Reaching the Home Stretch on Trade Deals

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June, 2015

POLICY UPDATE

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CANADIAN DEFENCE & FOREIGN AFFAIRS INSTITUTE

Prepared for the Canadian Defence & Foreign Affairs Institute
1600, 530 – 8th Avenue S.W., Calgary, AB T2P 3S8
www.cdfai.org

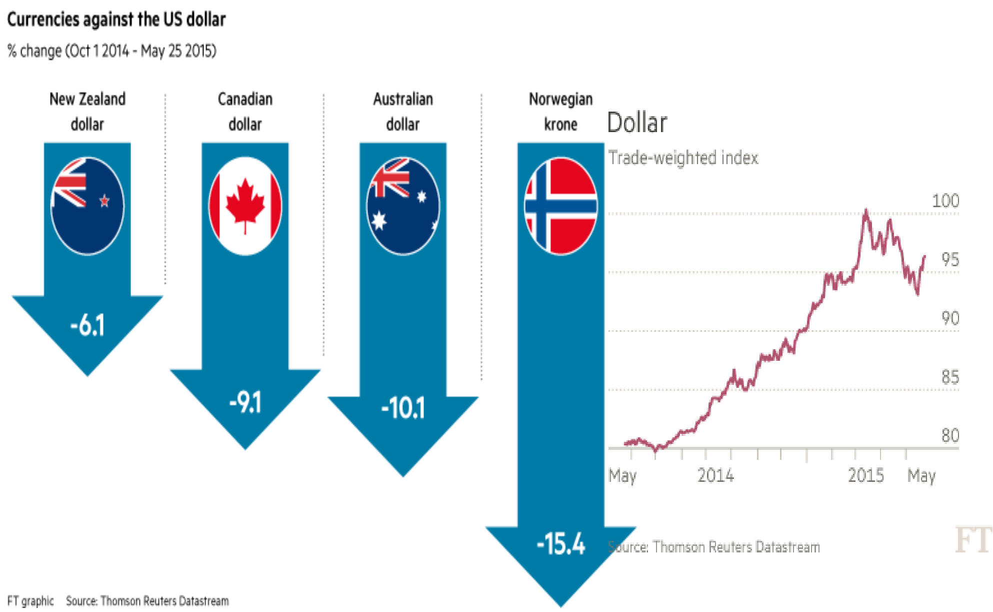
ISBN: 978-1-927573-39-6

For the past three years, Canada and Japan have been strengthening bilateral relations with the potential of a formal trade deal, called the Canada Japan Economic Partnership Agreement. Close observers of this bilateral partnership have suggested that such a trade deal is a natural extension of the Canada-U.S. free-trade deal, since extended to include Mexico, given the extensive trade and investment levels between these two Pacific Rim countries. But, as British Prime Minister Harold MacMillan once cleverly put it, when discussing change in circumstances, “Events, dear boy, events.”

In Japan, the election and then re-election of Prime Minister Abe gave a certain impetus to the trade deal with Canada, as part of his third arrow, including structural reform and opening certain closed industrial sectors. Indeed, two well-attended trade conferences on this bilateral trade deal, one in Tokyo and one in Toronto, showed that very few issues were deal breakers, unlike other trade negotiations with such challenges as very high tariffs on imported rice and the supply management protection of the dairy sector in Canada. Further, there was much to gain on both sides. Two dramatic examples are better access for Canadian firms to Japan’s phenomenal stock of intellectual property, gained over years of heavy investment in R&D, double the levels of Canada’s private sector. And, given the tragedy of the Fukushima nuclear disaster, and closing of nuclear plants (which produce more than a third of Japan’s electricity), Canada is a natural partner for a range of energy supplies, technology, and knowhow.

In reality, this bilateral deal has stalled. It may not happen. What was widely seen in Canadian trade and executive circles as an optimal position – a Free-Trade Agreement (FTA) deal with Japan, full membership in the Trans-Pacific Partnership (TPP), and future bilateral free-trade pacts with India and even possibly China - an ideal location platform for Asian investments to serve the Americas, Canada may end up as a signatory to TPP but in a diminished status because of politically-induced reluctance to make changes to its protected sectors, including the dairy sector. And changing currency alignments, including the rise in the American dollar against various currencies including Canada and Japan, impacts the corporate trade-offs between exports and investing abroad (a ¥1 decline against the dollar lowers Sony’s ¥7bn operating profits), so reduced tariffs are dwarfed by currency and treasury strategies.

The Rising US Dollar



A trade deal with Japan was an ideal goal but a hard sell, unless Canada took the same steps to enhance the negotiations as the Canada-USA FTA. After all, Japan's corporate community is far more knowledgeable about Canada than Canada's corporate community is about Japan. Japan has huge direct and indirect investments in Canada, in every province, while Canada's corporate profile is confined to a few leading firms like Air Canada, Manulife, and McCains. The best known Canadian brands remain Banff, Anne of Green Gables and the RCMP. Despite regular meetings of both negotiating teams, any deal was going to require heavy duty commitment on the Canadian side, including the PMO, senior ministers, and the business community.

In reality, despite initial optimism and seven negotiation sessions, Japan was shifting focus. For instance, Japan, preoccupied with a range of issues, including defence and security against China's aggressive maritime and naval reach, and the yen-dollar parity issues affecting economic growth and exports, put its main trade priority on TPP, the Trans-Pacific Partnership. This initiative was inspired by Washington, in part as a pivot away from military preoccupations in the Middle East, in part as a not too disguised effort to contain China, and a general recognition that the leading growth economies are in Asia.

Sadly, by any measure, this Asian trade initiative was not well-thought through. First, the TPP member countries didn't include Japan, by far the most important economy in Asia, or Canada.

By actual GNP, China may be bigger than Japan or even the USA, depending on the measures, but Japan's global industrial reach, its per capita income, its intellectual property, global banks and multinational firms, including the trading companies, put this country's multilateral trade position on a higher plane.

Whatever the economic merits of TPP, and virtually all serious analysis points to the long-term gains for all participating countries – better access to markets, better division of labour, a legal framework for trade and investment, and a system of dispute settlement. Opponents of TPP point to potential job losses, a hollowing out of many industrial sectors, and a decline in real wages, issues that are the current focus in Washington and drawing parallels with TPP and the NAFTA trade agreement.

Other voices go further and see TPP as a threat to Asian and American security interests. As one commenter wrote recently, "Because of the vast investments by U.S. companies there, they have often acted as lobbyists for the PRC because they are worried about protecting their investments. We can expect that, as U.S. company investments in the TPP countries increase, the potential for our firms to 'protect' their investments by advocating for the interests of their host country might be counter to some of our foreign policy or national security interests."

In Washington, where post 9-11, security and defence trump everything else, policy-makers see the rise of China differently. Given the massive post-1972 reforms, China has re-emerged from a two-hundred year economic and industrial siesta to become as a regional power in Asia, attracting up to $150 billion a year in foreign investment, with an annual growth rate of ten per cent annually in the last decade and now producing annually goods and services the equal of North America, Europe and Japan combined. Aside from security and defence challenges, China has signed trade agreements with twenty-three countries and has designs on its own Asian trade deal. This deal would include Russia, and ignore international norms of labor rights and standards, and environmental policies, thus perpetuating substandard conditions, work practices, faulty machinery and factory conditions found in China and some Asian nations, as illustrated by the terrible loss of life in a textile factory in Bangladesh.

In addition to pushing its own trade pact, called *One Belt, One Road*, China has initiated a new multilateral institution, the Asian Infrastructure Investment Bank. Years ago, China established the ASEAN-China Investment Cooperation Fund, starting at US$10 billion, with another $15 billion USD credit, including $1.7 billion USD favourable credit terms to support regional infrastructure construction, so this new initiative was hardly a surprise. New funding partners now includes Britain, Germany and South Korea but not Canada or the USA, a strategic policy error and reinforcing a we-they approach to Asian trade, even though in the short run this bank may help China's state-owned firms to design and construct Asia's huge, voracious demand for infrastructure of all types: ports, highways, pipelines, sewers, water dams and electricity plants, as well as, eventually, passenger train systems, subways, and superhighways.

It is these arguments – the need for cooperation with China as a partner in Asian growth, including India and South Asia, the rule of law, protection of workers, health standards, and worker safety, and a clear dispute settlement mechanism agreed by the signing parties – that provide the real rationale for TPP and its expansion to other countries, especially China and India. Of course, all parties to the TPP negotiations, a twelve-nation trade bloc that has the potential to be the largest free-trade agreement in world history, in excess of $1.7 trillion in goods and $260 billion in services in 2012, know there is an unspoken elephant in the room, which impede a final deal and last-minute bargaining, tradeoffs, and deal-makers rather than deal-breakers. That elephant is fast-track authority for the U.S. negotiating team.

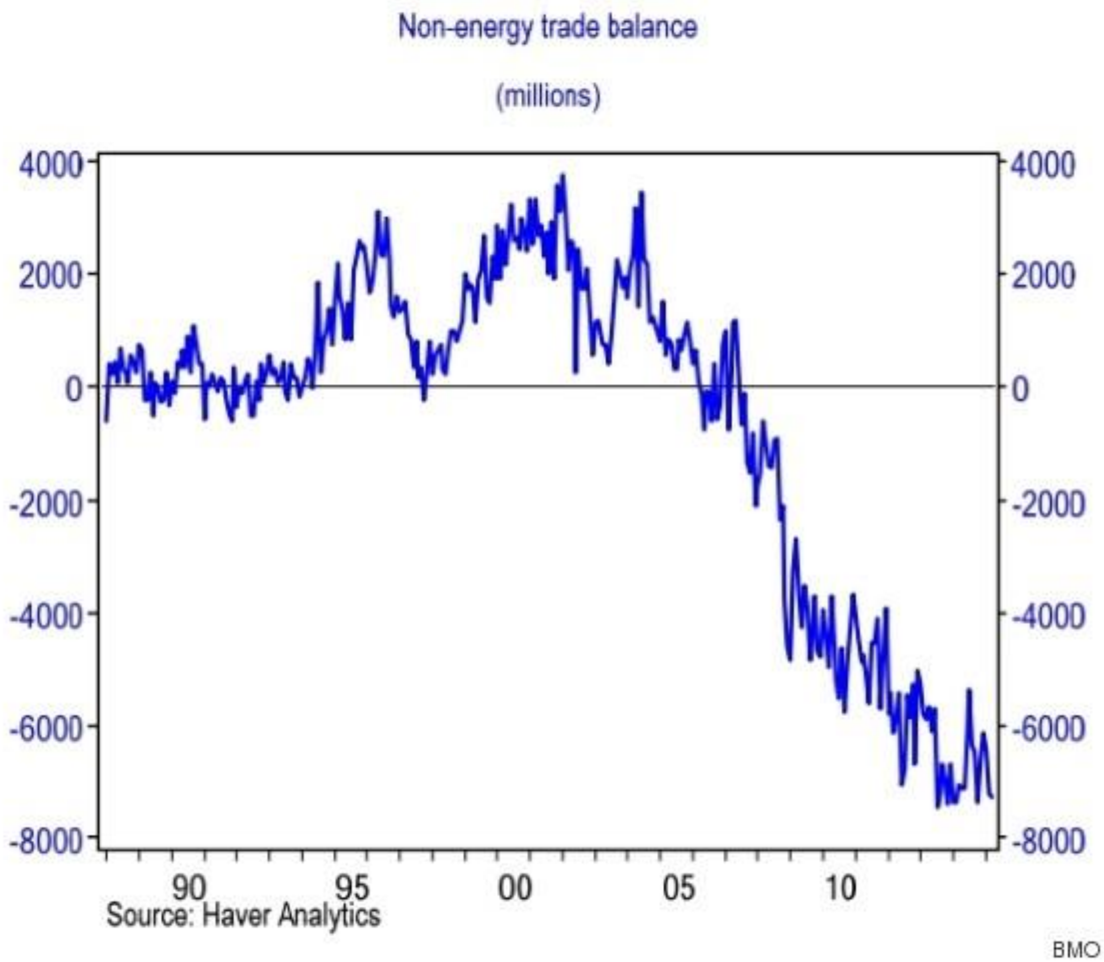
U.S. trade laws are, to put it mildly, very complex, involving procedural issues in Congress, committee votes that involve tit-for-tat to assure acceptance of reluctant members, and arcane workings between the House of Representatives and the Senate. But in the American system of permanent elections, TPP occurs in the current primary season, over a year before the 2016 Presidential election. President Obama needs fast-track authority to finalize negotiations on TPP, before bringing the deal for a yes or no vote in Congress, a system every president has enjoyed since FDR, with the exception of Richard Nixon. The double paradox for foreigners is that most of the opposition is from Obama's own party, the Democrats, the traditional party of free trade.

The TPP vote will be a near thing – thirty-one of forty-four Democratic senators opposed the Senate vote. Fast track authority will pass or fail mainly on the support of the Republican leadership, where the Ronald Reagan legacy of free trade is a Republican mantra, but where many Senators and members of the House of Representatives don't want to give President Obama a real legacy to his Presidency. Canada and Japan are basically on the sidelines while the U.S. settles these Washington-based partisan disputes, but the consequences of a failed agreement on TPP put both countries in a bind.

Japan, of course, has other trade deals in the works, including a potential partnership with the European Union, a deal with the USA, and strengthening thirteen bilateral deals, including one with India. Japan has put a priority on the Japan-EU deal by the end of 2015, a real signal with a deadline that was given publicly, a contrast to the protracted negotiations with Canada. Canada's signed but not ratified trade agreement with the European Union - the Comprehensive Economic and Trade Agreement - is another important game changer because it is a forerunner of a USA-EU deal, easily extended to EU-NAFTA with political will on all sides. But these and other deals now require a far more aggressive trade stance on the part of Canadian firms. Few Canadian firms outside the oil and gas sector or mining firms match the aggressive stance of firms like Manulife, Air Canada, Bombardier, and SNC, in their Asia operations.

Japan-EU Trade and Direct Investment

Consider the case of the collapse in oil prices and the domestic impacts on manufacturing, job creation, and trade balances. A recent depiction of these issues is shown in a chart from the Bank of Montreal, focusing on Canada's trade balance (imports and exports), with energy removed. As this report notes, "Our trade deficit with the rest of the world widened to a record high of $3.02 billion in March, but strip away energy — where we have a trade surplus — and that trade deficit balloons to $7.3 billion."



TPP vs. Canada Japan EPA

Too often, these trade pacts, TPP and Canada-Japan EPA, are seen as alternative choices, not complements. The complimentary nature of the Canadian and Japanese economies lends themselves to a trade and investment pact for two significant reasons. The first is to assure Japan of a secure source of commodity and energy supplies without the baggage of Washington's intensely partisan rhetoric on currency manipulation, closed markets, and protectionist policies, often directed at China, usually with little understanding of the huge imbalances in savings rates that account for bilateral currency levels. The second, on the Canadian side, is to raise the level of Asian awareness of future growth policies, but especially to increase the vital need to gain access, via corporate partnerships, alliances, and joint ventures in Japan's intellectual property capabilities. Only two Canadian firms, Blackberry and Open Text devote expenditures of research and development, in the order of $600 million, small change in the global research game.

But corporate R&D strategies are compliments to trade and talent strategies, and Canada, outside some dominant foreign multinationals in Canada – IBM, Siemens, Pratt and Whitney, to cite three – show that corporate Canada is falling behind, perhaps precipitously so, in the knowledge economy. In the short run, despite a few sectors like pork and beef, other participants in the TPP trade pack are better placed to gain trade advantages – they have more executives on the ground, more direct investments in plant and equipment, and more aggressive corporate plans to grow fast.

In the end, trade deals are political deals, requiring high level support and statesmen-like qualities of political leaders, willing to use political capital to secure success. That is not evident in the Canada-Japan EPA, despite excellent work by the trade negotiators. History may record that the bilateral meeting between Prime Ministers Abe and Harper in August 2014, where EPA was less of a priority than TPP, was the telling signal, one of many related to Canada's stance on protected sectors, of success or failure of this bilateral trade pact.

About the Author

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Canadian Defence & Foreign Affairs Institute

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