



CANADIAN GLOBAL AFFAIRS INSTITUTE
INSTITUT CANADIEN DES AFFAIRES MONDIALES

Japan in the New, Unpredictable World of Trade: What's in it for Canada?

by Ferry de Kerckhove
February 2018

INTERNATIONAL TRADE SERIES

JAPAN IN THE NEW, UNPREDICTABLE WORLD OF TRADE: WHAT'S IN IT FOR CANADA?

by Ferry de Kerckhove

CGAI Fellow
February 2018



CANADIAN GLOBAL AFFAIRS INSTITUTE
INSTITUT CANADIEN DES AFFAIRES MONDIALES

Prepared for the Canadian Global Affairs Institute
1800, 421 – 7th Avenue S.W., Calgary, AB T2P 4K9
www.cgai.ca

©2018 Canadian Global Affairs Institute
ISBN: 978-1-988493-88-6



From what happened in Vietnam on Nov. 10 at the Trans-Pacific Partnership (TPP) negotiations – maybe because of our own NAFTA issues with the U.S. – Canada may not have fully appreciated how much Japan is a pivotal player in international trade. Few countries have as high a stake as Japan had/has in the TPP, as trade accounts on average for [35 per cent](#) of Japan's GDP. To the extent that numbers matter, although difficult to predict accurately, Japan's recent agreements with 10 Pacific Rim countries and the EU would represent a minimum \$100 billion increase in GDP and a revised, Trump-less TPP would add the equivalent of [2.5 per cent of real 2016 GDP](#). To achieve such a result through the new Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), Japan is prepared to sustain more than a [\\$1 billion output loss](#) in agricultural, fisheries and forestry products.

Japan's relentless pursuit of the CPTPP, if need be to the detriment of bilateral agreements with former TPP associates such as Canada, is based on a clear-eyed view of the agreement's benefits for its economy and a belief that, inevitably, further down the road, the U.S. will rejoin.¹ All this takes place in a region swirling with a multiplicity of trade arrangements, agreements or pacts in the making through negotiations, such as the 16-member Regional Comprehensive Economic Partnership (RCEP) viewed by some as an alternative to the TPP, and which includes China and India.

TPP for Japan

It is no wonder that Prime Minister Shinzo Abe was [the first leader to go to Washington to meet Donald Trump](#) even before his inauguration. It was all about TPP and the defence of Japan's exports to the U.S. To Abe, TPP was as much a strategic bulwark against China as it was the ultimate framework to relaunch the Japanese economy. At 40 per cent of the world economy, the 2015 agreement was a huge rule-setting instrument, capable of offsetting both the dramatic 2008 collapse of the western economic model and Chinese initiatives such as the Asian Infrastructure Investment Bank or the Belt and Road initiative. Japan, somewhat oblivious to its own closed markets, saw TPP as opening opportunities overseas for its firms, notably in the automotive sector, thanks in part to changes in rules-of-origin provisions. Even in the agricultural sector, TPP was seen as [incentivizing Japanese producers](#) to become more competitive in more open markets.

TPP was an [integral part of Abenomics](#), aimed at sustaining external demand while stimulating domestic demand, as the latter was known to be inextricably weak, leading to continued deflation.² Abenomics was predicated on a stimulus package focused on recovery for the earthquake-affected areas, fostering globally competitive SMEs through financial support, innovation and promoting workforce diversity. High technology infrastructure investment underpinned these efforts. Some positive results were obtained in terms of growth although the trade balance eventually returned to negative territory. Having secured his reelection, Abe can push for further agricultural restructuring, energize the health-care industry, liberalize the energy sector and broaden labour market reform. Fiscal consolidation progressed but the ultimate results



of structural reforms will definitely depend on a predictable trade and commerce playing field which the new CPTPP is designed to provide. Growth will continue to depend on foreign trade until the reforms stimulate domestic demand.

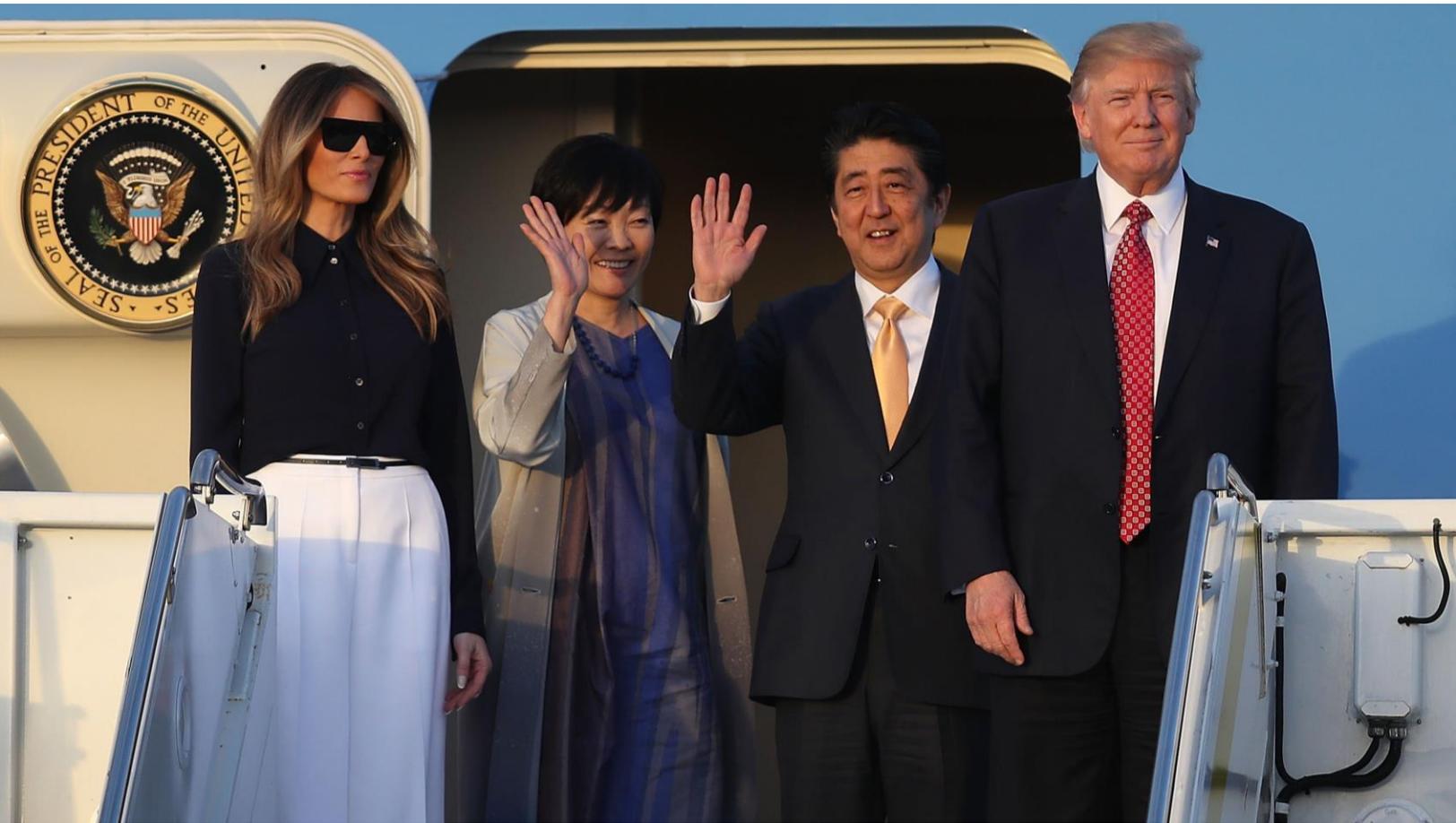


Figure 1: President Donald Trump and his wife Melania Trump arrive with Japanese Prime Minister Shinzo Abe and his wife Akie Abe on Air Force One at the Palm Beach International airport as they prepare to spend part of the weekend together at Mar-a-Lago resort on Feb. 10, 2017. (Joe Raedle / Getty Images)

A tough environment

There is some complacency on the part of non-Asian TPP partners about the security environment facing Japan within its immediate region, U.S. alliance notwithstanding. While there seems to be a lull in tensions between North and South Korea, there remain huge concerns about President Donald Trump's unpredictability between "fire and fury" and "I try so hard to be his friend". Managing its alliance with the U.S. is of critical importance for Japan. It is the only country to have had two North Korean missiles fly over its territory – with Kim Jong-Un threatening to "sink Japan". As much as South Korea and the U.S., Japan needs [China's assistance](#) in reining in Kim. China is also Japan's No. 1 trading partner – as all Asian nations are – which creates a fundamental ambiguity in terms of fostering a CPTPP which excludes China while "playing nice" to that country to avoid a backlash on Japanese exports. The Regional Comprehensive Economic Partnership (RCEP), if concluded, might partly offset these concerns. But all Asian countries have



had to face some of these choices when it came to the [Belt and Road initiative](#). Yet, despite what [Harsh V. Pant](#) calls “Trump’s shambolic approach to international affairs”, he sees some hopeful signs in the form of a “re-emergence of the idea of a democratic ‘quad’ focused on the United States, Japan, India, and Australia ... The reason is simple: there is growing nervousness in the regional power centers in the Indo-Pacific about China’s emergence as a major global power ... So [the Quad is back](#). It may still not work the way many would like it to. But the signals from the Indo-Pacific are that regional states are willing to work together to manage the externalities of China’s rise and America’s incompetence.”

Two elephants in the room and a bull in the U.S. shop

The U.S.:

As today’s U.S. tends to look at Japan from a strictly trade perspective, it fails to appreciate the significance of the changes Abe has made. As [Sheila Smith argues](#), “Japan’s choices in a changing Asia will define the region’s future and will have tremendous impact on U.S. policy in Asia.” This fact underpins the complexity of their trading relationship. As [Tobias Harris](#) puts it, “the United States and Japan want fundamentally different things from their trade relationship.” With the U.S. leaving the TPP, the Trump administration initially appeared to want to pursue a bilateral free trade agreement with Japan. However, Commerce Secretary Wilbur Ross indicated it was [premature](#) after having called it a high [priority](#). The [Pence/Aso meeting](#) in April 2017 led to a more modest statement, referring to the pursuit of discussing “a bilateral framework for setting high trade and investment standards; perspectives on trade and investment initiatives of the United States and Japan in the regional and global trading environment.” The bottom line for the U.S. is reducing the trade imbalance; an FTA with Japan on U.S. terms would entail harder rules-of-origin provisions than the TPP framework. Indeed, as Tobias adds, a U.S. FTA in the present circumstances “is a backward step for an Abe government determined to play a leadership role in Asia and the global economy – especially if the Trump administration were to demand concessions that went beyond the already historic concessions Japan offered to the United States in TPP negotiations.” This uncertainty and the concerns associated with an unpredictable U.S. administration strengthen Japan’s commitment to CPTPP as opposed to engaging in bilateral trade arrangements.

China:

Beyond Japan’s delicate dancing around on the Belt and Road initiative, there is the interconnection between its highly sensitive political relationship with China and a powerful trade relationship. Japan is [China’s fourth largest trading partner](#) after the EU, the U.S. and ASEAN. China is taking advantage of the U.S. policy vacuum to exercise pressure on Japan (and South Korea) to join its initiatives. As Chinese Premier [Li Keqiang argued](#): “China and Japan should work together to safeguard economic globalization, speed up the negotiations on the Regional Comprehensive Economic Partnership (RCEP) and free trade area talks between China, Japan, and the Republic of Korea, so as to contribute to the stability and prosperity of the region and the



world.” It is clear that both parties understand that the prosperity of the whole Asia-Pacific region depends on the peaceful management of their differences. But China gains more of the upper hand whenever the U.S. – through ineptitude or deliberate policy – withdraws further from its leadership role. In a way, the North Korean missile crisis forces the U.S. back into the fray, only to realize that the best cards are in China’s hand, spurring more defensive nationalism in the Japanese psyche.



Figure 2: Ministers in charge of the China-led Regional Comprehensive Economic Partnership trade framework attend a preparatory meeting Sunday in Manila. (Japan Times)

The bull:

Trump is playing a dangerous anti-multilateral game as other trade blocs strengthen or expand their links. Naturally breast-fed on a European unity ideal, French President Emmanuel Macron’s pro-Europe campaign rests in large part on the defence of the multilateral order and international rules-based trade. The rekindling of the faith in U.S.-less plurilateral trade agreements stems from the need to find alternatives to earlier objectives when the EU and Japan “for years had their eyes on separate trade agreements involving the United States — for Japan, the 12-nation Trans-Pacific Partnership (TPP), and for the EU, the Transatlantic Trade and Investment Partnership (TTIP). The prospect of deepened trade integration with the United States served both [economic and geostrategic rationales](#).” While negotiations between Japan and the EU (its second largest trade partner) have been ongoing since 2013, [a broad agreement](#) was pointedly announced a day before the Hamburg July 2017 G20 summit, lowering barriers on virtually all the goods traded between



them. [Brattberg and Schoff conclude](#): “In so doing, they are also sending a clear message to Washington: get on board or risk getting left behind ... The EU has also recently struck other trade deals in Asia with South Korea, Singapore, and Vietnam and is currently considering launching negotiations with Canberra on a bilateral EU-Australian FTA. This flurry of activity puts Brussels, not Washington, in the driver seat of global trade.” Importantly, in this day of Brexit and obtuse nationalism, as [Anthony Fensom puts it](#), “The Japan-European Union (EU) trade pact has sent a powerful message to the rest of the world, amid concerns over growing protectionism.”

The Canadian dimension

In light of what is at stake in these multi-country, multi-billion dollar, multiple trade agreements, arrangements or concluding processes, as many commentators have underscored, Canada should be under no illusion that the prime minister's opting out of a son-of-TPP signing ceremony on the creation of the CPTPP provoked a [very negative reaction](#) on the part of key players. It is seldom that Japanese at the highest levels openly express their displeasure. The Australians had no qualm about stating how they felt. It is important to remember that Canada is the second largest economy in the U.S.-less TPP after Japan, the next country in line being South Korea. Some expressed an exaggerated concern that in response to Canada's withdrawal, “countries currently working with Japan on the TPP will seek out other trade partnerships in the region and [look to China for leadership](#).” But there is no question that the Canadian walk-out sent shock waves through the system and that Canada has a long way to go to re-establish fully its relationship with its Asian and other partners. This was followed by the prime minister coming out pretty empty-handed from China, after hopes for the launching of a trade agreement negotiation collapsed on the altar of Canada's legitimate push for the protection of labour and gender rights. But that should have been cleared before the trip for, as [John Manley put it](#), “Prime ministers usually don't go on trips like that without something to announce.” The withdrawal from the TPP meeting is all the stranger because all this takes place in the context of ongoing work towards the finalization of the Japan-EU Economic Partnership Agreement (JEEPA), which is very much along the lines of the Canada-EU CETA model. For Japan it was a very serious rebuff “as the country seeks to solidify a trade and investment regime for the region that would serve as a [touchstone for other future deals](#)”.

While the TPP, renamed the Comprehensive and Progressive Agreement for Trans-Pacific Partnership – allegedly to please Prime Minister Justin Trudeau – was salvaged after long negotiations, questions remain as to Trudeau's motivations, which are critical in terms of Canada's next steps. The Business Council of Canada had [clearly indicated](#) its view to the government, quoting the deputy chief economist of Global Affairs Canada to the effect that “the TPP 11 could be more beneficial to Canada than the original agreement.” The rationale was based on the preferential access to Japan, the world's third largest economy, and other TPP markets, while the [United States remained frozen out](#).



The [reason Trudeau put forward](#) was: “I wasn’t going to be rushed into a deal that was not yet in the best interest of Canadians. That is what I’ve been saying at least for a week, and I’ve been saying it around TPP12 for years now and that position continues to hold.”

[Various reasons](#) were attributed to Trudeau’s sudden change of heart, such as concerns over automotive imports and cultural issues, and Canada’s desire to appear a tough negotiator amid new talks with the United States over NAFTA. But none of the specific trade issues were deal killers, a point made by Japanese interlocutors. Indeed, the Japanese negotiators were all the more upset because the Canadian trade minister had told them the day before that Canada was in, but also that the issues worrying Canada on labour, culture and gender were easily manageable (culture was one of the limited set of provisions which will be suspended). Some referred to a possible hidden agenda, such as wishing to avoid annoying the American president or even a snub because of Japan’s continuing refusal to renew bilateral trade negotiations with Canada, a \$25 billion merchandise trade relationship. ³

Looking to the future

Obviously, Canada should make all necessary efforts to ensure that the bad feelings are rapidly erased and that it fully engages in the finalization and subsequent implementation of the CPTPP agreement which “maintains the high standards, overall balance, and integrity of the TPP while ensuring the commercial and other interests of all participants”. While Canada is totally consumed with the NAFTA renegotiations, it will be able to benefit early on from the CPTPP [which includes](#) “all of the tariff reductions and goods market access outcomes originally offered by this group.” While not as impressive as the TPP including the U.S., the CPTPP offers real advantages to Canadian exporters and as the second largest economy, Canada should be in the co-driver seat with Japan the sooner they kiss and make up.

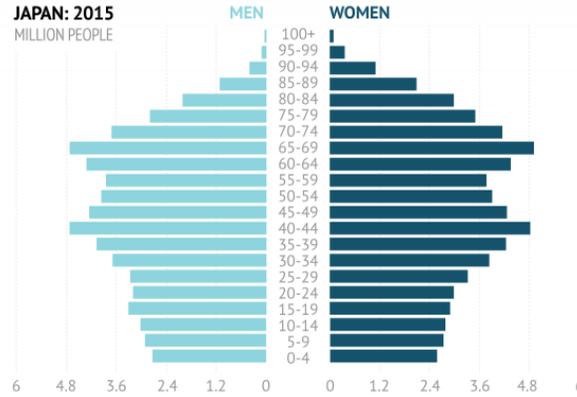


¹ Some of the information revealed here is based on conversations with Japanese officials.

² Japanese deflation has many causes, including low birth rates, decrease in number of workers, declining productivity growth, lack of innovative products and insufficient number of women and older people in the workforce, all of which cannot be resolved strictly with monetary easing. See *The Economist*, "Ending Deflation in Japan: An Old Problem," Feb. 10, 2011. Population projections are far from reassuring:

DEMOGRAPHIC PYRAMIDS

By 2025, Japan's workforce will shrink by around 5.5 million, and by 2040, people over 65 will make up 36 percent of the population.



Source: U.S. Census Bureau International Programs

Copyright Stratfor 2015 www.stratfor.com

³ In 2012, Canada and Japan launched negotiations toward a bilateral free trade agreement (also known as an economic partnership agreement or EPA). This historic announcement followed the March 7, 2012, release of the Report of the Joint Study on the Possibility of a Canada-Japan Economic Partnership Agreement. The study summarizes the significant economic gains to be achieved for Canada and Japan through free trade. Estimated GDP gains would be between US\$4.4 billion and US\$4.9 billion for Japan and between US\$3.8 billion and US\$9.0 billion for Canada (based on 2010 GDP data). http://www.canadainternational.gc.ca/japan-japon/bilateral_relations_bilaterales/index.aspx?lang=eng

► About the Author

Ferry de Kerckhove was born in Belgium in 1947. He has a B.Soc. Sc. Honours in Economics, an M.A. in Political Science from the University of Ottawa and pursued Ph.D. Studies at Laval University in Québec City.

He joined the Canadian Foreign Service in September 1973. From 1981 to 1985, he was Economic Counsellor at the Canadian Delegation to NATO. In September 1992, he was posted to Moscow as Minister and Deputy Head of Mission. In 1995 he became Associate Chief Air Negotiator, then Deputy Head of the Policy Branch and Director-General, Federal-Provincial Relations in Foreign Affairs and International Trade. He was named High Commissioner to the Islamic Republic of Pakistan in August 1998. In September 2001, he became Ambassador to the Republic of Indonesia. He was also accredited to Timor Leste.

In September 2003 he joined the Faculty of Social Sciences at the University of Ottawa as a Canadian Center for Management Development Diplomat in Residence. In 2004 he became Director General, International Organizations. In July 2006, he added to his responsibilities the function of Personal representative of the Prime Minister for Francophonie. In 2008 he was named ambassador to the Arab Republic of Egypt.

He retired from the Foreign Service on September 23d, 2011. He is a Senior Fellow at the Graduate School of Public and International Affairs, Faculty of Social Sciences, University of Ottawa, a Fellow of the Canadian Global Affairs Institute, and a Member of the Board of the Conference of Defence Associations Institute. He is the author of the CDA Institute's Strategic Outlook for Canada 2016. He is a former board member of WIND Mobile Canada. He is President of Ferry de Kerckhove International Consultants Inc.

► **Canadian Global Affairs Institute**

The Canadian Global Affairs Institute focuses on the entire range of Canada's international relations in all its forms including (in partnership with the University of Calgary's School of Public Policy), trade investment and international capacity building. Successor to the Canadian Defence and Foreign Affairs Institute (CDFAI, which was established in 2001), the Institute works to inform Canadians about the importance of having a respected and influential voice in those parts of the globe where Canada has significant interests due to trade and investment, origins of Canada's population, geographic security (and especially security of North America in conjunction with the United States), social development, or the peace and freedom of allied nations. The Institute aims to demonstrate to Canadians the importance of comprehensive foreign, defence and trade policies which both express our values and represent our interests.

The Institute was created to bridge the gap between what Canadians need to know about Canadian international activities and what they do know. Historically Canadians have tended to look abroad out of a search for markets because Canada depends heavily on foreign trade. In the modern post-Cold War world, however, global security and stability have become the bedrocks of global commerce and the free movement of people, goods and ideas across international boundaries. Canada has striven to open the world since the 1930s and was a driving factor behind the adoption of the main structures which underpin globalization such as the International Monetary Fund, the World Bank, the World Trade Organization and emerging free trade networks connecting dozens of international economies. The Canadian Global Affairs Institute recognizes Canada's contribution to a globalized world and aims to inform Canadians about Canada's role in that process and the connection between globalization and security.

In all its activities the Institute is a charitable, non-partisan, non-advocacy organization that provides a platform for a variety of viewpoints. It is supported financially by the contributions of individuals, foundations, and corporations. Conclusions or opinions expressed in Institute publications and programs are those of the author(s) and do not necessarily reflect the views of Institute staff, fellows, directors, advisors or any individuals or organizations that provide financial support to, or collaborate with, the Institute.