>2</sub> capture and storage, uranium as a source of nuclear generation which greatly contributes to greenhouse reduction, and renewable energy sources (e.g. bio-ethanol). Partnership in energy cooperation will greatly contribute to energy efficiency, clean energy and diversification of energy resources, and it could lead to further facilitating trade and investment between the two countries.

In this regard, Canada and Japan welcome the energy dialogue, which was agreed at the meeting in May 2007 between the Parliamentary Secretary for Economy, Trade and Industry of Japan and the Minister of Natural Resources Canada. Both governments will hold such dialogues to address various areas of cooperation in the energy sector.

### **6.3.2.3 Cooperation on Science and Technology**

The Agreement on Cooperation in Science and Technology (S&T) of 1986 (Canada-Japan Science and Technology Cooperation Agreement) allows for complementary and effective cooperation between relevant government agencies as



well as our scientific researchers and institutions. In addition, the 2005 Economic Framework reflects new realities and outlines strategic actions for expanding the scope of cooperation and moving the level of collaboration to the realm of applied and commercialized S&T.

With a view to achieving a better balance and wider spectrum of knowledge sharing, both Canada and Japan should continue to actively develop initiatives through the framework of the Joint Committee under the Canada-Japan Science and Technology Cooperation Agreement aimed at expanding the scope of collaboration, such as increased exchanges, fostering programs that support women in science, as well as considering methods for an even more effective use of the Joint Panels, including possibilities for their increase and/or enhancement.

Canada and Japan each place a high value on innovation and the importance of deepening industry-academia-government collaboration. Both countries would benefit from the identification of joint initiatives that will help facilitate the global commercialization of their research, such as public-private partnerships, cluster-to-cluster linkages, joint research networks, or other endeavours that both sides agree could offer mutual benefit.

With a view to a more strategic engagement focused on R&D and commercialization, Canada and Japan should discuss the respective strengths and weaknesses of each country's science and technology sectors and the complementary areas that ought to drive further collaboration through the framework of the Joint Committee under the Canada-Japan Science and Technology Cooperation Agreement.

To ensure an increase in our capacity for innovation and continued economic growth, it is important that the necessary resources be allocated in support of the aforementioned actions.

#### **6.3.2.4 Air Services**

The last consultations on air services were held in January 2007 and resulted in expanded rights for both sides, including additional capacity to be offered between the two countries and increased operational flexibility for carriers. This included the introduction of a simplified allocation system based on flight frequency rather than aircraft type, up to a 450-seat limit, additional capacity to be offered between the two countries, excluding Tokyo airports, the removal of city-pair frequency limitations for code sharing on third-country carriers and an increase in "beyond" points for these code-sharing flights.

Some of the new rights confirmed in the recent consultations have been put into actual application by carriers of both countries working in partnership, notably code-sharing rights at points in the United States and at "beyond" points in Asia.

However, bilateral relations on air services could benefit from further improvements to meet continued market developments between the two countries. The Japanese Civil

Aviation Bureau of the Ministry of Land, Infrastructure and Transport and the Canadian civil aviation authorities have decided to meet in spring 2008. The launch of another round of talks to facilitate air services between the two countries would allow both trading partners to address the issues relating to promotion of trade in goods and services and investment between the two countries.

### **6.3.2.5 Intellectual Property**

#### **Intellectual Property Rights**

As intellectual property has become borderless in the global economy, it is our task to find global solutions to help protect and enforce intellectual property rights (IPR) so that economies all over the world can transact under the same conditions. This will provide legal stability, transparency and fair ground, which eventually facilitate fair trade and distribution of goods. Intellectual property rights, such as patents, trademarks and copyrights, contribute to the development and progress of society. Therefore, it is important to provide the proper environment that helps foster creation and innovation protected through intellectual property rights in the future, while protecting and utilizing outcomes of past creative activities.

In these circumstances, Canada and Japan can cooperate in two aspects of IPR. One is to prevent proliferation of counterfeit and pirated goods, and the other is to reinforce the protection of IPR, particularly by improving patent examination systems. These actions are essential and necessary to encourage emerging industries, which will help to develop our nations based on engineering and technology.

Japan has been advocating the creation of an international legal framework on preventing proliferation of counterfeits and pirated goods. Canada and other interested parties have engaged in a constructive dialogue since last year on this issue. Canada and Japan both agree on the importance of continuing to cooperate bilaterally as well as multilaterally on the fight against counterfeiting and piracy.

#### **Patent Cooperation**

Canada and Japan recognize the global increase in patent application filings. Both countries' patent offices have been discussing this issue and other important topics such as streamlining patent processing and ensuring the high quality of granted patents. The Canadian Intellectual Property Office (CIPO) and the Japan Patent Office (JPO) should continue discussion on this and other patent-related issues, especially the Patent Prosecution Highway.

### **6.3.2.6 Mutual Recognition Agreement on Telecommunications Equipment**

Technical barriers to trade, such as standards, are often cited by business communities in both countries as warranting attention by the respective governments. Concluding a mutual recognition agreement (MRA) will facilitate market access and trade in goods, by reducing costs and the number of organizations related to conformity assessment

processes. Any country has its own technical regulation for network protection, electromagnetic interference and other purposes, and certificates and marks are issued to the products that conform to the technical regulation. An MRA stipulates conditions under which the results of conformity assessment done in an exporting country will be accepted by the importing country.

As economic globalization progresses, implementing mutual recognition is increasingly important for promoting trade and facilitating a borderless business environment. With the rapid development in information technologies, there is an increased demand from industries for MRAs in this area. Responding to these voices, Canada and Japan have respectively concluded MRAs for telecommunications equipment with other countries and regions.

In the case of Canada and Japan, at the private sector consultations of both countries, mutual recognition on the results of conformity assessment for telecommunications equipment was pointed out as a potential option to strengthen the bilateral economic relationship. Canada and Japan are advanced countries in the area of information and communications technologies; thus their markets have high potential to become more attractive to each other as a result of MRA. Considering the characteristics of each economy, and based on experiences with other countries, a bilateral MRA in telecommunications equipment would help boost trade between Canada and Japan.

## Chapter 7

### SUMMARY OF FINDINGS

In January 2005, the Prime Ministers of Canada and Japan determined that the two countries would conduct a Joint Study with the following aims:

- a. to examine the benefits and costs of further promotion of trade and investment, as well as other cooperative issues between the two countries;
- b. to identify and describe the current status of the bilateral economic relationship, including the identification of areas for further development;
- c. to consider the possibility of pursuing various cooperative bilateral trade and economic initiatives to re-energize the relationship; and
- d. to give appropriate consideration to the interests of the private sector.

The following are the major findings from the Joint Study.

**Chapter 2** examined Canada-Japan economic relations in the context of bilateral, regional and multilateral initiatives. While both countries are firmly committed to multilateral and regional efforts to promote open and secure trade, such as through the World Trade Organization or the Asia-Pacific Economic Cooperation forum, the important role that strong bilateral relationships can play in promoting the principles of free trade and in facilitating closer cooperation in multilateral and plurilateral settings was also endorsed.

**Chapter 3** reported the past and present trends in the bilateral economic relationship. Canada and Japan have long been important economic partners, with significant levels of two-way trade in goods and services, flows of direct and portfolio investment, flows of technology and ideas, and movement of people. Yet, for some time, the overall commercial relationship has underperformed. As Japan's economic recovery is now strengthening, while Canada is seeking new opportunities to increase its prosperity by strengthening international linkages, the overall economic relationship between Canada and Japan is in a position to move forward more strongly than it has in the recent past.

**Chapter 4** provided a summary of areas of current collaboration, such as the Joint Economic Committee, early results under the Canada-Japan Economic Framework, and private sector initiatives. Canada and Japan clearly enjoy a rich and prosperous relationship involving a myriad of actors in both the public and private sectors. The existing array of multilateral and bilateral policy and private sector mechanisms provides a solid basis upon which to build more vigorous economic relations in the periods ahead.

**Chapter 5** examined the existing measures limiting the full potential of trade and investment, drawing from input received from the Canadian and Japanese private

sectors. Canada and Japan to date have promoted liberalization measures of various kinds, though there remain various challenges that affect trade and investment relations between the two countries in a number of sectors. In addition to suggestions on specific areas for cooperation, comments were provided on the potential of an FTA/EPA and enhanced regulatory environments.

**Chapter 6** examined the benefits and costs of the further promotion of bilateral trade and investment, including economic modelling on the potential impact of trade and investment liberalization, as well as other cooperative issues between the two countries.

Based on the private sector consultations and analysis of previous chapters, there are a number of initiatives that both countries will pursue for enhancing future bilateral economic relations. The initiatives that Canada and Japan have advanced are generally classified into the following categories: (1) multi-sectoral initiatives and (2) sector-specific initiatives.

#### (1) Multi-Sectoral Initiatives

The initiation of a dialogue on regulatory reform to address regulatory barriers, which may influence trade and other commercial activities, will facilitate economic relations between the two countries. Cooperation between Canada and Japan on their respective Asia-Pacific Gateway initiatives will strengthen ties with trading partners and promote economic growth. Similarly, Canada and Japan have placed increased importance on investment promotion and cooperation to facilitate the movement of capital and information. In addition, updating the double taxation agreement between Canada and Japan would contribute to the promotion of trade and investment between the two countries. Canada and Japan decided to revisit the possibility of an FTA to follow up the Joint Study report, through appropriate channels including at the next Joint Economic Committee (JEC).

#### (2) Sector-Specific Initiatives

Cooperation on regulatory issues relating to food safety and intellectual property will promote information sharing to help address Canadian and Japanese concerns in these sectors. A partnership in energy cooperation will contribute to energy efficiency, clean energy and diversification of resources, while further collaboration in science and technology will facilitate innovation and the global commercialization of research. Canada and Japan have also decided to continue consultations on air services to improve the flow of people, and consider that a bilateral mutual recognition agreement in telecommunications equipment would help boost trade in this sector.

The Joint Study Working Group expects that the Joint Study will enhance mutual understanding about bilateral trade and investment relations and be useful in further considering measures to strengthen the economic linkages between Canada and Japan.