



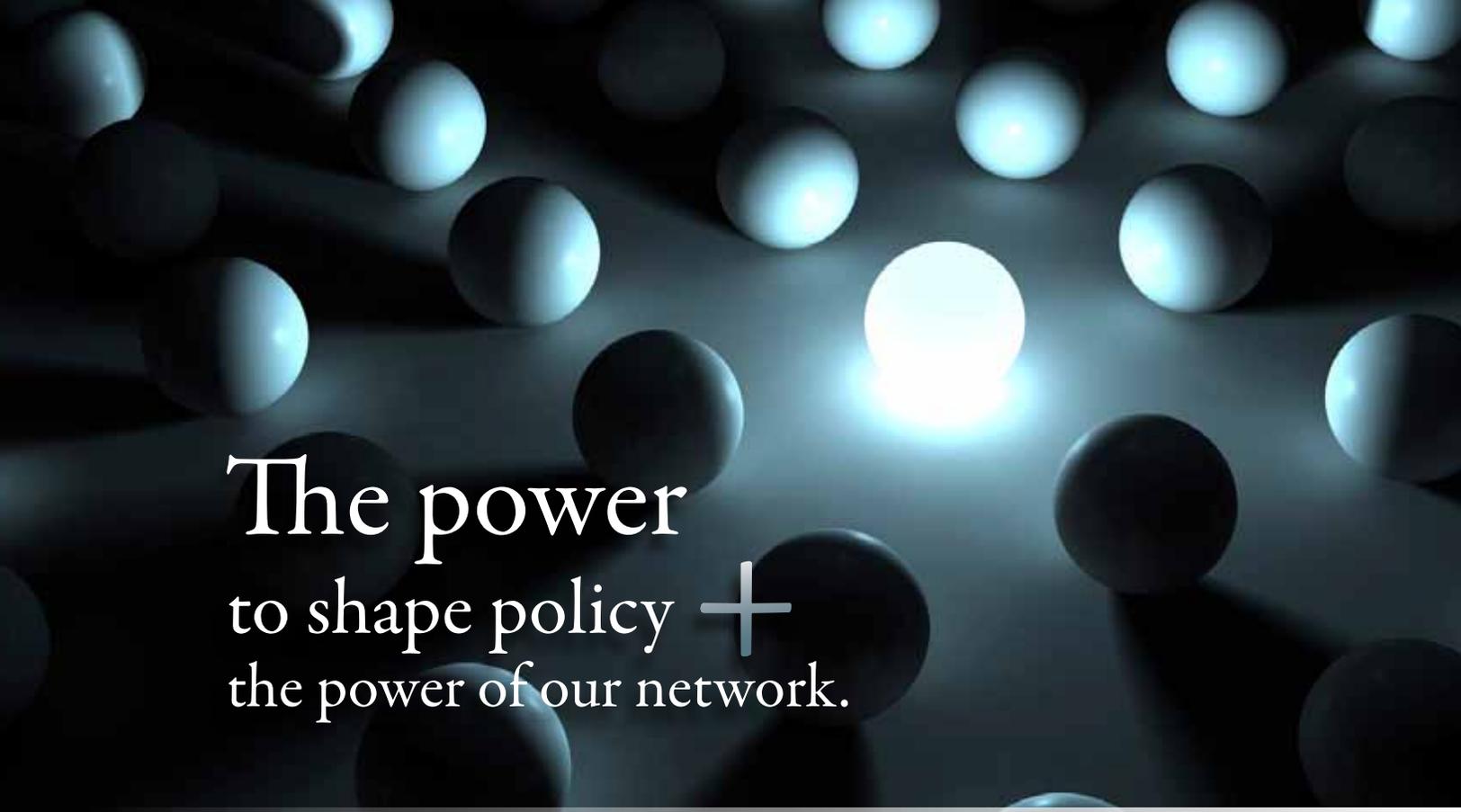
# Canada-Japan: Revitalizing the economic partnership

*November 2011*



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## EXECUTIVE SUMMARY

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Canada is a trading nation, and open, rules-based trade is a foundation of our country's prosperity and quality of life. Trade accounts for some two-thirds of Canada's GDP. One-third of Canadian jobs depend on exports and over one-tenth of jobs depend on international investment. For a mid-sized trading nation like Canada, it is critical for businesses to boost their global competitiveness through trade. International trade and investment allows businesses of all sizes to draw capital and inputs, tap into global value chains and markets, achieve economies of scale and grow.

Today, a worldwide economic recovery is taking hold, though it remains fragile and imbalanced. The U.S. economy is on the move again, yet as a result of the recent global financial and economic crises, Canadian businesses have realized that they can no longer depend on U.S. markets alone – markets where others are competing too. Canadian businesses will continue to pursue trade and investment opportunities in the United States – our top economic partner – but they are also looking to diversify by reaching out to other key markets in Europe, Asia and Latin America.

Japan is one such key market. It is the world's third largest economy and Asia's second. It is a prosperous one, though tariff and non-tariff barriers to trade and investment have kept many opportunities beyond the reach of Canadian businesses. Trade and investment ties with Japan are below potential.

The Canadian Chamber, representing 192,000 businesses of all sectors, sizes and regions of Canada, has welcomed the announcement by the governments of Canada and Japan regarding the launch of a Joint Study whose purpose will be to scope the possibility of a Canada-Japan Economic Partnership Agreement (EPA). An EPA with Japan – provided it achieves real market access for Canadian goods and services – would revitalize our economic ties with Japan to our benefit, and be a good step in moving Canada's business presence in the Asia-Pacific region forward.

We have consulted with our members, partner associations and opinion leaders for their thoughts on a Canada-Japan EPA. This document outlines what we believe an eventual agreement with Japan should include.

- An EPA should be a high-quality agreement that achieves real market access for Canadian businesses across sectors, for services as well as for goods. Greater labour mobility and the mutual recognition of professional certification are key to Canadian professionals delivering their services offer in Japan.
- An EPA should not only remove tariffs on Canadian exports, but also remove the many non-tariff barriers in Japan that stand in the way of real market access for Canadian businesses in that market.
- An EPA should greatly strengthen regulatory cooperation, make use of business-friendly rules of origin and bolster cooperation on the protection of intellectual property (IP) rights.
- An EPA should consider the multiple-speed removal of tariffs in order to provide vulnerable Canadian industries with a period of transition and adaptation.

Meanwhile, during the Asia-Pacific Economic Cooperation (APEC) 2011 Summit in Hawaii, both Canada and Japan strongly signalled their intention to join the Trans-Pacific Partnership (TPP) negotiations. Participating in the TPP negotiations are Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, Vietnam and the United States. The TPP negotiations aim to deliver an ambitious trade and investment framework for the Asia-Pacific that will enhance rules-based commercial and capital exchanges, promote innovation and sustain economic growth in participating countries. We strongly support Canada joining the TPP process at the earliest opportunity, and as a business community, we are looking closely to see if Japan will join. Should Canada and Japan both join the TPP, we would expect that regional framework to complement a bilateral EPA between the two countries.

# PART I: INTRODUCTION

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## 1. Removing barriers so Canadian companies can do more trade and investment with key markets

Canada relies on open, rules-based international trade and investment for its businesses to innovate and grow, create good jobs for Canadians and maintain a high-quality of life. After all, trade represents nearly two-thirds of our country's GDP. One-third of Canadian jobs directly depend on exports and over one-tenth of them depend on international investment. Goods and services exports generated some C\$507 billion for Canada in 2010.<sup>1</sup> Cross-border investment is also essential to Canada; our country's stock of outward direct investment was C\$617 billion in 2010, versus a stock of inward direct investment of C\$562 billion.<sup>2</sup>

However, there are barriers to effective market access abroad, as well as some barriers in Canada, which make the cross-border movement of goods, professional persons and financial capital unduly complicated, costly or inequitable for Canadian companies of all sizes. In particular, the small and medium-sized enterprises that make up most of our business community have limited resources to overcome trade and investment barriers. It is therefore an important task for governments to remove such barriers and level the competitive playing field for Canadian businesses by engaging with other governments, using World Trade Organization (WTO) mechanisms and pursuing high-quality free trade and investment agreements with those key economic partners which represent significant new market opportunities for Canadian goods and services.

The North America Free Trade Agreement (NAFTA) has been a boon to Canadian business, and exchanges with the United States remain a mainstay of our country's economic prosperity. Yet, a growing number of Canadian companies are now seeking to pursue trade

and investment opportunities in markets beyond those lying just south of our border. Official statistics reflect this; exports to the United States have moved from over 80 per cent of our total exports less than a decade ago to roughly 70 per cent today. The need to expand trade and investment, notably with prosperous Europe and ascendant Asia, and also with parts of Latin America, has become clearer to many in the business community since the recent global financial crisis. The United States will no longer be the sole motor of growth in the global economy.

The Canadian Chamber, the voice of 192,000 businesses of all sizes and sectors from across the country, has advocated the conclusion of those high-quality, comprehensive free trade agreements (FTAs) and investment promotion and protection agreements that will yield the greatest benefits to Canadian companies. Negotiations for an ambitious Comprehensive Economic and Trade Agreement (CETA) with the European Union are on course, and both the government of Canada and Canadian provincial governments have taken initiatives to enhance economic ties with the Asia-Pacific region, such as the Comprehensive Economic Partnership Agreement (CEPA) negotiations with India and economic cooperation with China.

These are significant and often challenging undertakings, but they should not preclude broadening and deepening ties with Asia's most advanced and only G8 economy – Japan.

Japan is a highly developed, sophisticated market and represents a major market opportunity for Canadian-produced goods and services, provided that Japan is willing to significantly open its historically closed market to increased imports and investment in all sectors.

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1 *Canada's State of Trade: Trade and Investment Update – 2011* (Foreign Affairs and International Trade Canada, June 2011)

2 *Ibid.*

## 2. An Economic Partnership Agreement: the next step in Canada-Japan ties

The Canadian Chamber of Commerce welcomed the February 23, 2011 announcement by the governments of Canada and Japan regarding the launch of a Joint Study whose purpose will be to scope the possibility of a Canada-Japan Economic Partnership Agreement (EPA). This is a good step toward what we hope will be the launch of negotiations for a high-quality, balanced and comprehensive agreement between the two countries. It is also a logical follow-up to the 2007 *Canada-Japan Joint Study on Benefits and Costs of Further Promotion of Bilateral Trade and Investment* concluded under the Canada-Japan Economic Framework initiative.<sup>3</sup>

Given the history of political and economic cooperation between Canada and Japan, Japan's profile as an advanced economy and the significant complementarities between the two countries' economies, a high-quality EPA that extensively opens real market access for Canadian companies in Japan would be the natural path forward for Canada-Japan ties.

2012 represents a unique opportunity to begin such negotiations.

Until quite recently, Japan, unlike many of its Asian and G8 counterparts, had avoided trade liberalization done with other advanced economies on a bilateral basis. That stance has changed under the leadership of former Prime Minister Naoto Kan, as the Japanese government has signalled it would ambitiously revisit its traditional trade policy and market-access issues so as to negotiate and conclude high-quality free trade agreements with both advanced and large developing partner economies. Japan is pursuing free trade negotiations with Australia and India and it is exploring free trade negotiations with the European Union, China, South Korea and the countries of the Trans-Pacific Partnership (TPP). Japan is also looking to Canada.

At the 2011 Asia-Pacific Economic Cooperation (APEC) Summit in Hawaii, the governments of Canada and Japan signalled their intention to join Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, Vietnam and the United States in the TPP

negotiations. The objective of those negotiations is to produce a far-reaching, next-generation free trade and investment agreement that will enhance open, rules-based trade and investment, promote innovation and sustain economic growth in the participating countries. While we believe pursuing a Canada-Japan EPA, provided it is of the right quality, makes good sense, we also strongly support Canada joining the TPP. Should Japan also join the TPP, that regional agreement would complement a bilateral Canada-Japan EPA.



<sup>3</sup> Report of the Canada-Japan Joint Study on Benefits and Costs of Further Promotion of Bilateral Trade and Investment (Foreign Affairs and Investment Trade Canada, Ministry of Foreign Affairs of Japan, October 2007): <http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/canjap-report-en.pdf>

## PART II: THE POTENTIAL BENEFITS OF A CANADA-JAPAN AGREEMENT DONE RIGHT

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### **1. Canada and Japan have largely complementary economies. Greater effective market access through an EPA could yield economic gains for both countries.**

Canada and Japan are mature, industrialized economies that benefit from excellent governance. Both countries seek to increase their prosperity by fostering economic linkages with other advanced and large developing economies. The two countries' manufacturing and services sectors, as well as commodities in the case of Canada, have become tightly meshed with regional and global value chains.

Japan matters to Canada. Although some view Japan as an economic power whose sun is past its zenith, it remains the world's third largest economy and Asia's second largest economy just behind China's. With per capita GDP of US\$42,000 in 2010 (compared with Canada's per capita GDP of US\$46,000),<sup>4</sup> it has one of the world's wealthiest societies, made up of over 126 million consumers who possess the financial wherewithal to purchase value-added Canadian exports. While rising economies such as China's and India's have overtaken or are expected to overtake it in GDP terms, Japan is forecasted to remain one of the world's foremost economies for decades to come. According to a recent report by Goldman Sachs, Japan will likely continue to rank amongst the world's top 10 largest economies in 2050.<sup>5</sup>

Japan remains a world leader in a number of high-tech and precision industries. It provides technological inputs that Canadian industries use and final products that Canadians consume. Imports to Canada from Japan include motor vehicles, machinery, electronics,

technical and scientific instruments, and rubber, metallic and plastic articles. Lately, Japanese pop-culture imports such as comic books (*manga*) and films have also been making their mark.

Canada also matters to Japan. Japan possesses limited natural resources and hence is a major importer of commodities (including the world's largest net importer of foodstuffs). It requires reliable, secure access to high-quality energy, raw material and food imports. No country is in a better position to respond to Japan's needs in these regards than Canada. After all, Canada's political-risk is null and commercial shipping between the two countries criss-crosses the benign North Pacific rather than the riskier maritime lanes of the South China Sea and the Indian Ocean. Canada's advantage is already reflected in its top exports to Japan, which include fossil fuels, minerals, oil seeds, meat, wood, pulp and paper, cereals and fish and seafood products.

Canada's value proposition is not limited to its excellence in commodities and processed foods. According to Statistics Canada, chemicals, inorganic chemicals, pharmaceuticals, plastics and plastic articles, and aircraft and spacecraft all rank amongst those Canadian merchandise exports to Japan that grew by 50 per cent or more between 2001 and 2010.<sup>6</sup> Electronics, medical equipment and therapies, clean-technology, defense and high-tech manufacturing are also components of Canada's value proposition with both export and commercial investment potential.

Then, there are services. Canada markets its travel services and draws an important number of Japanese tourists to its cities and nature spots each year. Canada

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<sup>4</sup> World Economic Outlook Database (International Monetary Fund, October 2010)

<sup>5</sup> Jim O'Neill and Anna Stupnytska, *Global Economics Paper No. 192: The Long-Term Outlook for the BRICs and N-11 Post Crisis* (Goldman Sachs, December 4, 2009)

<sup>6</sup> Trade Data Online (TDO), Statistics Canada

also has world-class expertise in commercial services, especially in significant export areas such as computer services, sustainable engineering, architecture and advertising. Canada's world-class financial services are another considerable part of the Canadian value proposition to Japan.

Japan, like other Asian countries, was impressed by the resilience of Canadian financial institutions during the 2008 economic crisis. For example, Canadian life and health insurance expertise can respond to the needs of a rapidly aging Japanese population, and Canadian banking leads globally in mining finance and is very well-placed in financing clean-tech and small and medium-sized enterprise activities. Information and communications technology (ICT) is another area where Canadian expertise can respond to Japanese business and consumer demand. Canada is also an exceptional provider of high-quality post-secondary and English-/French-as-a-second-language (ESL/FSL) education through its universities, colleges and language institutes.

When mention is made of open trade, sensitivities on both sides crop up, notably in Japanese agriculture and Canadian supply-managed farm industries. While Canada has sizeable agricultural export interests, for instance in the beef, pork, wheat and biotechnology industries, in the Canada-Japan context the supply-management issue should be of minimal concern as Japan is not an exporter of dairy, egg or poultry products.

The Canadian and Japanese economies matter to each other and are largely complementary in their trade profiles. As the 2007 *Canada-Japan Joint Study* observed, each specializes in products that the other does not intensively export.<sup>7</sup> Export industries on both sides

would stand to gain from a preferential trade and investment agreement, provided it is ambitious in removing both tariff and non-tariff trade barriers and in facilitating trade so as to achieve effective and equitable market access for businesses from both countries. The Joint Study or subsequent studies should model and quantify the expected economic gains of a Canada-Japan EPA.

## **2. Canada and Japan are important trade partners, but the value of two-way trade has not moved much in a decade. An EPA would revitalize commercial ties.**

In 2010, Japan was Canada's fifth merchandise trade partner, down from third in 2005. The total value of two-way trade in goods declined by almost 30 per cent over the past decade, from C\$31.3 billion in 2001 to C\$22.6 billion in 2010, in contrast with Canada's growing total trade with the world.<sup>8</sup> However, that decline was entirely borne on the import side, as Canada's merchandise exports to Japan actually grew by just over 10 per cent over the past 10 years. Moreover, Canada's merchandise trade deficit with Japan has decreased sharply during that time, from nearly C\$15 billion in 2001 to approximately C\$4 billion in 2010.<sup>9</sup> Canada was Japan's 14<sup>th</sup> trade partner in 2009 on the import side and 16<sup>th</sup> on the export side.<sup>10</sup>

Although Canada's export performance has improved, the Canada-Japan goods-trade relationship remains below potential. Canada's total trade with the world's third largest economy remains a minute fraction of our country's total trade with the world. In 2010, the value of Canada's merchandise trade with Japan amounted to a mere 2.8 per cent of Canada's total merchandise trade, a notch down from 2.9 per cent a year earlier.

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7 Report of the Canada-Japan Joint Study on Benefits and Costs of Further Promotion of Bilateral Trade and Investment (Foreign Affairs and Investment Trade Canada, Ministry of Foreign Affairs of Japan, October 2007): <http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/canjap-report-en.pdf>

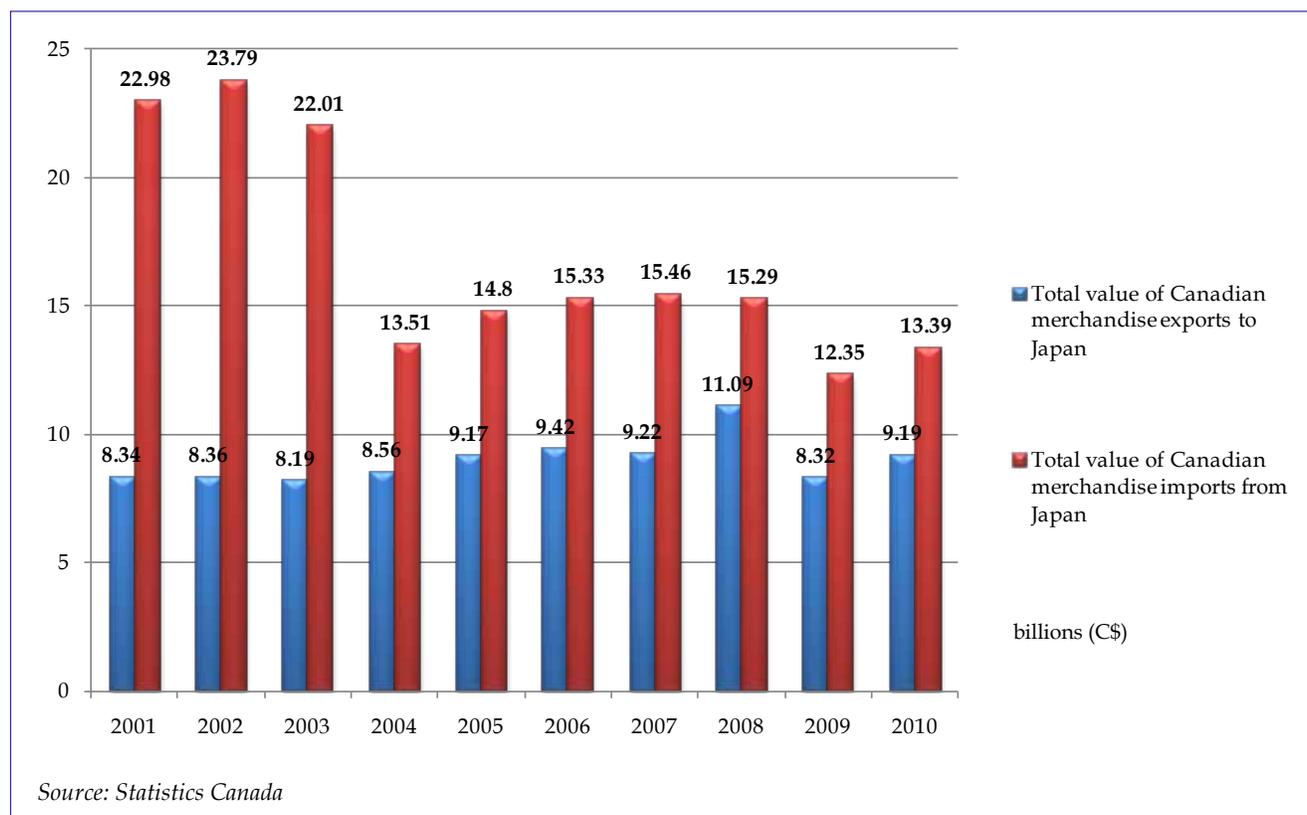
8 Statistics Canada

9 Ibid.

10 *Canada-Japan Relations* (Ministry of Foreign Affairs of Japan, July 2010 update)

The value of Canadian merchandise exports to Japan as a percentage of total Canadian merchandise exports has only slightly budged up to 2.3 per cent in 2010 from 2.1 per cent five years earlier.<sup>11</sup> Canadian metal, mineral, chemical, pharmaceutical, aerospace and oil

seed exports to Japan enjoyed high rates of average annual export growth over the past decade. In more recent years, wood exports to Japan have also grown substantially. On the import side, Japanese automotive products, machinery and equipment remain dominant.<sup>12</sup>



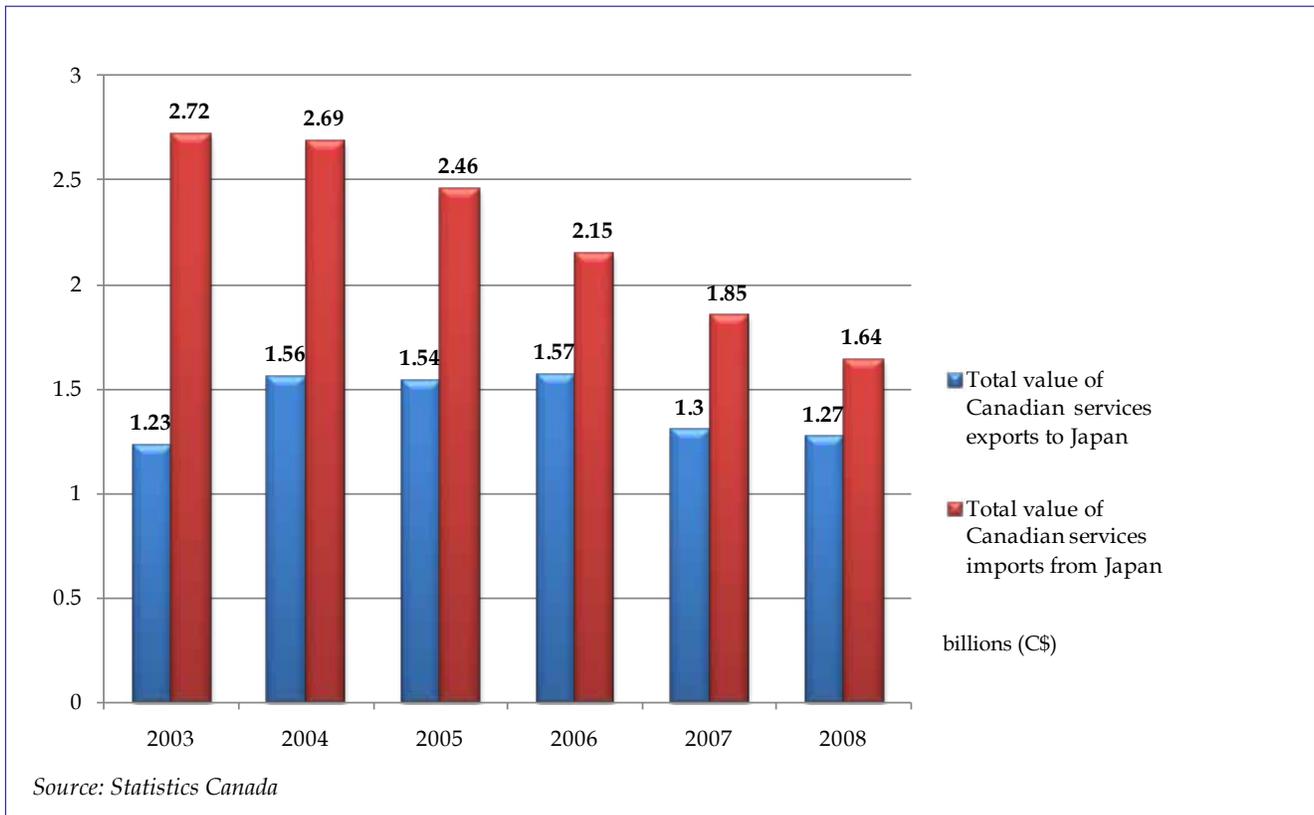
Services are an increasingly important component of the Canadian economy overall. They generate some two-thirds of Canadian GDP and employ three-quarters of Canadians. Canada’s services trade with the world has also grown by 23 per cent between 2003 and 2008, from C\$135 billion to C\$167 billion.<sup>13</sup> Yet during that same period, our country’s services trade with Japan

has decreased by 26 per cent. In 2008, the last year for which Statistics Canada figures are available, Canada’s services trade with and services exports to Japan were C\$2.9 billion and C\$1.3 billion respectively—less than two per cent of Canada’s total services trade with and exports to the world.

11 Statistics Canada

12 *Canada’s State of Trade: Trade and Investment Update – 2011* (Foreign Affairs and International Trade Canada, June 2011)

13 Ibid.



Given the integration of global value chains, the importance of commercial ties may be somewhat underestimated by official figures, as both Canadian and Japanese goods and service exporters may be capturing value from indirect trade with each other. Moreover, certain services revenues generated abroad are not incorporated into export statistics. Even so, Canada's goods and services trade with Japan is considerably below potential; for example, when one compares Canada's booming trade with similar industrialized economies such as the European Union or Korea over the past few years. An ambitious, balanced Canada-Japan EPA would give a new and needed kick-start to two-way trade in goods and services.

### 3. A Canada-Japan EPA would also strengthen investment ties.

The 2007 Joint Study noted that a growing number of Japanese companies were turning toward Canada as an investment destination in view of gaining North American market access while taking advantage of lower Canadian operating costs at the time. An example of this is that of Japanese automotive sector investments in Canada. In the same vein, Canadian companies' investment in Japan was geared toward the Asian market and sourcing of Asian inputs. Significant investments in Japan had been made by Canadian insurance and automotive companies prior to 2007.<sup>14</sup> Since then, however, much Canadian investment has

<sup>14</sup> Report of the Canada-Japan Joint Study on Benefits and Costs of Further Promotion of Bilateral Trade and Investment (Foreign Affairs and Investment Trade Canada, Ministry of Foreign Affairs of Japan, October 2007): <http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/can-jap-report-en.pdf>

pulled out of Japan, notably in financial services.<sup>15</sup> For Canadian business, as for many of foreign counterparts, Japan's investment environment remains relatively closed with often convoluted rules and restrictions. While the Japanese government has moved to further open Japan's sectors to foreign investment, more remains to be done.

While once-lower operating costs are no longer part of Canada's appeal as an investment destination (due to Canadian-U.S. dollar parity), the availability of a skilled workforce, the world-class know-how found in many of Canada's sectors and lower Canadian corporate taxes are. Canada's commodities are another area of high potential in attracting Japanese investment, as are clean technologies. Canada strongly welcomes Japanese commercial investment in these areas. In 2008, Japan held the sixth largest stock of foreign direct investment (FDI) in Canada, after the United States, the United Kingdom, the Netherlands, France and Switzerland, amounting to C\$13 billion—up from C\$9.9 billion in 2003.<sup>16</sup> However, this still represents less than three per cent of the total stock of FDI in Canada. Japan was not amongst the top 10 recipients of Canadian FDI.

Foreign investment is an essential means of plugging companies and industries to global value chains, and it also serves as a conduit for sharing best practices within and between industries and to draw in new technologies and improved methods of management. Recognizing this, Canada and Japan have sought to enhance bilateral investment; for example, with the signing of a 2005 Memorandum of Understanding on investment.

Investment ties have yet to reach their full potential. Canada's embassy, consulates and trade offices in Japan have held investment forums to promote investment opportunities between the two countries. However, barriers on capital flows remain. The EPA, as a next-generation agreement, could further boost two-way flows of FDI by incorporating a chapter on investment that would remove investment barriers in place across various sectors on a mutual basis. It would be an opportunity for Japan to further liberalize its historically closed investment environment.

#### **4. A Canada-Japan EPA would strengthen rules-based global trade and investment.**

As noted in the 2007 Joint Study, Canada and Japan enjoy a history of broad political and economic cooperation, on the bilateral side and through their membership in multilateral institutions such as the World Trade Organization (WTO) and the Organisation for Economic Co-operation and Development (OECD).

As trade-reliant nations, both Canada and Japan are committed to safeguarding and advancing an open and equitable international trade and investment system through their work in the WTO and via their political and economic relations with third countries. Certainly, there are areas where we hope to see Japan improve its record in strengthening that system; for example, by moving away from the use of opaque non-tariff barriers and exchange rate interventionism. While both countries support multilateral trade liberalization, the WTO Doha Development Agenda negotiations appear stalled and many countries are now pursuing bilateral and regional next-generation trade and investment agreements. Additionally, Canada and Japan share concern vis-à-vis growing protectionist pressures in many countries that could distort the rules-based trade system. A comprehensive EPA with Japan would serve as a model and building block for multilateral trade liberalization and a rebuke of lose-lose protectionism in global markets.

Value chains have become global as the production of a single good or the delivery of an end-service involves research and development (R&D) activities, financing, intermediate goods and services, product assembly, marketing, shipping and after-sales services sourced from around the world. Canada and Japan, notwithstanding strong linkages with the United States and Northeast Asia respectively, are also at the forefront of the wider integration of value chains across the Pacific.

Through the Asia-Pacific Economic Cooperation (APEC) forum, Canada and Japan have actively collaborated to strengthen the rules of equitable trade and dismantle barriers to the movement of goods, delivered services and capital within the region. At the 2010 APEC

15 *Canada-Japan Relations* (Ministry of Foreign Affairs of Japan, July 2010 update)

16 Office of the Chief Economist, *Canada's State of Trade: Trade and Investment Update - 2009* (Foreign Affairs and International Trade Canada, June 2010): [http://www.international.gc.ca/economist-economiste/performance/state-point/state\\_2009\\_point/2009\\_6.aspx?lang=eng#a6](http://www.international.gc.ca/economist-economiste/performance/state-point/state_2009_point/2009_6.aspx?lang=eng#a6)

Summit in Yokohama, leaders pledged to take concrete steps toward the realization of a Free Trade Area of the Asia-Pacific (FTAAP) centred on next-generation trade and investment issues.<sup>17</sup> A high-quality Canada-Japan EPA would help set a high standard for a future FTAAP.

**5. Canada and Japan are both actively negotiating FTAs or seeking to enter such negotiations with other countries. In the absence of a Canada-Japan CEPA, both countries stand to lose.**

Canada and Japan have been relative latecomers to the FTA game, but both countries have moved quickly over the past few years in pursuing high-quality free trade and investment agreements.

Canada has concluded FTAs with Peru and Colombia and is negotiating one with Korea. It is working to conclude a next-generation agreement with the European Union and has recently begun negotiations with India. Japan, under its current government, is reviewing its FTA strategy and is looking to negotiate trade agreements with large advanced economies—a new direction in Japanese trade policy. In particular, Japan is actively seeking to join Trans-Pacific Partnership (TPP) negotiations, which include the United States, Australia and a number of other Southeast Asian and Latin American countries, and it is working with the European Union toward the launch of EU-Japan negotiations.

In the absence of a Canada-Japan EPA, how do both countries stand to lose? For example, the Canada-EU CETA, once in force, will offer two-way preferential market access to Canadian and European companies in each other's market. In the absence of a similar Canada-Japan agreement, competitive Japanese companies could lose market share to European rivals benefiting from preferential access to the Canadian market by virtue of the CETA—a phenomenon known as trade diversion. Similarly, once Australia's free trade negotiations with Japan reach the finish line, rival Australian exporters will benefit from preferential access to the Japanese market—preferential access Canadian exporters will not have. These are examples of how businesses in both countries could lose in the absence of a comprehensive economic agreement. The time is right for Canada and Japan to look to each other as serious partners and begin negotiating an agreement of their own, based on a mutual desire to pursue liberalized trade on a level playing field.



<sup>17</sup> *Pathways to a Free Trade Area of the Asia-Pacific* (APEC/Yokohama declaration, November 13, 2010)

# PART III: WHAT IS NEEDED IN AN ECONOMIC PARTNERSHIP AGREEMENT (EPA) WITH JAPAN?

## 1. A comprehensive and ambitious trade and investment agreement

The 2007 Canada-Japan Joint Study noted that Japan's bilateral FTA negotiations cover not only goods or services trade but a wider range of areas such as investment, the movement of people, intellectual property (IP) and competition policy, reflecting the high degree of integration between Japan and its worldwide economic partners.<sup>18</sup> This matches Canada's recent experience of negotiating ambitious and comprehensive agreements—next-generation agreements—that go beyond the scope of NAFTA, such as our country's negotiations with the European Union.

A Canada-Japan EPA should be comprehensive and ambitious. It should aim to lower or eliminate tariff and non-tariff barriers. It should ensure a non-discriminatory (level playing field) trade and investment environment between the two countries, enhance transparency and opportunities for mutual, early consultations on regulations, achieve greater mutual recognition of differing regulatory standards where such standards are demonstrated to pose a barrier to trade, improve the movement of professional persons between the two countries and adopt trade-facilitating measures, so that Canadian companies can sell goods and deliver services to Japanese customers in a more straightforward and cost-effective manner. That means reducing the burden of red tape. Those same standards of openness should be extended to Canadian investors—and likewise for Japanese companies looking to doing business in or with Canada.

The EPA should also extend cooperation in other areas, such as setting high standards of intellectual property (IP) rights protection and competition policy. IP rights are crucial to the growth of knowledge-based

industries in both Canada and Japan. A Canada-Japan EPA should serve as a building block for greater economic integration and open, balanced, rules-based trade and investment in the Asia-Pacific region.

### RECOMMENDATION

**That a Canada-Japan EPA be a comprehensive, high-quality agreement that achieves real market access for Canadian businesses across sectors.**

## 2. An agreement for the long-term: services and investment

Given the rapid pace of innovation in the economy, the use of negative lists ensures that agreements remain comprehensive and relevant over time, as services sectors evolve at a rapid pace. Likewise, the decline of certain industries, the transformation of others and the continuous emergence of new products and processes makes the use of negative lists for investment an important part of a high-quality trade and investment agreement. Investment openness of this sort encourages greater commitment and longer-term engagement by foreign investors and draws in new management approaches, technologies and skills. It will therefore be important for Canada and Japan to apply negative lists to the services and investment components of an EPA. The use of negative lists would be consistent with both countries' approach to trade negotiations.

An EPA must also ensure improved labour mobility, including the mutual recognition of professional qualifications and certification, as well as the use of permits

<sup>18</sup> Report of the Canada-Japan Joint Study on Benefits and Costs of Further Promotion of Bilateral Trade and Investment (Foreign Affairs and Investment Trade Canada, Ministry of Foreign Affairs of Japan, October 2007): <http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/canjap-report-en.pdf>

and streamlined procedures to admit people under temporary entry conditions on longer-term work assignments. Facilitating the movement of professional persons between Canada and Japan and their ability to work legally within their professions in each others' territories is a quintessential component of services trade liberalization as the delivery of a commercial, educational or other service often requires temporarily expatriating skilled professionals to provide that service. Mode 4 restrictions in Japan on the movement of professionals and the restrictions on the employment of spouses of Canadian expatriates working in Japan should be lifted. The 2006 Social Security Agreement between the two countries is a positive foundation to build upon through a Canada-Japan EPA to facilitate Canadian professionals' ability to work in Japan under temporary conditions.

## RECOMMENDATION

**That a Canada-Japan EPA include services and investment as well as goods, that negative lists be applied to services and investment, and that labour mobility and mutual recognition of professional qualifications be enhanced to ensure any eventual agreement is high-quality and geared toward the long run.**

### 3. Lowering tariffs on goods

A trade agreement with Japan must improve market access to the Japanese market for Canadian companies. Both countries have lowered tariff lines across sectors significantly under the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) and in separate bilateral and regional FTAs with third parties. They are working on lowering tariff lines through the WTO Doha Round. A Canada-Japan EPA should seek to go beyond what was contemplated in the Doha Round in terms of ambition. There remain a number of sectors on both sides where tariff lines are significant. On the Japanese side, substantive tariffs exist in the following:

- Processed and non-processed food products
  - Beef
  - Pork
  - Fish and seafood (e.g. pollock, cod roe, sea urchins, scallops, mackerel)
  - Vegetable oils
  - Wheat
  - Barley
  - Fruit
  - Sugar
- Wine
- Commodities
  - Certain woods (e.g. spruce pine fir, amabilis fir), plywood and engineered wood products
  - Certain processed metals (e.g. nickel, copper, aluminium) and metal articles
- Industrial goods
  - Chemicals
  - Plastics
  - Textiles, apparel and footwear

## RECOMMENDATION

**That a Canada-Japan EPA remove tariffs on important Canadian exports, including agri-food and seafood products, forestry and industrial products.**

### 4. Removing non-tariff barriers on goods and services for effective market access

Lowering tariff lines remains an essential component of any free trade agreement, and it is a key request for several of Canada's exporting sectors. However, lowering tariff lines alone does not guarantee effective market access. Most glaringly, it leaves out services, a growing and critical component of Canada's international trade profile, as well as investment. When they trade, Canadian companies deal with a wide range of non-tariff barriers (including technical barriers to trade) at the border of foreign jurisdictions and within those jurisdictions. These barriers include: regulatory standards that hinder the export, sale or end-use of

Canadian products overseas; standards that differ from common international practice and norms; rules and standards that differentiate or discriminate between foreign and domestic enterprises; opaque regulatory processes; excess red tape that makes it difficult for smaller and medium-sized enterprises to operate; and barriers on the delivery of services by Canadian professionals. Such barriers hinder or impede market access even where tariff lines are nil.

Non-tariff barriers unnecessarily raise the cost for businesses of trading goods and services, impede that trade from happening altogether, or deter smaller companies with fewer resources from considering trade opportunities that could otherwise be lucrative.

From the viewpoint of Canadian business, Japan represents a particularly challenging case when it comes to non-tariff barriers. Dismantling such barriers on a bilateral basis would be a quintessential component of any successful EPA. There is concern with a number of discriminatory non-tariff barriers on goods and services, including subsidies, which are defensive in nature and deter foreign competition in the Japanese market. These should be tackled head-on.

Then, there are non-tariff barriers resulting from different regulatory and legal traditions. While many regulatory standards are in place for legitimate reasons such as consumer safety or environmental protection, a reasonable approach to these is necessary. After all, they do hamper trade by raising costs for Canadian (and other foreign) exporters—sometimes prohibitively. Japan's turn toward an active trade negotiation agenda under its current government, including ongoing Trans-Pacific Partnership (TPP) negotiations (with the United States and other countries) and possible free trade talks with the European Union, are a golden opportunity for Japan to undertake reforms in order to bring its regulatory standards closer in line with internationally recognized practices and norms.

Finally, there are also barriers on the delivery of services. These include Mode 4-type restrictions in Japan—laws and regulations on the temporary access of professional people in services industries and their right to work in Japan on a temporary basis.

The Canada-Japan Cooperation Agreement on Anti-competitive Activities, which came into force in 2005 and whose purpose it was to combat anticompetitive business practices, struck the right tone in terms of what is needed. Since then, Japan has actively tackled a number of anticompetitive practices that have long been an issue with its trade partners. However, much remains to be done. An EPA would provide an opportunity to remove many of the outstanding competitive barriers that remain and hinder Canadian market access in Japan, on a mutual basis.

Examples of barriers to Canadian goods and services exports to Japan include *but are not limited to* the following:

- Food products and beverages:
  - Labelling requirements for imported processed food products are overly complex and cumbersome.
  - Inspections and approval processes for food products and use of food additives are protracted, strict and occasionally deviate from standard international practice (e.g. the non-acceptance of numerous food additives in Japan that are commonly used worldwide).
  - Grains produced domestically in Japan, such as wheat and barley, are propped by significant government subsidies.
  - Wheat and wheat flour enter Japan under a tariff-rate quota, where imports exceeding the quota face high tariffs. Yet even within the quotas, the Food Department of Japan's Ministry of Agriculture, Forestry, and Fisheries has the exclusive right to import and resell foreign wheat into the Japanese market, and it typically adds a price mark-up that erodes the competitiveness of imported wheat. Japanese wheat production also benefits from subsidization.
  - Market access for foreign pork products is constrained by Japan's gate price system, whereby imports that fall below a Japanese government-established reference price pay a supplemental duty fee equal to the difference

- between the import value and the reference price. Pork products from countries such as Mexico and Chile that have free trade agreements with Japan benefit from duty-free quotas.
- Legislation on trade in beef is not aligned with World Organisation for Animal Health practices, and the acceptance by Japan of scientific evaluations conducted by international bodies (i.e. Joint FAO/WHO Expert Committee on Food Additives, Codex Alimentarius Commission) remains limited. Canadian beef imports are limited to those derived from cattle under 21 years in contradiction of international standards that advise against such age limits. Imported beef is also subject to a safeguard measure triggered when the volume of imports expands by more than 17 per cent from the level of the previous Japanese fiscal year on a cumulative quarterly basis.
  - The approval of products derived through biotechnology in Japan is hampered by lengthy delays, possibly driven by anti-biotechnology sentiment and its political ramifications. This adversely impacts Canadian canola products as well as several corn and soybean products developed for use in North America.
  - Plant quarantine measures on fruits and vegetables are restrictive and do not fully conform to the Sanitary and Phytosanitary (SPS) chapter of the General Agreement on Tariffs and Trade (GATT) and to generally accepted international science and standards. Plants are denied entry due to the presence of pests (including those commonly found in Japan).
  - Licence applications for the wholesale and retail of wines and spirits are convoluted and are not processed in a consistent manner.
- Construction materials:
    - The regulatory environment for construction materials continues to diverge significantly from internationally recognized practices and scientific standards.
    - Japan continues to favour the use of domestic wood in construction through preferential subsidy programs that erode the competitive
  - ness of Canadian engineered wood, as well as through the use of biased domestic wood terminology.
    - Even allowing for unique Japanese conditions (e.g. seismic resistance requirements), a number of safety measures on the use of wood in construction, such as size and distance limitations, diverge from sound science and international practice.
  - Auto vehicles and auto parts:
    - Technical guidelines for imported motor vehicles are burdensome and relatively opaque.
    - Japanese light motor vehicles (i.e. *keijidōsha*) benefit from regulatory and fiscal privileges (e.g. taxation and insurance) which distort competition vis-à-vis imported foreign vehicles.
    - Japanese government programs such as the 2009 vehicle scrappage stimulus program exclude imported vehicles while favouring Japanese produced vehicles
    - Despite a zero tariff on imported vehicles, Japan remains a very closed automotive market due to a panoply of non-tariff barriers, regulatory and fiscal measures. Japan's import penetration rate is less than five per cent, versus an average of nearly 50 per cent amongst member states of the Organisation of Economic Co-operation and Development (OECD).
  - Information and communication technology (ICT):
    - Contractors are not allowed to own the intellectual property rights to software they develop, which erodes the profit potential for software products in the Japanese market.
  - Pharmaceuticals:
    - The system for reviewing and conducting clinical trials of pharmaceutical products is cumbersome.
    - Approval processes for products are lengthy and labelling rules are overly burdensome.

- Financial services:
  - Japanese insurance market regulation differs between Japanese providers and Canadian (and other foreign) private sector life insurance companies, resulting in an unlevel playing field for foreign participants. Two issues of particular concern are the regulation of Japan Post Insurance, which benefits from unique legal, regulatory and taxation exemptions (including exemptions from Japan's Insurance Business Law), and the *kyosai* (agricultural) cooperatives that are not subject to Japanese Financial Services Agency regulation.
  - Japan's "General accepted accounting principles" diverge from the International Financial Reporting Standards used in Canada and in other jurisdictions (though we note that Japan is currently working to remove inconsistencies between the two systems).
  - The transparency and predictability of rule interpretation and inspections processes is insufficient.
- Education services:
  - Foreign universities operating branch campuses in Japan are exempted from tax benefits available to their Japanese counterparts.
- Government procurement:
  - Although Japan is a signatory of the 1996 WTO Agreement on Government Procurement (GPA), public procurement decisions are oftentimes taken on a non-competitive basis, notably through the use of bid-rigging and the use of narrow Japan-specific criteria that preclude Canadian and other foreign businesses from competing for projects.
- Other non-tariff barriers:
  - Japan's long-standing tradition of actively intervening in foreign exchange markets to push down the market-driven value of the yen, provides a cost-advantage for its export industries relative to Canadian products. Currency interventionism of this sort is inconsistent with



the level competitive playing field that trade liberalization agreements seek to achieve.

- Notwithstanding recent improvements in Japan's competition regime, including curbs on the practice of *amakudari* (the post-retirement employment of senior bureaucrats in companies they regulated), anti-competitive activities such as bureaucrat-led bid rigging persist.
- In some sectors, businesses must be able to demonstrate prior experience in Japan, which effectively blocks new entrants into the market.
- Licensing powers are often vested with industry associations with limited membership, thereby impeding foreign businesses from obtaining the required licences to operate in Japan.

- Japanese public broadcasting has portrayed the quality of foreign products in an unfavourable light relative to their Japanese equivalents, sometimes on objectively / scientifically unjustified grounds (e.g. safety of Canadian beef, quality of high-tech imports), which erodes foreign brand value vis-à-vis Japanese consumers.
- Internal distribution mark-ups in Japan are high, often exceeding the cost of shipping products from Canada to Japanese ports. Foreign freight carriers also face very high airport-related costs in Japan.

## RECOMMENDATION

**That a Canada-Japan EPA remove, on a bilateral basis, the many non-tariff barriers that hinder the market access of Canadian exporters and investors in Japan.** Removing non-tariff barriers would be the core of any meaningful agreement with Japan.

### 5. Regulatory cooperation and trade facilitation

Regulatory cooperation covering goods, services and investment would be an indispensable part of a high-quality Canada-Japan EPA. In the past, the lack of regulatory cooperation has generated problems for Canadian businesses. On one level, as mentioned above, differing regulatory standards compounded with the non-recognition of equivalency in general has and continues to deter Canadian companies from seeking opportunities in the Japanese market. This can hamper the efficient movement of goods and services.

Canada and Japan, as advanced economies and members of the Organisation for Economic Co-operation and Development (OECD), have proven track records of implementing and adhering to exemplary standards on the sale and use of goods and services. Yet, many Japanese regulatory standards are overly

convoluted or diverge from those commonly used in other developed countries, which restricts market access to Canadian exports. Some standards deviate from internationally recognized sound scientific norms. Harmonizing or mutually recognizing regulatory standards on a bilateral basis where divergence hampers legitimate trade must therefore be part and parcel of an EPA with Japan.

On another level, the introduction of new regulation in the absence of prior consultation with foreign economic partners can upset normal trade and investment flows for businesses. An EPA would therefore need to ensure that the introduction of new regulations in Japan be done transparently and through a process that allows for advance comment with sufficient lead-time by Canadian government counterparts and business stakeholders on the potential impacts on trade and investment. That transparency needs to exist at both the national and sub-national levels, and both Japan and Canada would need to commit to such a process rather than leaving it voluntary.

Also, an EPA must further facilitate trade between Canada and Japan. Ensuring that customs procedures conform with rules of origins provisions in the agreement without adding burdensome procedures for companies on either side is essential. Real efforts need to be made to reduce duplicative procedures facing both Canadian and Japanese exporters and importers. Overly complex certification and documentation that drain limited business resources should be done away with, with remaining procedures harmonized, where possible, and rendered more transparent for the business communities on both sides of the Pacific.

For those sectors where it is appropriate, mutual recognition of regulatory standards must include recognition of licensing and certification procedures, and the harmonization of international product testing protocols, including the use of conformity assessment bodies. This can further facilitate two-way trade and avoid adding unnecessary, essentially duplicative, procedural and financial burdens for Canadian and Japanese businesses alike.

## RECOMMENDATION

**That a Canada-Japan EPA strengthen regulatory cooperation between the two countries.** Regulatory cooperation should include harmonizing or mutually recognizing regulatory standards on a bilateral basis where divergence hampers trade. It must also include ensuring transparency on the introduction of new regulations and standards on both sides, through government-to-government consultations involving business stakeholders and with sufficient lead-time.

### 6. Liberal, business-friendly Rules of Origin (ROOs)

Jurisdictions have different approaches to Rules of Origin (ROOs) and this is certainly the case of Canada and Japan. Canada's approach to ROOs is both straightforward for businesses to use and fairly liberal to the extent that it takes account of integrating global value chains. ROOs used in a Canada-Japan EPA must be business-friendly. They must consider the increasingly interconnected nature of global value chains, where the production of many finished goods involves inputs, technologies, services and financing from different countries and jurisdictions. In particular, ROOs must take into account Canada's broad and deep integration with U.S. value chains. A good produced in Canada that meets NAFTA content rules should be considered "Canadian" and eligible under the terms of an EPA with Japan.

ROOs must likewise be clear and easy-to-use by businesses, as complex rules consume business resources, generate unnecessary opportunity costs and hamper the efficiency of business operations. The origin defining criteria must be limited to the known criteria which is specific to each sector or other criteria Canadian and Japanese sectors have commonly agreed.

## RECOMMENDATION

**That a Canada-Japan EPA make use of sufficiently liberal, business-friendly rules of origin.** The integrated nature of many Canadian sectors at the North American level should be taken into account.

### 7. Intellectual property rights protection

Intellectual property (IP) is a fundamental component of a business's assets, involving large investments made over many years in research and development (R&D), training and skills. It can be at the core of a company's value. IP is central to businesses maintaining their competitive and technological edge, fostering investment in innovation and creating high-quality jobs in a knowledge-based economy. It is vital to protect companies undertaking investments in IP from poaching.

High standards of IP rights protection are crucial to a well-functioning, open trade and investment system and should be part of any high-quality trade agreement. Both Canadian and Japanese businesses view IP rights protection as crucial to their success. An EPA between Canada and Japan would be a golden opportunity for both countries to boost their cooperation on IP issues, and for both countries to further improve their record on IP rights protection where it is still lacking. Japan generally has strong IP rights protection and is a signatory of the World Intellectual Property Organization (WIPO) Copyright Treaty and Performances and Phonograms Treaty. Some lapses remain, such as on the ownership of software-related IP as mentioned earlier.

Canada has much further to go on IP, and we are encouraged by the Canadian government's determination to bring Canadian IP rights protection up to par with that of its trading partners. Currently, Canada's protection of the recording industry's material and films is poor; Canadian authorities are not adequately empowered to search, seize, and destroy counterfeited and pirated products; and patent-term restoration is absent, to the detriment of pharmaceutical innovation.

## RECOMMENDATION

**That a Canada-Japan EPA strengthen cooperation on intellectual property rights protection, key to the innovation and success of the Canadian and Japanese knowledge-based economies.**

## 8. A multiple-speed lifting of tariff barriers is necessary

Canada's business community is concerned about the potential impact that Japanese products may have on the competitiveness of Canadian manufacturing in the domestic market following the lifting of tariff barriers. There are worries that competitive pressures on Canadian producers will push some to shut down or move production overseas. For certain industries, transition periods will be needed for them to adapt to a new context of tariff-free Canada-Japan trade, and therefore, a multiple-speed lowering of tariffs lines would need to be considered.

In sectors where there is presently a zero tariff on Canadian-produced goods, but where there is a recognized one-sided flow of trade, such as is the case of the auto sector, it will be important to see non-tariff barriers reduced in order to allow a meaningful increase in market penetration by Canadian imports, which is key to achieving a balanced agreement. During those transition periods, temporary safeguards against sudden import surges could be considered.

### RECOMMENDATION

**That a Canada-Japan EPA incorporate a multiple-speed lowering of tariffs to provide Canadian sectors with a needed period of transition and adaptation.** Where zero tariffs on Canadian goods apply, it would also be essential to verify that non-tariff barriers are reduced.

## PART IV: CANADIAN COMPETITIVENESS AND THE PACIFIC

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This document underscores some of the key ingredients which the Canadian Chamber of Commerce believes should be part of a high-quality and balanced Economic Partnership Agreement (EPA) with Japan. EPA negotiations are the next logical step to revitalize our country's economic partnership with Japan, the world's third largest and one of its most prosperous markets.

An agreement of the right quality could better open the doors of opportunity for Canadian businesses, small and large, at a time when they are actively working to diversify their international trade beyond the United States—at a time when Canadian business is striving to have more of its eggs, and bigger eggs, in different baskets. However, a Canada-Japan EPA, like other trade negotiations, must not be concluded for its own sake. To deliver tangible benefits to Canadian companies, it must open real market access in Japan for our country's goods and services.

At a time when our country is focused on ensuring that our economy and the businesses that drive it are competitive, create jobs and grow in a changing global economic landscape, the development of a Joint Study with Japan raises important questions for Canada:

- As we pursue high-quality trade and investment agreements with key trade partners, are we committed to advancing the right policies at home to ensure businesses are well-equipped to be competitive—policies that remove home-grown barriers to business growth and innovation; that strengthen our IP regime; that ensure Canada continues to boast a plentiful and skilled workforce; and that remove barriers to internal trade within Canada?
- Are businesses prepared to take advantage of the trade and investment opportunities opened to them with the lifting of barriers? Are they prepared



to boost their productivity, innovate, tailor their goods and services to meet the demands of new markets, take smart business risks and actively explore opportunities that are within their reach?

- Is Canada ready to be an active part of the broader regional agreements for open, rules-based trade and investment, which will shape economic exchanges in the Asia-Pacific region for decades to come – agreements such as the Trans-Pacific Partnership (TPP)?

We believe the answer to these questions is – or rather must be – “yes”, in the long-term economic interest of our country.

Canada came out of the global recession of 2009 with its financial system intact and the most robust economy of the G8. With the right effort and motivation, Canada and its businesses are well placed to seize opportunities in Japan and other large markets. Canada’s private sector is equipped for greater leadership in business beyond our country’s borders.

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