

A Macro Analysis of Japan-Australia Bilateral Trade Relations: Present Status and Future Trends

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Abstract

The Australia-Japan relationship has undergone a number of notable changes over the past fifty years, both in terms of institutional frameworks and the nature of commercial engagement. The institutional framework for the bilateral relationship is built upon two Agreements, each of which has treaty-status: the Australia-Japan Agreement on Commerce of 1957 (usually known as the Commerce Agreement); and, the Basic Treaty of Friendship and Co-operation, of 1976 (also known as the Nara Treaty). Now, Australia and Japan enjoy one of the most significant economic partnerships in the East Asian region. The Australia-Japan economic relationship has developed on the basis of strong complementary interest and corporation in wide range of areas. Trade flows have been at the core of economic relationship, Japan has long been Australia's most important export market. Australia's total exports to Japan accounted for 3 per cent of Australia's GDP in 2004. Australia is one of Japan's largest sources of imports overall and a principal source of a number of indispensable commodities. Over the decades, Australia has been a stable secure source of such raw materials for Japan, benefiting both economies. In turn, Japan provides Australia with large volumes of manufactured products contributing significantly to the welfare of its consumers and the efficiency of its industries. Investment flows are also important. Japan is the third-largest source of foreign investment in Australia and there is a demonstrated capacity to expand Australia's investment in Japan. Service trade is strong in some areas such as tourism, but remains a small proportion of total bilateral trade¹.

The bilateral trade relationship between Japan and Australia differs from those between many other developed nations. This reflects the complementary of both countries' natural advantages. Australia is a competitive, efficient, resource rich country, while Japan is renowned for its ability to produce competitive high-tech goods and services. While Australia's exports to Japan are concentrated in primary goods, Japan's exports to Australia are predominantly elaborately transformed manufactures².

According to Australian Chamber of Commerce and Industry, a bold and comprehensive Trade and investment Framework Agreement between Australia and Japan would open the prospect of new trade opportunities for each country in unrealized niche markets, while reinforcing the traditional trade and investment complementarities which have driven the bilateral relationship for the past century³.

This paper outlines the main growth areas in Australia-Japan trade relations and analyses potential for the future growth within the proposed Japan-Australia free trade agreement (JAFTA). The specific aims of this paper are: (i) to investigate the current status of Australia-Japan trade relations, and (ii) to analyze the impact of proposed Japan-Australia free trade agreement on future trade relations between Japan and Australia.

Economic Interdependency

The economic interdependency between Japan and Australia is growing fast. This economic interdependency has clearly stated in the joint study report on economic relations between Japan and Australia including the feasibility or pros and cons of a free trade agreement released in December 2006⁴).

Japan is Australia's largest trading partner and it has long been, by far, Australia's largest export market. In 2005, Australia's exports to Japan were \$A 31.6 billion (around ¥2.7 trillion) — an increase of 24 per cent and larger than Australian exports to China and the United States combined⁵). On the other hand, Australia is Japan's twelfth largest export market and seventh largest trading partner, taking over ¥1.4 trillion (around \$A 16.6 billion) of Japan's export in 2005. Australia is Japan's second largest export market for automobiles and their parts (\$A 8.5 billion/¥712 billion in 2005), and is a key market for many other industrial goods⁶).

Australia is Japan's fifth largest source of imports — imports which play a key role in the Japanese economy. Australia is Japan's third largest supplier of minerals and energy and the largest contributor to Japan's energy supply. Australia's stable supply of minerals and energy to Japan is essential for powering the Japanese economy. Japanese continues to rely on Australia for well over a half its iron ore and coal needs, one sixth of its natural gas needs and one third of its uranium needs. Australia is Japan's largest supplier of a further six key minerals: zinc, bauxite/alumina, lead, silica, titanium minerals and zircon. Australia is one of the world's largest suppliers of resources with the world's largest known reserves of numerous minerals and energy and one of the few net energy exporters in the developed world. At the same time, Japan as a big purchaser of minerals and energy provides an important market for Australia⁷).

Australia's high quality, safe food exports are also important to Japan, including as valuable inputs to the food processing and stock-breeding industries. Japan's self-sufficiency ratio is as low as 40 per cent on a calorie basis and raising this ratio, ensuring stable and reliable food imports and maintaining multi-functionality of agriculture are important policy objectives of Japan. Japan aims to ensure stable and reliable food imports through diversifying food supply sources and maintaining relations with major food exporting countries. Japan relies on the United States for 31 per cent of its food imports, the EU for 14 per cent and China for 12 per cent. Under the existing trading arrangements, Australia is Japan's fourth largest supplier of agriculture and food imports supplying 10 per cent of Japan's needs. Japan relies on Australia for half of its beef needs, one third of its cheese requirements and about one fifth of its wheat and sugar consumption. Japanese farmers purchase from Australia more than half of their feed barley⁸).

Australia, for its part, relies on Japan for important industrial products. 58 per cent of im-

ported passenger vehicles, 37 per cent of imported commercial vehicles and 27 per cent of imported construction equipment comes from Japan. These contribute to robust economic activity in Australia, including in the mineral and energy fields.

Service trade is also an important component of bilateral trade. For Australia, Japan is its third largest export market for services and its fifth largest source of services and its ninth largest source of services import as at end 2005. Tourism and travel receipts are particularly important, and account for the largest proportion of services trade in both directions. As Australia and Japan are both developed economies, with advanced and competitive service sectors, and have a mature economic relationship, there is great potential to expand trade in this sector. Growth in Japan's services exports to Australia in recent years, much in non-travel sectors, is indicative of the potential⁹⁾.

Japan is Australia's third largest foreign investor, with an investment stock of A\$ 53 billion (¥4.5 trillion) as at end 2005. Around 45 per cent of this was direct investment, 44 per cent was portfolio investment and 10 per cent was categorized as other investment. Japanese investment has been vital in developing many of the export industries that drive Australia's strong export performance. In a virtuous circle, Japanese investment to meet Japanese demand has been vital in the expansion of the Australian resource industry, particularly iron ore and coal. Exports of such resources have in turn fuelled Japan's exports worldwide — including to Australia. Japanese investment has also been important for the development of a competitive, export-oriented manufacturing sector in Australia. In tourism Japanese investment has contributed to the growth of the Australian industry, with Japanese-funded infrastructure underpinning a significant proportion of Australia's export earnings in this sector. Japan has made substantial investments in the Australian food sector to serve demand in Japan and Australia¹⁰⁾.

Japanese Exports to Australia

Japan's merchandise exports to Australia are predominately composed of manufactured items, accounting for around 98 per cent of Australia's total imports from Japan in 2004. This proportion has not changed markedly since 1990. These goods are predominantly made up of elaborately transformed manufacturers, including transport equipment, construction equipment, office equipment, electronics and other machinery. The remaining imports are composed of 'other' items (predominantly chemical compounds) at around 1.2 per cent and primary products, which account for around 0.8 per cent. Motor vehicles and auto parts dominate Japanese exports to Australia, together accounting for more than half of total Australian imports. Passenger motor vehicle imports from Japan have grown very rapidly since 1989, with a trend growth rate of 8 per cent. In 1989, these vehicles accounted for 17 per cent of Australian imports from Japan; by 2004, these cars accounted for 39 per cent of Australian imports. Other key imports include goods vehicles, radio transmission

apparatus, motor vehicle parts, civil construction machinery and rubber tires, many of which grew faster than the overall trend of imports from Japan.

On the other hand, Japan's service exports to Australia have grown strongly in recent years. Japan is Australia's fourth largest source of services imports, behind the United States, the United Kingdom and Singapore. The value of transportations services imports from Japan rose from S\$553 million to US\$611 million in 2002–03, while travel rose strongly from \$US 111 million in 1989–90 to \$US 191 million.

According to Japanese statistics, its exports to Australia fell from 1996 to 2001 but have rebounded strongly since then. In Australian dollar terms, this represents a solid growth trend over the seven years to 2003. Japanese data also show exports to Australia are greater than shown by Australian statistics. In 2003, Japan's total services exports to Australia were valued at \$US 1.7 billion, the largest single component of which was transportation, at \$US 0.7 billion¹¹).

Table 1 shows top 20 Japanese merchandise exports to Australia. As shown in Table 1, in 2004, passenger motor vehicles top the list with \$US 4803 million or 39.2 per cent of Japan's total merchandise exports to Australia. Export of goods vehicles to Australia show a marginal decline to

Table 1: Top 20 Japanese Merchandise Exports to Australia (1990 and 2004)

Top 20 Exports	1990	% of total	2004	% of total	Trend growth
Passenger motor vehicles	1326	18.2	4803	39.2	8.1%
Goods vehicles	750	10.3	1121	9.1	0.9%
Radio transmission apparatus	144	2.0	403	3.3	6.7%
Parts and accessories for motor vehicles	322	4.4	377	3.1	1.3%
Civil construction machinery	138	1.9	357	2.9	7.6%
New pneumatic tires	149	2.0	290	2.4	4.0%
Televisions	3	0.0	261	2.1	33.1%
Motorcycles	62	0.8	197	1.6	9.2%
Computers	335	4.6	170	1.4	-3.1%
Parts and accessories for office machines	219	3.0	167	1.4	-3.0
Tubes and pipes	3	0.0	164	1.3	22.8%
Internal combustion piston engines	102	1.4	156	1.3	2.6%
Combined miscellaneous items	138	1.9	148	1.2	2.7%
Photo-copying apparatus	126	1.7	135	1.1	-0.4
Fork-lift trucks; other works trucks fitted with lifting equipment	49	0.7	128	1.0	7.3%
Air or vacuum pumps	75	1.0	101	0.8	-1.1%
Aid conditioning machines	48	0.7	86	0.7	1.1%
Motor vehicles for the transport of ten or more persons	30	0.4	84	0.7	4.4%
Starter motors, alternators, etc.	18	0.2	56	0.5	8.5%

Source: Australia-Japan Trade and Economic Framework (Joint Study). At the time of compilation, data for 2005 onwards were not available for inclusion. Ministry of Foreign Affairs, Japan, 2005.

9.1 per cent in 2004 from 10.3 in 1990. However, the total is 48.3 per cent or almost half of Japan's total merchandise exports to Australia. This is mainly due to very high demand in the Australian market for Japanese automobiles. Goods vehicles rank number two with \$US 1121 million in 2004. However, as shown in Table 1, compared to 1990, some merchandise exports from Japan show a decline in 2004. For example, Japanese exports of computers in 1990 show \$US 335 million and in 2004, Japanese computer exports to Australia have declined to \$US 170 million. One major reason for this downward trend is rapid growth of computer technology both hard ware and soft ware in Australia. And also severe international competition has a major impact to decline Japan's computer market share in Australia. However, in general, the consumer demand for Japanese value-added products is still strong in the Australian market.

The Australian and Japanese services sectors are the dominate sector in their economy; in 1999, they accounted for 71 per cent of Australia's total value added and 66 per cent of Japan's value added¹²). However, outside travel growth in bilateral services, trade has been moderated and this trade remains a small share of total bilateral trade. Transportation services account for more than half of Japan's service exports to Australia. As the value of service exports from Japan between 1990–91 and 2001–02 moved relatively little, Japan's share of Australia's overall non-travel service imports declined from 8.1 per cent in 1986–87 to a low of 4.2 per cent in 1997–98. However, Japan's share recovered to 6.1 per cent of service imports in 1999–00.

Australian Exports to Japan

Over the last 40 years the geographic representation of the countries that Australia exports to has significantly changed. No longer is Australia heavily dependent on the United Kingdom or other European countries. The formation of European Economic Community (EEC) in 1958 made trade Europe increasingly difficult for non-European countries and when the United Kingdom joined the EEC in 1973 Australia's export opportunities were reduced even further. Replacements for the EEC were found in Asian nations, with their rapidly growing economies, which provided close, large markets for Australia's exports. Table 2 shows Australia's top 10 export destinations in 2001, 2003 and 2006.

Australia trades with over 220 countries, although the 10 largest export destinations by value account for about two-thirds of the total (Table 2). Japan tops the export destination list with \$23,728 million in 2001 and \$ 31,082 million in 2005–06. However, Japan's share has fallen by 8 percentage points during the period 1995–2003. This reflected slow-consumer demand growth in Japan after the recession and the weaker conditions throughout the region, which dampened demand for Australian-sourced materials embodied in Japanese exports. However, during the period 2003–06, Australian merchandise exports to Japan show a steady growth from \$21,738 million in

Table 2: Australia's Top 10 Export Destinations (Comparison of Change)

Destination	Value in 2001 (\$ Million)	Destination	Value in 2003 (\$ Million)	Destination	Value in 2005–06 (\$ Million)
Japan	23,728	Japan	21,738	Japan	31,082
USA	11,971	USA	10,369	China	18,140
South Korea	8,869	South Korea	9,116	South Korea	11,753
China	7,588	China	8,793	USA	9,785
New Zealand	6,972	New Zealand	8,120	New Zealand	8,747
Taiwan	5,339	United Kingdom	7,236	United Kingdom	7,792
Singapore	5,161	Singapore	4,655	India	7,382
United Kingdom	5,160	Taiwan	4,314	Taiwan	5,909
Hong Kong	4,141	Hong Kong	3,215	Singapore	4,203
Indonesia	2,746	Indonesia	2,908	Indonesia	3,982

Source: Year Book- Australia 2004, pp. 816–817, Trends in Australia's Exports, *Reserve Bank of Australia Bulletin*, April, 2002, and ABS — International Trade in Goods and Services, p. 26, 2006.

2003 to \$31,082 million in 2005–06.

Composition of Australian Exports to Japan

Australia is a key supplier of primary products to Japan, including agricultural commodities, minerals and energy resources. In 1990, these exports accounted for 85 per cent of total Australian merchandise exports; by 2004, they accounted for 89 per cent of Australian exports to Japan. Within primary products, the composition of Australian exports to Japan has changed marginally since 1990, with rural exports declining (primarily due to declining wool exports to Japan), while food and 'other' exports expanded their shares. At the product level, Australia's exports are heavily concentrated on four products- coal, iron ore, aluminium and beef — which together account for 52 per cent of Australia's total merchandise exports to Japan. Japan is its largest market for coal, aluminium and beef and second largest for iron ore. Japan buys 43 per cent of Australia's total coal exports, 37 per cent of its total iron ore exports, 49 per cent of its beef exports and 36 per cent of its aluminium exports.

Japanese imports of Australian beef during 2005 reached a record 411,442 metric tons — a four per cent increase over the previous year and the fifth consecutive yearly increase, according to figures released by Meat and Livestock Australia (MLA). In 2006, it was 405,796 metric tons. Table 3 shows Australian beef exports to Japan in 2005 and 2006.

There has been strong growth in key resource commodities such as coal, iron ore, aluminium, copper ore, petroleum gas and crude petroleum. Some agricultural exports have also shown growth, particularly cheese, canola and animal feed. Forestry exports such as wood chips have also grown

Table 3: Australian Beef Exports to Japan–2005–2006

Value (A\$'000)	2006	2005	% Change
Total chilled exports:	1,525,618	1,652,730	–8%
Carcase	432	50	769%
Bone in	2,020	2,933	–31%
Boneless	1,523,165	1,649,747	–8%
Total frozen exports	701,972	715,245	–2%
Carcase	894	1,200	–26%
Bone in	2,807	5,775	–51%
Boneless	698,272	708,270	–1%
Total beef exports	2,227,590	2,367,975	–6%
Carcase	1,326	1,250	6%
Bone in	4,827	8,708	–45%
Boneless	2,221,437	2,358,016	–6%

Source: Statistical Summary of Australian Beef Exports to Japan, Meat and Livestock Australia, (MLA) 2007 (MLA Market Information).

Table 4: Australia's top 20 exports to Japan 1990 and 2004 (\$US million)

Items	1990	% of total	2004	% of total	Trend growth
Coal	2,442	23.3	4,229	26.0	2.1%
Combined confidential items	631	6.0	2,709	16.6	12.1%
Iron ores and concentrates	951	9.1	1,645	10.1	2.6%
Chilled beef	453	4.3	1,132	6.9	1.4%
Unwrought aluminium	809	7.7	946	5.8	3.1%
Wood chips	293	2.8	556	3.4	1.8%
Frozen beef	234	2.2	518	3.2	3.2%
Copper ore and concentrates	149	1.4	420	2.6	8.4%
Petroleum gases	392	3.7	392	2.4	–5.6%
Petroleum oils, crude	237	2.3	287	1.8	1.1%
Cheese and curd	44	0.4	267	1.6	10.7%
Rape seed	–	–	219	1.3	–
Fodder	27	0.3	179	1.1	14.2%
Animal feed	39	0.4	168	1.0	8.0%
Edible offal	31	0.3	161	1.0	12.5%
Cobalt matters	–	–	123	0.8	–
Gold unwrought	751	7.2	123	0.8	–14.7%
Crustaceans	166	1.6	115	0.7	–3.8%
Zinc ores and concentrates	279	2.7	104	0.6	–6.9%
Petroleum oils and oils other than crude	15	0.1	90	0.6	30.9%

Source: Australia-Japan Trade and Economic Framework (Joint Study); Ministry of Foreign Affairs of Japan, p. 7, (2005). At the time of compilation, data for 2005 onwards were not available for inclusion.

progressively. Table 4 shows the composition of Australian top 20 exports to Japan in 1990 and 2004.

As shown in Table 4, Australia exports primary resources to Japan. Japan is a major destination for Australian resources. In 1990, Australia exported \$US 2,442 million (23.3% of total exports) worth of coal to Japan and in 2004 coal exports to Japan increased to \$US 4,229 million (26% of total exports). However, in recent years, Australia's share of the Japanese market has declined. In 1990, Australia accounted for 5.3 per cent of Japan's total imports, or \$US 12.3 billion. By 2004, this share had risen in absolute terms to \$US 19.4 billion, but as a share had fallen to 4.3 per cent. In 1990, Australia was Japan's third largest resource of imports, while by 2004, it had dropped to fourth, next to China, USA, South Korea.

Current Status of Bilateral Trade

Japan is Australia's largest trading partner and it has long been, by far, Australia's largest export market. In 2005, Australia's exports to Japan were \$A 31.6 billion (around ¥2.7 trillion) — an increase of 24 per cent and larger than Australian exports to China, South Korea and the United States (Table 2). On the other hand, Australia is Japan's twelfth largest export market (Table 5) and

Table 5: Value of Japan's Exports and Imports
Major Destinations—2004

Japan's Exports (\$M)		Japan's Imports (\$M)	
Country	Export Volume	Country	Import Volume
USA	127,007	China	94,362
China	73,913	USA	62,511
South Korea	44,248	South Korea	22,051
Taiwan	42,019	AUSTRALIA	19,449
Hong Kong	35,411	Indonesia	18,695
Thailand	20,277	Saudi Arabia	18,491
Germany	18,970	UAR	18,343
Singapore	17,976	Germany	17,079
UK	14,987	Taiwan	16,687
Netherlands	13,387	Malaysia	14,112
Malaysia	12,565	Thailand	14,106
AUSTRALIA	11,811	Canada	8,407
Philippines	9,600	France	8,351
Indonesia	9,075	Iran	8,268
France	8,364	Philippines	8,246
WORLD TOTAL	565,752	WORLD TOTAL	455,254

Source: Ministry of Economic, Trade and Industry of Japan—2005.

seventh largest trading partner, taking over ¥1.4 trillion (around \$A 16.6 billion) of Japan's exports in 2005. Australia is Japan's second largest export market for automobiles and their parts (\$A 8.5 billion/¥713 billion in 2005), and is a key market for many other industrial goods Table 5 shows Japan's exports and Imports by destination.

Australia is Japan's fourth largest source of imports — imports which play a key role in the Japanese economy. Japan imported \$19,449 worth of commodities from Australia in 2004. From mineral supplies, Australia is Japan's third largest supplier of minerals and energy and the largest contributor to Japan's energy supply. Australia's stable supply of minerals and energy to Japan is essential for powering the Japanese economy. Japan continues to rely on Australia for well over half of its iron ore and coal needs, one sixth of its natural gas needs and one third of its uranium needs. Australia is Japan's largest supplier of a further six key minerals: zinc, bauxite/alumina, lead, silica, titanium minerals and zircon. Australia is one of the world's largest suppliers of resources with the world's largest known reserves of numerous minerals and energy and one of the few net energy exporters in the developed world. At the same time, Japan as a big purchaser of minerals and energy provides an important market for Australia¹³).

On the other hand, Australia's high quality, safe food exports are also important to Japan, including as valuable inputs to the food processing and stock-breeding industries. Japan's self-sufficiency ratio is as low as 40 per cent on a calorie basis and raising this ratio, ensuring stable and reliable food imports and maintaining multi-functionality of agriculture are important policy objectives of Japan. Japan aims to ensure stable and reliable food imports through diversifying food supply sources and maintaining relations with major food exporting countries. Japan relies on the United States for 31 per cent of its food imports, the EU-15 for 15 per cent and China for 12 per cent. Under the existing trading arrangements, Australia is Japan's fourth largest supplier of agriculture and food import supplying 10 per cent of Japan's needs. Japan relies on Australia for half of its beef needs (Table 3), one third of its cheese requirements (Table 4) and about one fifth of its wheat and sugar consumption. Japanese farmers purchase from Australia more than half of their feed barley¹⁴).

Australia, for its part, relies on Japan for important industrial products. 58 per cent of imported passenger vehicles, 37 per cent of imported commercial vehicles and 27 per cent of imported construction equipment comes from Japan (See Table 1). These contribute to robust economic activity in Australia, including in the mineral and energy fields.

Service trade is an important component of bilateral trade. For Australia, Japan is its third largest export market for services and its fifth largest source of service imports. For Japan, Australia was its thirteenth largest export market for services and its ninth largest source of services imports as at end 2005. Tourism and travel receipts are particularly important, and account for the largest proportion of services trade in both directions. As Australia and Japan are both developed

economies, with advanced and competitive service sectors, and have a mature economic relationship, there is great potential to expand in this sector. Growth in Japan's services to Australia in recent years, much in non-travel sectors, is indicative of the potential¹⁵⁾.

Japan is Australia's third largest foreign investor, with an investment stock of \$A 53 billion (¥4.5 trillion) as at end 2005. Around 45 per cent of this was direct investment, 44 per cent was portfolio investment and 10 per cent was categorized as other investment. Japanese investment has been vital in developing many of the export industries that drive Australia's strong export performance. In a virtuous circle, Japanese investment to meet Japanese demand has been vital in the expansion of the Australian resource industry, particularly iron ore and coal. Exports of such resources have in turn fuelled Japan's exports worldwide — including to Australia. Japanese investment has also been important for the development of a competitive, export-oriented manufacturing sector in Australia. In tourism Japanese investment has contributed to the growth of the Australian industry, with Japanese-funded infrastructure underpinning a significant proportion of Australia's export earnings in this sector. Japan has made substantial investments in the Australian food sector to serve demand in Japan and Australia¹⁶⁾.

Australia is Japan's 15th largest source of foreign investment. Australia's stock of investment in Japan was \$A 32 billion (¥2.7 trillion) as at end 2005. Direct investment account for less than 1 per cent of the stock. That said, in recent years Australian investors have responded to opportunities provided by Japan's economic reforms and deregulation to make notable investment in Japan. This responsiveness to opportunity can do much to realize the potential for the economic integration of two advanced economies. Australia has a large pool of managed funds, the fourth largest in the world. Australia also has an excellent profile as an investor in other advanced economies¹⁷⁾.

Japan-Australia Free Trade Agreement (JAFTA)

Australia and Japan currently have bilateral trade and investment agreements with several countries. Australia has bilateral trade and investment agreements with New Zealand (entered in to force in 1983), Singapore (2003), Thailand (2005) and the United States (2005). Australia is also in the process of discussing agreements with China, Malaysia and ASEAN members. On the other hand, Japan has (economic partnership) agreements with Singapore (2002) and Mexico (2005). Japan is discussing trade agreements with ASEAN members and the Republic of Korea.

Australia and Japan already have bilateral arrangements promoting deeper commercial relations — the Australia-Japan Commerce Agreement of 1957 and the Basic Treaty of Friendship and Cooperation of 1976 (the so called Nippon Australia Relations Agreement, or NARA Treaty). The NARA treaty contains provisions for the 'fair and equitable treatment' of nationals from the other party with respect to their business or professional activities undertaken within the territory of each

country.

A free trade agreement (FTA) between Japan and Australia could strengthen the relationship between the two countries and ensure the prosperity of their businesses in the long-run. A bilateral free trade agreement (FTA), focused on security of supply and increased trade in the agricultural and service sectors, would appear to make sense — especially when seen as a stepping stone on the long road to multilateral free trade. It has the potential to strengthen an already strong relationship and ensure that Japanese and Australian businesses, and their customers, suppliers, employees and shareholders, prosper in the decades ahead. Australia and Japan need to work more closely on opening their economies and improving their competitiveness and a broader trade base is needed between them.

Four considerations should be taken into account in investigating the feasibility of the FTA between Japan and Australia: that government policies making trade and investment more difficult will prompt international businesses to pursue opportunities elsewhere; that cultivating international investment stimulated the domestic economy; that business would respond to the changing demographics of both countries, and that greater business opportunities may exist in financial and professional services and agricultural trade and services subject to appropriate policies¹⁸).

Japan's Cabinet ministers for international trade matters have approved a joint report submitted by Japanese and Australian experts recommending initiating talks on a bilateral free trade agreement. The approval will pave the way for the opening of negotiations in 2007. The expected FTA talks with Australia will be Japan's first such parley with a major exporter of farm products, so there could be serious roadblocks ahead in view of Japan's heavy protectionism in agriculture, especially the rice sector. According to the joint report, some trade items might be exempted from the terms of the FTA, although it proposes covering of all products in the trade liberalization talks. The report has indicated that all options would be open, including provision of exemptions for important farm products such as beef, and the matters concerning such products might be negotiated in the future.

An Australia-Japan Free Trade Agreement (JAFTA), if realized, would take the already strong commercial and economic relationship that exists between Australia and Japan to a new, higher level. Econometric modeling undertaken by DFAT in 2003 pointed to the substantial gains for both Australia and for Japan from the liberalization likely to flow from such an agreement.

In present value terms, over a 20 years period, a high quality JAFTA could add as much as \$ A 39 billion to Australia's national output, while the gains for Japan could be around \$A 27 billion (or some ¥2.2 trillion). These estimates are likely to be on the conservative side. Mathematical-economic modeling undertaken by the Australian Chamber of Commerce and Industry as part of Australian Chamber of Commerce of Industry to the JAFTA processes also shows high degrees of trade complementarities between Japan and Australia. That is, each is producing and exporting to

the other what the other wants to buy and import — a solid springboard for a JAFTA¹⁹). While some are inclined to place the question of a JAFTA in the ‘too hard’ basket, in some areas like merchandise trade there is not a great distance to travel. At present, around 80 per cent of Australian exports to Japan enter duty free and 87 per cent of those goods subject to duty are at rates of less than 10 per cent.

It is clear that effort needs to be made to strengthen the economic relationship between Australia and Japan. It is slipping in comparison to relationship with Australia’s other trading partners. The standard signature of political interest in strengthening a trade relationship today is a Free Trade Agreement. It creates legally binding obligations to expand economic relationship.

Bilateral trade and investment liberalization between Australia and Japan is likely to remove some barriers to bilateral trade and investment. At present Australia maintains specific limits on, or requirements relating to, foreign investment in: newspapers; broadcasting; urban land; shipping; Qantas and other Australian international airlines; Telstra; Commonwealth Serum Laboratories; investment by foreigners in existing Australian businesses in the media sector including direct investment irrespective of size and portfolio investments of 5 per cent or more; and acquisitions of interests in Australian urban land (with the exception of acquisition of interests in developed commercial real estate), and so forth.

On the other hand, Japan’s investment barriers include: prior notification of foreign investment is required in sections identified by the OECD as having ‘the potential to compromise a country’s safety, prevent maintenance of law and order, or cause damage to the protection of public safety’; mining; telecommunications; broadcasting; maritime transport, and so forth.

As a result of investment liberalization, Japan and Australia can have a number of favorable impacts: ① Increasing the allocative efficiency of investment. That is, investment can move to areas where it has the highest marginal product of capital or can generate the greatest value of production. This can happen by reducing discrepancies in the marginal product of capital between different countries. Alternatively, it can happen if investment is attached to particular skills and technology, in which case these attributes are allocated more efficiently. Improvements in allocative efficiency can drive up productivity; ② Lowering the cost of investment through increasing the pool of available funds. A reduction in investment barriers may effectively increase the supply of funds for investment and therefore lower the cost of obtaining these funds, and ③ Lowering the transaction costs of investment barriers²⁰.

According to data released by Japan External Trade Organization (JETRO), in 2003, Australia ranked number 8 in the list of Japan’s foreign direct investment (FDI), and in 2004, Australia’s position went up by two points to number 6 (Table 6). Japan is an important source of FDI for Australia, with just under 10 per cent of Australia’s inward FDI stock coming from Japan. Inward FDI is quite considerable for Australia with an FDI stock to GNP ratio of over 40 per cent. This FDI

Table 6: Japan's Top 10 Foreign Direct Investment Destinations (2002–2004)

Country	2003	Rank	Country	2004	Rank
USA	10,733	1	USA	7,530	1
China	3,950	2	China	3,950	2
Netherlands	3,419	3	Netherlands	3,355	3
United Kingdom	2,500	4	Cayman Islands	2,746	4
Cayman Islands	1,659	5	Thailand	1,874	5
France	1,174	6	AUSTRALIA	1,654	6
Brazil	1,089	7	United Kingdom	1,625	7
AUSTRALIA	946	8	South Korea	771	8
Belgium	734	9	Belgium	654	9
Germany	715	10	Germany	642	10

(US\$ million) Source: Japan External Trade Organization, 2005

stock is not so important from Japan's perspective, making up fewer than 4 per cent of Japan's total outward FDI stock²¹). However, with the liberalization of investment between Japan and Australia, there is a strong potential to Australia to attract more Japanese FDI. The liberalization of investment would have a positive impact on Japan- Australia investment relations.

Japan and Australia expect substantial economic benefits from the FTA. Both countries expect to increase their GDP, trade and investment as a result of FTA. The estimated magnitude of the macroeconomic gains varied from 0.66 per cent to 1.79 per cent for Australia's GDP in 2020, and between 0.03 per cent and 0.13 per cent for Japan's GDP in 2020²²). In net present value terms over 20 years, the lower end of the range of Australia's GDP gains would equate to \$A 39 billion (around ¥3.3 trillion), while Japan's would be \$A 27 billion (around ¥2.3 trillion). Australian consumers would be \$A 19 billion (¥1.6 trillion) better off over 20 years, while Japanese consumers would gain \$A 68 billion (¥5.7 trillion) over the same period²³).

However, Japan is highly sensitive in the fields of agriculture, forestry and fishery. Japan concerns the potential negative impact of tariff elimination to its agriculture. Japan's agricultural policy is to securing its domestic food supply to maintain and enhance domestic production, combined with ensuring stable and reliable imports. Agriculture is a key part of the FTA and that the productive negotiations in the agricultural sector between Australia and Japan provide mutual benefits for both countries, namely, the reliable supply of safe and high quality food to Japan and export opportunities for Australia.

According to Joint Study Report released in 2006²⁴), the study group has noted that food is a key part of the economic and strategic relationship between the two countries has provided benefits for both countries, namely, the reliable supply of safe and high quality food to Japan and export opportunities to Australia. In 2005, Japan imported \$4329 million worth of food items (or 8.6 per cent of total imports) from Australia. On the other hand, in 2005, Japan exported \$30 million worth

Table 7: Japan's Food Imports –2003–2005

Country	2003		2004		2005	
	Imports	Share	Imports	Share	Imports	Share
World Total	44,086		49,637		50,399	
USA	11,592	26.3	11,308	22.8	11,121	22.1
China	6,251	14.2	7,635	15.4	8,148	16.2
Australia	2,999	6.8	4,344	8.8	4,329	8.6
Canada	2,615	5.9	3,074	6.2	3,073	6.1
Thailand	2,450	5.6	2,362	4.8	2,521	5.0
Brazil	859	1.9	1,299	2.6	1,495	3.0
France	1,299	2.9	1,493	3.0	1,466	2.9
Chile	939	2.1	1,238	2.5	1,384	2.7
Denmark	1,308	3.0	1,653	3.3	1,366	2.7
South Korea	1,312	3.0	1,453	2.9	1,351	2.7
10–Country Total	31,624	71.7	35,859	72.2	36,254	71.9
Other Countries	12,462	28.3	13,778	27.8	14,145	28.1

Source: Trade Statistics, Ministry of Finance–Japan: JETRO, 2006

of food items to Australia. The proposed FTA will further strengthen Australian-Japan food trade. Table 7 shows Japan's food imports in 2003, 2004 and 2005. At present, Australia ranks No.4 in the food import list in Japan and the trade volume shows an upward trend. With the implementation of the proposed FTA, Australia has very high potential to further increase its food export volume to Japan.

Further, the study group has noted that Japan's policy for securing its food supply is to maintain and enhance domestic production, combined with ensuring stable and reliable imports and stockpiling. The proposed FTA will assist to strengthen food trade relations and help Japan to realize its food security objectives, including in such cases as world supply shortages. Australia will benefit from enhanced export opportunities to its most valuable customer and from close integration with Japanese food supply chains. According to study group report, both countries should consider measures to strengthen and provide stability and reliability in the food supply relationship between Japan and Australia, as part of a comprehensive bilateral FTA²⁵).

On the other hand, there is a close investment relationship between Australia and Japan. Some evidence indicates that the current level of investment is lower than the expected level. In liberalizing the markets, investments will be more attracted to both directions and be consistent with Japan's objective of promoting inward FDI and contribute further to Australia's economic growth. Further, even at present both countries have derived significant gains from bilateral investment and will benefit from its further growth. Japanese investment in the Australian minerals, energy, food, and tourism sectors has contributed significantly to the development of these sectors. Recently Aus-

tralian investors have taken advantage of new investment opportunities in Japan. These investments have increased tourism in Japan, contributed to economic development in Japan's regional areas, and helped build a closer relationship between the countries.

Conclusion and Final Remarks

In this paper, author has investigated two major issues: ① current status of trade relations between Australia and Japan, and ② the potential benefits to Japan and Australia in implementing the proposed Japan-Australia Free Trade Agreement. And also we observed why the Australia-Japan trade relationship is important in the long-run and what mutual benefits they gain. Australia has always reaped considerable wealth from the export of its key commodities such as coal, iron, beef and wood chips to Japan. The quid pro quo is that it has also needed to import a wide range of merchandise and services such as automobiles, machinery, spare parts, civil construction machinery and equipments from Japan which is unable to source locally at competitive prices. Australia supplies some 60 per cent of Japan's coal and iron ore needs and 13 per cent of its LNG requirements. In 2005, Australia exported more than 90 per cent of Japan's beef requirement. On the other hand, from Japan's side, Japan is Australia's second largest source of tourists, with over 700,000 Japanese visited Australia in 2005. Australia is Japan's sixth largest foreign direct investment destination in 2004, and for Australia, Japan is the fourth largest investment destination. It is clear that Japan and Australia have established a strong base for their bilateral trade and services.

Australia's most important Asian trading partner is Japan which accounted for 13.5 per cent of two-way trade flows in 2003. The impetus of these freer trades with these two countries is clear. The trade relationship between the Japanese and Australian business sector has been strong and stable, but further strength and development is needed. Considering recent development in the world trade and the globalization process, further enhancement of the Australia-Japan trade relationship is required. In various trade and service sectors, the trade relations between Australia and Japan can further be promoted. These areas include goods and services, investments both inward and outward, access to government procurement markets, financial transactions, communication, tourism and other activities. In establishing strong and stable free trade agreement between Japan and Australia, these activities can further be promoted. The FTA will be a good opportunity to help Japan and Australian business community to reaffirm the significance of economic relationship between Australia and Japan.

Japan is dependent on imports for its energy supply and Australia is a major and reliable supplier of energy. Australia and Japan have built a bilateral business partnership that is important to both countries. Japanese business investors are looking for new investment opportunities and strongly request that the Japan-Australia FTA remove the restrictive measures on trade and invest-

ment and the movement of people and take steps to improve the investment and trade environment. This will also contribute to economic integration in the region.

Economic modeling undertaken by DFAT in 2003 pointed to the substantial gains for both Australia and for Japan from the liberalization likely to flow from such an agreement. In present value terms, over a 20 year period, a high quality FTA could add as much as \$A 39 billion to Australia's national output, while the gains for Japan could be around \$A 27 billion (or some ¥2.2 trillion). These estimates are likely to be on the conservative side.

While the Australia-Japan relationship is important to both countries, each has active foreign, trade and security relations elsewhere in the Asia Pacific region and around the world. In the trade area, both Australia and Japan have maintained a strong commitment for a long period of time to multilateral, rules-based trading system in the form of the World Trade Organization. Both countries are also looking to cement various bilateral economic and trade relations through free trade agreements with important trading partners. Australia already has high quality FTAs with New Zealand, Singapore, Thailand and the United States and negotiating with ASEAN, China, Malaysia and the United Arab Emirates among others.

Also Australia is doing preliminary studies with Mexico, India and prospectively South Korea.

On the other and Japan is also building its stock of bilateral trade agreements with countries such as Mexico, Singapore and the Philippines and is talking to Malaysia, South Korea, Thailand and the ASEAN grouping as a whole.

Despite Japan's economic stagnation and periodic recessions, Japan's importance as Australia's largest export market has contributed right throughout the past decade, increasing its intake of goods and services from Australia by almost 65 per cent over the period. Japan represents a fifth of Australia's total exports, a quarter bigger than Australia's second largest trading partner, the United States. In 2000 alone, Australia sold \$25.5 billion worth of goods and services to Japan.

The proposed FTA will further strengthen Australia-Japan trade relations and enhance dialogue and cooperation in new emerging areas such as biotechnology, energy and resources, financial and other professional services, information technology, consumer and privacy policies, e-government and mobility of business people. It will also address many other issues of concern to business in both countries — intellectual property, common standards and competition guidelines for example.

Endnotes

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- 2) Ibid p. 3.
- 3) An Australia-Japan Trade and Investment Framework Agreement, ACCI Review, January 2002, (Australia Chamber of Commerce and Industry)
- 4) Joint Study for Enhancing Economic Relations between Japan and Australia, including the Feasibility or Pros and Cons of a Free Trade Agreement (Final Report, December 2006), p. 6.

- 5) Ibid p. 6.
- 6) Ibid p. 6.
- 7) Ibid p. 7.
- 8) Ibid p. 7.
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- 22) Joint Study For Enhancing Economic Relations, 2006, (Ibid p. 8)
- 23) Ibid pp. 8–9.
- 24) Ibid p. 12
- 25) Ibid p. 12.

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