

Japan-Australia Trade Issues: An analysis of recent developments in market liberalization

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Abstract

The rapid development of Japan's relations with Australia in the post-war era was based on mutually complimentary trade links. Since then, the relationship has expanded to economic activities, politics, culture and various other fields. As trusted partners in the Asia Pacific region, Japan and Australia share a common interest in regional stability and prosperity.

Australian trade had shifted away from other Commonwealth countries toward Asia from around sixties and seventies. Japan in particular had emerged as the leading trading partner. Japan is now the largest export market for Australia, although Japan is ranked only third as a source of imports to Australia after America and China. Because of this, Australia has had a trade surplus with Japan.

Australia is a predominant source of food and raw materials for Japan. In 1990 Australia accounted for 5.3 percent of total Japanese imports, a share that held relatively steady in the late 1980s. Australia was the largest single supplier of coal, iron ore, wool, and sugar to Japan in 1990. Australia is also a supplier of uranium. By 1988 Japanese investment made Australia the single largest source of Japanese regional imports. The ban on American and Canadian beef recently made Australia the largest supplier of beef in Japan.

Resource development projects in Australia attracted Japanese capital, as did trade protectionism by necessitating local production for the Australian market. Investment in Australia totaled US\$8.1 billion in 1988, accounting for 4.4 per cent of Japanese direct investment abroad. But, because of the broadening reach of Japan's foreign investment, this share had been declining, down from 5.9 percent in 1980. During the 1980s, Japanese real estate investment increased in Australia, particularly in the ocean resort area known as the Gold Coast, where Japanese presence was strong enough to create some resentment.¹⁾

As Japan protects its agriculture, Australia faces quotas, high tariffs, and unusual standards barriers in exporting agricultural products including beef, butter, and apples to Japan. Australia is eager to sign a Free trade agreement with Japan. Both nations attract a considerable number of tourists from the other country, with Australia being a favorite diving and surfing spot and Japan famous for its culture.

This paper investigates Australia-Japan trade issues with special reference to recent developments in market liberalization and its impact to two countries. The paper also investigates problems faced by both countries in establishing a common framework for free-trade.

Key Factors on Australia-Japan Trade

In December 2006, the Australian and Japanese governments announced that they will com-

mence negotiations on an Australia-Japan Free Trade Agreement (AJFTA) in 2007. Any JAFTA must be bold and comprehensive, covering all sectors – including agriculture- and be consistent with both countries' obligations under the World Trade Organization (WTO) – namely, 'covering substantially all trade'.²⁾ Importantly, it should also be 'WTO- plus' – delivering outcomes above and beyond those already available to each country through the multilateral trading system. Without prejudging any negotiations, priority sectors for commerce and industry would include areas such as government procurement, investment, movements of natural persons and services.

For Japan, trade with Australia is very important. Japan is Australia's largest trading partner and has been so for the past 40 years. After the 'lost decade' of the 1990s, and early this century – marked by negligible economic growth and for a time, price deflation- Japan's economy has more recently on the upswing. Australia exports over A\$34 billion worth of goods and services per year to Japan and Australia-Japan two-way trade relationship is worth almost A\$54 billion (See Table 1).

Over the last couple of years in particular, the Australia-Japan Business Cooperation Committee (AJBCC) and its Japanese counterpart have called for the significance of the commercial relationship to be recognized and enhanced through an Economic Partnership Agreement, including a Free Trade Agreement that was comprehensive and WTO consistent.

As part of the lead-up to the announcement of FTA negotiations, the two national governments have jointly undertaken several studies over the past five years and these have greatly en-

Table 1 Some Key Facts on Australia-Japan Trade

1	Japan is Australia's number one export market at A\$ 34.5 billion or 18 per cent of total exports in 2005–06 Fiscal Year
2	Japan is Australia's number one trading partner at \$50.6 billion or 14 per cent of total trade in 2005 Calendar Year or A\$53.9 billion in 2005–06 Fiscal Year.
3	Japan is Australia's third largest source for imports at \$19.1 billion or 10 per cent of total in 2005 Calendar Year
4	Australia's minerals and energy exports to Japan were worth \$21 billion in 2005–06 Fiscal Year.
5	Japan is Australia's largest market for coal, aluminium, LNG, LPG and copper ore as well as beef and dairy producers
6	In December 2006, Japan's was Australia's 3 rd largest source of foreign investment (total investment valued at A\$53 billion) and Japan is the 4 th largest destination Australian outward investment.
7	Japan is Australia's third largest source of tourists with 674,400 Japanese visiting Australia in Fiscal Year 2005–06.
8	Japanese companies employ more than 200,000 Australian workers
9	Over 3,600 Australian businesses export to Japan (goods, Fiscal Year 2005–06) and 14 per cent of All Australia's SMEs export to Japan

Source: Australian Trade Commission, 2007 and Australian Chamber of Commerce and Industry, 2007.

hanced their mutual understanding of the key bilateral trade and investment issues. These studies provide useful background, context and information for the two governments, as well as business and other interested parties, and will facilitate progress of negotiations. The studies also provided useful econometric modeling which quantified the potential economic and commerce impact of bilateral trade liberalization.

Recent Trends in Bilateral Trade and Investment

The Australia-Japan Trade and Economic Framework signed by former Japanese Prime Minister Koizumi and former Australian Prime Minister Howard in 2003, was a major step forward in the bilateral economic, trade and investment relationship. It includes a commitment for both countries to “work forwards the liberalization of trade and investment between Australia and Japan on a balanced and comprehensive basis through various avenues”.

In 2003, an Enhanced Framework for Cooperation in the Energy and Minerals sectors was signed. The Framework enabled broader discussion on energy and minerals issues and facilitated private sector involvement in the Japan-Australia High Level Group on Energy and Minerals Consultations. The first discussion held in 2004, provided a valuable opportunity for Government and research organizations to exchange information on developments in the energy and mineral sectors, explore areas for future collaboration including research into mining and energy technologies, and to identify opportunities for expanding bilateral trade and investment.

Also in 2003, a cooperative framework between the customs agencies of both countries was signed, to expedite customs clearance procedures, provide for exchanges of views of bilateral trade in engineering services.

Also in 2003, a mutual recognition framework was signed to facilitate the recognition of each other’s registered or licensed engineer qualifications, assisting the development of bilateral trade in engineering services. In the same year, Australia and Japan signed a memorandum of understanding on investment promotion to reaffirm the already strong cooperative relationship between both countries’ investment promotion agencies.

In December 2003, an enhanced framework for cooperation on the information economy and the information and communications technology industry was signed, providing for wide-ranging discussions on each country’s approach to this rapidly changing area.

In 2004, a statement of intent was signed by the Australian Securities and Investments Commission and the Japanese Financial Services Agency to cement bilateral cooperation in securities market regulation. In 2005, the Japan Patent Office and IP Australia exchanged a memorandum of understanding to assist each office to gain a better understanding of each other’s patent system.

In addition, there have been numerous discussions on other facilitation items, particularly on

food safety, food technical issues, government procurement and construction business licenses.³⁾

The Base for the Australia-Japan Co-operation

The Australia-Japan economic and trade relationship is built on several economic fundamentals. The most important of these fundamentals is trade and economic relations. Australia extended “Most Favored National Status” to Japan (at the time only the second country in the world, other than the U.S., to do so).⁴⁾

The Commerce Treaty was complimented twenty years later (1976) by the Treaty of Friendship and Co-operation (also known as Nara Treaty) which emphasized Australia-Japan mutual interests in maintaining stable trade relations. Another important, and more recent, building block is the Australia-Japan Trade and Economic Framework (TEF) signed by former Prime Ministers Howard and Koizumi in Tokyo in July 2003.⁵⁾ The TEF reflects the desire to further strengthen bilateral relations by, amongst other things, working toward the liberalization of trade and investment between two countries. It also usefully sets down a number of important areas for enhanced co-operation for the mutual benefit of both countries. These include: information and communication technology; investment promotion; mutual recognition of professional qualifications; regulatory co-operation in securities markets; and expanded information exchange in areas such as intellectual property and government procurement.⁶⁾

Overview of Australia-Japan Economic Relationship

Australia and Japan enjoy one of the most economic and trade partnerships in the world. The Australia-Japan economic relationship has developed on the basis of strong complimentary interests and cooperation in a wide range of areas. Trade flows have been at the core of the economic relationship. Japan has long been Australia’s one of the biggest export markets. 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 principle source of a number of indispensable commodities. Over the decades, Australia has been a stable, secure source of raw materials for Japan. In turn, Japan provides Australia with large volumes of manufactured products such as motor cars and other manufactured products contributing significantly to the quality of life in the Australian society.

Japanese foreign direct investment flows are also important to both countries. Japan is third-largest source of foreign direct investment in Australia.

The bilateral trade relationship between Japan and Australia differs from those many other developed countries. Australia is a competitive and efficient, natural resource rich country, while Japan is renowned for its ability to produce competitive high quality high-tech goods and services.

According to Japanese data, in 2004, Japan exported US\$11.8 billion of merchandise goods to Australia, accounting for 2.4 per cent of Japanese exports in that year. In the same year, Japan imported US\$19.4 billion worth of merchandise goods from Australia, or 4.3 percent of total imports⁷⁾.

In recent years Australia's share of the Japanese market has declined. In 1990, Australia accounted for 5.3 percent of Japan's total imports, or US\$12.3 billion. By 2004, this share has risen in absolute terms to US\$18.4 billion, but as a share had fallen to 4.3 percent. In 1990, Australia was Japan's third largest source of imports, while by 2004, it had dropped to fourth.⁸⁾

As well as being its largest export market, Japan is an important source of investment for Australia. Japanese investment in Australia was US\$32 billion in 2003, making Japan the third largest investor. Foreign direct investment (FDI) comprised almost 40 percent of total Japanese investment in Australia and was valued at US\$12 billion in the same year. On the other hand, total Australian investment in Japan was US\$13 billion in 2003. Japan is the fourth most important destination for Australian outward investment. The bulk of this investment represents capitalization of banks and financial institutions, and the establishment of regional offices by Australian exporters.

Japan-Australia Free Trade Agreement (FTA)

Australian and Japanese governments are currently actively engaged in a feasibility study examining the potentials for a FTA between two countries. An Australia-Japan Free Trade Agreement (JAFTA) if realized would take the already strong commercial and economic relationship that exists between two countries to a new, higher level. Econometric modeling undertaken by Department of Foreign Affairs and Trade (DFAT) in 2003 pointed to the substantial gains for both Australia and for Japan from the liberalization likely to flow from such an agreement.⁹⁾

In present value terms, over a 20 year period, a high quality JAFTA could add as much as A\$39 billion to Australia 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.¹⁰⁾

Mathematical economic modeling undertaken by the Australian Chamber of Commerce and Industry as part of their contribution to JAFTA processes also shows high degrees of the trade complementarity 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 FAFTA. At present around 90 per cent of Australian At the same time exports to Japan enter duty free and 87 percent of those goods subject to duty are at rates of less than 10 per cent.

Structural Reforms in the Japanese Market

Australian Chamber of Commerce and Industry argues that important priorities for Australia in the bilateral relationship must include encouraging further fundamental structural changes in the Japanese economy, more liberal market access for Australian products and maintaining Australian partnership in key regional and multinational trade sectors.¹¹⁾ Australian annual exports to Japan by value are one-quarter more than goes to each of Europe and ASEAN, two thirds more than the United States, and a massive four time to China. Over the last decade, the value of Australian exports to Japan has increase by a massive 65 per cent, to A\$25.5 billion annually.

Australia and Japan have also shared commercial and economic policy priorities, not least of which was the strong bilateral co-operation of the 1980s and early 1990s which led to formation of the Asia Pacific Economic Co-operation (APEC).

Official statistics indicate the Japanese economy experienced real economic growth of just over 1 per cent for the decade to 2001, well short of 4 per cent figure for the proceeding decade. The repeated 'fiscal stimulus' packages of the past decade have not worked. Rather than kick-starting the Japanese economy, they have saddled it with a debt-to-GDP ratio of a massive 120 per cent, one of the highest rates in the industrial world. Because of this, the near-zero interest rate strategy has failed to stimulate business or consumer spending, with the large overhang of bad loans resulting in continued weakness in Japanese financial institutions, which is likely to impair sustained economic recovery.¹²⁾

Official statistics indicate the growth in the bad debt burden of Japanese banks exceeded their write-off rate by a massive 40 per cent in 2000, and now account for as much as 10 per cent of Japan's sizable GDP.

According to ACCI, one important barrier of broadening and deepening the Australian-Japan relationship is presence in both countries of what are seen to be outdated stereotypes of each other. On the Australian side, Japan is regarded as a difficult market to enter, with pervasive barriers to new business players, especially for foreign firms and for small to medium sized firms. In short, Japan is seen as 'too hard and not worth the effort'. According to ACCI, from the Japanese side, Australia is oft-regarded as little more than a 'firm, mine, and quarry', with funny animals and nice beaches. Australia does not appear to rate in Japanese perceptions as a produce of value-added goods and services, and are not seen as even on the 'new economy' playing field.¹³⁾

Trade between Japan and Australia

Japan has consistently been Australia's major export destination since 1969. Australian exports

to Japan are concentrated in mining commodities, such as coal, liquefied natural gases (LNG), and iron ore, beef, and aluminum, which together account for around 60 percent of merchandise exports. In all five product categories, Japan is Australia's largest market: coal (42 percent), iron ore (39 percent), beef (38 percent), and aluminum (34 percent).¹⁴⁾ (See Table 2)

On the other hand, Australia absorbs only a small part of the overall Japanese exports, and they are concentrated in transportation equipments (passenger cars, buses and trucks) and components. Japan is the second largest source of merchandise exports for Australia. (See Table 3).

Bilateral trade relations represent their comparative advantages, but the division of labor is less

Table 2 Australia's Top Exports to Japan (1990–2004) (\$ Million)

Top Exports	1990	Top Exports	2004
Coal	2442	Coal	4229
Iron ores and concentrates	951	Combined confidential items	2709
Unwrought aluminum	809	Iron ores and concentrates	1645
Gold unwrought	751	Chilled beef	1132
Combined confidential items	631	Unwrought aluminum	946
Chilled beef	453	Wood chips	556
Petroleum gases	392	Frozen beef	518
Wood chips	293	Copper ore and concentrates	420
Zinc ores and concentrates	279	Petroleum gases	392

Source: Australia-Japan Trade and Economic Framework (Joint Study) 2005

Table 3 Japan's Top 10 Merchandise Exports to Australia (1990–2004) (\$ Million)

Top 10 Exports	1990	Top 10 Exports	2004
Passenger motor vehicles	1326	Passenger motor vehicles	4803
Goods vehicles	750	Goods vehicles	1121
Computers	335	Radio transmission apparatus	404
Parts and accessories for motor vehicles	322	Parts and accessories for motor vehicles	377
Parts and accessories for office machines	219	Civil construction machinery	357
New tires	149	New tires	290
Civil construction machinery	138	Televisions	261
Combined miscellaneous items	138	Motorcycles	197
Photo-copy pumps	126	Computers	170
Internal combustion piston engines	102	Parts and accessories for office machines	167

Source: Australia-Japan Trade and Economic Framework(Joint Study)2005.

than perfect. While Japan is poor in natural sources and has to depend on Australian exports. Australia has domestic automobile production under some protective import tariffs. Japan could enjoy cheaper Australian meat and dairy products, had it removed restrictive import tariffs and quotas on them. The relative absence of the manufacturing industries in Australia limits the volume of components and capital goods exports from Japan.¹⁵⁾

Australia's trade and investment relationship with Japan:

Australian merchandise trade with Japan, 2008–09:

Exports to Japan (A\$m): 52,597 22.8% 1 st 50.4%

Imports from Japan (A\$m): 17,839 8.1% 3 rd -9.3%

Total trade (exports + imports) (A\$m): 70,436 15.7% 2 nd 28.9%

Major Australian exports, 2008–09* (A\$m):

Coal 23,428 Passenger motor vehicles 5,515

Iron ore & concentrates 7,342 Refined petroleum 1,369

Beef 2,101 Goods vehicles 1,098

Aluminium 1,422 Civil engineering equipment & parts 712

**Includes A\$9.9 bn of confidential items, mainly LNG, nickel, wheat & sugar, 19% of total exports.*

Australia's trade in services with Japan, 2008: Total share:

Exports of services to Japan (A\$m): 2,418 4.5%

Imports of services from Japan (A\$m): 2,601 4.8%

Major Australian service exports, 2008 (A\$m): Major Australian service imports, 2008 (A\$m):

Personal travel excl. education 836 Transportation 1,292

Transportation 804 Personal travel excl. education 296

Australia's investment relationship with Japan, 2008 (e): Total: FDI:

Australia's investment in Japan (A\$m): 29,108 1,112

Japan's investment in Australia (A\$m): 89,511 35,959

Framework for strengthening Japan-Australia Trade

Prime Minister Junichiro Koizumi of Japan and Prime Minister John Howard of Australia signed the Framework agreement in July 2003. The Framework calls for Japan and Australia to take steps regarding liberalization of trade and investment. The Framework does not represent a binding document in the nature of a bilateral treaty or international covenant, yet it is expected to be effective in promoting bilateral investment, trade and facilitation measures (e.g. customs cooperation etc.), mutual recognition of technical specialist qualifications, and the development of e-commerce infrastructure.¹⁶⁾

An agreement such as this is not legally binding, yet there is still a very good chance of it promoting closer economic partnership, since once a broad-ranging general agreement like this has been reached, the two countries are likely to engage in regular talks and meetings toward that end.

Also, in the midst of weakening Japan-Australia economic relations, the Framework has probably afforded increased opportunities for the two countries to establish forward-looking agreements. A framework agreement of this sort would eventually serve as basis for future discussion of a comprehensive free trade agreement between Japan and Australia.

The primary content of this framework includes the following: (1) areas for mutual cooperation and an action plan (customs cooperation, mutual recognition of technical specialist qualifications, promotion of investment, etc.); (2) joint research by the two governments regarding liberalization of trade in goods and services; and (3) an agreement concerning the impact of trade and investment agreements with third countries.

Japanese Agriculture – Major obstacle for market liberalization

FTA negotiations with Australia are part of Japan's strategic efforts to counter the influence of China in a proposed East Asian Community (EAC), which figured high at the inaugural East Asia Summit in Malaysia in December 2005. Japan has strongly advocated the inclusion of Australia (and New Zealand) in the proposed EAC, an idea opposed by China and some other Asian nations.

Australia is a major supplier of coal, iron ore and LNG, which together account for nearly 60 percent of Japan-bound exports. With the world's largest uranium deposits, Australia is also an important country for Japan's civilian nuclear policy. The Japanese government's New National Energy Strategy, adopted in May 2006, calls for promotion of nuclear energy to raise the percentage of nuclear power in the total national electricity supply from the current 30 percent to between 30 and 40 percent or more than in 2030.

Meanwhile, the FTA negotiations with Australia are Japan's first with a major agricultural exporter. Despite being the world's second largest economy and racking up huge trade surpluses for many years through robust exports of automobiles and other high-tech products, Japan is reluctant to open its heavily protected agricultural market. It would be fare to note, though, that Japan is the largest net food-importing country in the world, buying from around 60 percent of its food consumed domestically on a calorie basis. Japan has defended its farm protectionism, citing the need for food security. Agriculture will certainly be the biggest obstacle to a successful conclusion of FTA negotiations between Australia and Japan.

Japan has refused to put many of its agricultural products on the table with other trading partners. Under the basic agreement with Indonesia, for example, Japan will cut tariffs on nearly all industrial and forestry products while removing gradually those on tropical fruits. The pact excludes so-called sensitive products such as rice, wheat and meat.

Agricultural, forestry and fishery products account for about 22 percent of Japan's overall import from Australia. The Agriculture, Forestry and Fisheries Ministry estimates that if import tariffs

on Australian farm products are eliminated, import of such main items as wheat, sugar, dairy products and beef could rise sharply, is resulting in a reduction in domestic output worth nearly 800 billion yen (about \$6.7 billion).¹⁷⁾

The Japanese law makers representing farmers are demanding exclusion of those four items, as well as rice, the nation's most politically sensitive item, from any agreement with Australia. But Australia has shown reluctance about the idea.

Economic benefits from trade liberalization

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. Japan continues to rely on Australia for well over 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 world's largest known reserves of numerous minerals and energy and one of the few net energy exporters in the develop world. At the same time, Japan as a big purchaser of minerals and energy provides an important market for Australia.¹⁸⁾

On the other hand, Australia, for its part relies on Japan for important industrial products. 58 percent of imported passenger vehicles, 37 percent of imported commercial vehicles and 27 percent of imported construction equipment comes from Japan. These contribute to robust economic activity in Australia, including in the mineral and energy fields.

Also Japan is Australia's largest foreign investor, with an investment stock of A\$53 billion (¥4.5 trillion) as at end 2005. Around 45 percent of this was direct investment, 44 percent was portfolio investment and 10 percent was categorized as other investment. Japanese investment has been vital in developing many of the export industries that drive Australia's strong export performance.¹⁹⁾

Australia and Japan were developed, open market economies with strong, transparent regulatory systems that foster competition and provide robust protection for intellectual property and investment.

Econometric modeling undertaken jointly by Japanese and Australian governments, have concluded that both countries would derive significant economic benefits from an Economic Partnership Agreement (EPA) and Free Trade Agreement (FTA).²⁰⁾ GDP, trade and investment would increase in both countries as a result of an EPA/FTA. These gains were larger than the gains that could be expected from EPAs/FTAs with most others. The estimated magnitude of the macro-

economic gains varied between the two econometric studies undertaken, ranging from 0.66 percent to 1.79 percent for Australia's GDP in 2020, and between 0.03 percent and 0.13 percent for Japan's GDP in 2020. In net present value terms over 20 years, the lower end of 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 period. The study group also noted the modeling indicated a reduction in production and employment in some sectors including those of some agriculture sector in Japan from trade liberalization.²¹⁾

Economic impact of tariff elimination

For Australian exports, Japanese tariff is a major problem. Japanese government is reluctant to remove tariff imposed on Australian agriculture and livestock products because of domestic farming. On the other hand, the Australian government has imposed some tariffs for goods imported from Japan. Custom duties are levied on over 70 percent of the goods imported from Japan to Australia and around 20 percent of goods imported from Australia to Japan. The simple average applied tariff of Australia is 3.5 percent and that of Japan is 7.1 percent in 2006.

There would be substantial benefits to both Japan and Australia from the liberalization of trade and goods. The trade liberalization would increase export opportunities for Australia and Japan, including redressing discrimination as a result of Free Trade Agreements with other countries. A liberalized trade policy would increase economic growth, trade, investment and employment in both countries. It would also foster structural reform and improve productivity. Consumers including businesses that use the products as inputs to their production would benefit.²²⁾

But Japan is concerned about potential impact of tariff elimination on its agriculture, forestry and fishery sector. Japan depends for 60 percent of its food on import from foreign countries. In particular, more than half the agricultural products imported from Australia are sensitive items such as rice, wheat, barley, sugar, dairy products and beef. Farming in Japan is extremely small-scale compared to Australia and tariff elimination of these sensitive items would have a serious effect.

On the other hand, the food supply is a key part of the economic and strategic relationship between Japan and Australia and stable relationship between the two countries provide benefits for both countries, namely, the reliable supply of safe and high quality food to Japan and export opportunities for Australia. The Japan's policy for securing its food supply is to maintain and enhance domestic production, combined with ensuring stable and reliable import and stockpiling. The tariff elimination should assist to strengthen food trade relations and help Japan to realize its food security objectives, including in such cases as world supply shortages. Australia would gain the maximum benefit from enhanced export opportunities to Japan and from closer integration with Japa-

nese food supply chains.

As a part of Japan-Australia comprehensive bilateral trade, it would benefit to both countries to consider measures to strengthen and provide improved stability and reliability in the food supply relationship between Japan and Australia²³). These could include:

- (i) prohibiting the use of measures that prohibit or restrict agricultural exports to Japan and also prohibiting export duties;
- (ii) provisions to liberalize and facilitate two-way investment in the food sector;
- (iii) measure to help ensure the high levels of safety and quality of food exports;
- (iv) provisions to promote transparency and consultation; and
- (v) provisions allowing for review of an FTA with respect to the food sector.

Macro Economic Impacts of Trade Liberalization²⁴

The trade liberalization between Australia and Japan expects benefits to both countries. Such trade liberalization would enable Japanese producers improved access to the Australian market, and at the same time, it would improve the competitive position of Australia's producers in the Japanese market.

This section will present some sections of the APG-Cubed presented by the Center for International Economics (CIE) with the permission of Center for International Economics, 2005. (*Australia-Japan trade and investment liberalization: Assessment of the economic impacts, report prepared for the Australian Department of Foreign Affairs and Trade, CIE, Sydney*). This section also focused to GTAP/TAP model presented by Kenichi Kawasaki and Philippa Dee.

Both economic modeling studies used global general equilibrium models to provide quantitative estimates of the economic impacts that could arise if Australia and Japan undertook a program of comprehensive bilateral trade and investment liberalization. APG-Cubed is used to analyze the dynamic aspects of the economic impacts over time, incorporating both the real and financial sectors. GTAP/FTAP are long run snapshots models and are used to investigate the impacts on the various sectors in detail. To minimize differences between the two studies, both studies have used (to the extent possible) the same underlying data (trade flows, trade barriers, economic structure etc).

The magnitude of the macro economic (and welfare) impacts is primarily determined by several trade related features of the two economies. These include the contribution of exports and imports to GDP; the significance of bilateral trade between two countries; and the size of barriers to trade and investment prior to trade liberalization. Dynamic effects arising from greater capital accommodation and productivity gains also are important. Table 4 provides results for key macro-economic indicators. Results from both economic models (results from GTAP and FTAP have been

Table 4 Macroeconomic Impact – Comparable results, 2020

Economic Indicator	Australia		Japan	
	APG-Cubed % deviation	GTAP/FTAP % deviation	APG-Cubed % deviation	GTAP/FTAP % deviation
Gross domestic product	0.66	1.79	0.03	0.13
Investment	1.22	3.15	0.05	-0.01
Total exports	2.35	2.11	0.33	0.64
Total imports	1.96	4.95	0.27	0.46
Bilateral exports (to Japan)	21.30	53.79	Na	Na
Bilateral exports (to Australia)	Na	Na	17.98	23.87
Employment	0.11	Na	-0.00	Na
Wages	0.64	1.72	0.02	0.28

Sources: APG-Cubed, GTAP and FTAP modeling simulations; Center for International Economics report on Australia-Japan trade and investment liberalization, 2005, and Australia-Japan trade and economic framework (joint study), 2003–05. Reproduced with the permission of CIE, Canberra.

combined) are broadly in line, with results differing in magnitude only. The change in Australian GDP is estimated to be 0.66 percent in the study by CIE and 1.79 percent in the study by Kawasaki and Dee. The change in Japanese GDP is estimated to be 0.03 percent in the study by CIE and 0.13 percent in the study by Kawasaki and Dee.

The macroeconomic results differ in magnitude due to assumptions underlying the economic modeling. For example, in the study by Kawasaki and Dee the standard GTAP model was modified so as to incorporate the dynamic effects of capital accumulation and dynamic productivity gains arising from greater import competition. These two dynamic effects account for around 60 percent of Australia's welfare gains.

The APG-Cubed model also incorporates these two dynamic effects (APG-Cubed also includes dynamic productivity gains arising from greater exporting and FDI inflows). However, the dynamic effects account for a smaller share of the gains in APG-Cubed than in the case for GTAP. Hence the difference in magnitude for the results is primarily attributable to different 'values' being assigned to the parameters governing the responsiveness of capital accumulation to changing incomes in APG-Cubed are smaller than those used in GTAP.

The main area of difference in the results concerns investment in Japan. The study by CIE estimates that investment in Japan would increase by 0.05 percent, whereas the study by Kawasaki and Dee forecasts a small (0.01) percent fall in investment in Japan. It is important to note that the decline in investment does not mean negative investment in Japan; rather, it means investment would be marginally lower than otherwise. The small decline in investment in Japan can be attributed to a decline in production of the capital incentive Agriculture and food sector, and hence a re-

duced demand for capital goods and investment.²⁵⁾

Impact to Australian Economy

According to APG-Cubed, for Australia, the liberalization brings about a positive and large impact. Both output and welfare increase above the baseline after the liberalization commences. The rise in real GDP peaks about 13 years out at 0.7 percent above baseline. The rise in real consumption- the preferred welfare measure- peaks at 0.6 percent above baseline 15 years out. The APG-Cubed also points out the increased openness to FDI lowers the cost of investing Australia. This combined with improved access to the Japanese market and the greater domestic efficiency that trade liberalization brings, sees capital in the Australian economy earning a higher return. This in turn causes a rise in real investment, with investment peaking at 1.9 percent above baseline in 2012.

According to APG-Cubed, despite rising GDP, domestic saving does not increase by a sufficient amount to cover the rise in investment. Hence the extra capital for investment is met by additional capital inflow, which drives the capital account into surplus. As a balanced Balance of Payment is assumed in the long run, the increasing capital account necessitates, by definition, a deterioration of the current account (that is, import exceed exports). The current account deficit increases by 1.7 percent above baseline in 2014- equivalent to 0.1 percent of real GDP in that year. After 2014, the demand for capital inflow eases once the new investment is in place.

According to APG-Cubed, the lift in exports from Australia amounts to 2.6 percent above baseline in 2009, with the increase slightly declining to 2.4 percent in the following year and staying steady afterward. The kink in the export growth is due to the MFN trade liberalization undertaken by Australia, which has the effect of diminishing the net effect of the trade liberalization undertaken as part of the bilateral liberalization with Japan. With the rise in economic activity and lower barriers to Japanese imports, there is an increase in imports of a slightly lower magnitude than for exports. Australia's total imports rise to a peak of 2.1 percent above baseline in 2009.

According to APG-Cubes, the relatively higher change of exports than in imports may seem counter to the required deterioration in the current account. Although the percentage increase in exports is slightly higher than that in imports, in absolute terms the change (increase) in imports is greater than the change in exports due to imports being at a higher base level (that is, in the baseline a current account deficit exists). Hence due to differing base levels, a similar percentage change translates into a larger absolute increase in imports than exports.

CIE argues, to facilitate the capital inflow and trade changes, there must be an appreciation of the Australian currency. According to APG-Cubed the Australian dollar is stronger against in the US dollar in nominal terms by 0.6 percent, and in real terms by 0.2 percentage points, in 2015.

According to APG-Cubed, with the increase in real GDP, the trade and investment liberalization has a large positive impact on employment in Australia. Although APG-Cubed assumes fixed labor supply and full employment determined by the population growth rate in the long run, in the short run employment deviates from the full employment equilibrium level because real wages adjust slowly to labor market conditions and the model takes account of adjustment costs. After the liberalization commences, adjustment costs dominate the extra demand for labor brought about by the increase in production. This means there is a small initial dip in employment of 0.05 percent below baseline. However, with sticky nominal wages the extra demand quickly dominates and employment picks up to 0.3 percent above baseline by 2012.

Impact to Japanese Economy

According to APG-Cubed, the trade liberalization would also have a positive impact on Japan. However, Japan is the second largest economy, and given the relatively small trade with Australia – Australia is the destination for 2 percent of Japan's exports and the source of 4 percent of imports in 2004 – it is natural that trade liberalization with Australia would bring smaller gains for Japan.

APG-Cubed estimated that Japan's exports would increase after the liberalization commences, and would peak at 0.5 percent above baseline in 2006. Japan's imports would jump by 0.26 percent in 2005, and gradually increases to be 0.28 percent higher than the baseline level in 20 years. The higher increase in exports than in imports means a further strengthening of the current account surplus – 0.05 percent higher in 2008 and 0.04 percent higher in 2025.

The productivity and allocate efficiency gains brought about by the trade liberalization sees real investment in Japan rising due to capita earning a higher return and the increase in economic activity. The rise in Japan's real investment peaks at 0.1 percent in 2007, and would be 0.06 percent higher than the baseline level in 20 years.

According to APG-Cubed, similar to the impact on Australia, with a higher level of economic activity the trade and investment liberalization has a positive, albeit smaller, impact on employment in Japan. Due to slow adjustment in wages, employment would rise initially, peaking at 0.04 percent higher than the baseline level in 2007. In the long run, the real wage rate adjusts to ensure that employment falls back to its baseline level. The long run gain in employment is reflected in higher real wage rates which is 0.02 percent higher than the baseline level in 2025.

Conclusion and Final Comments

The Australia-Japan economic and trade relationship is built on several economic fundamen-

tals. The most important of these fundamentals is trade and economic relations. Australian and Japanese governments are currently actively engaged in a feasibility study examining the potentials for a FTA between two countries. An Australia-Japan Free Trade Agreement if realized would take the already strong commercial and economic relationship that exists between two countries to a new, higher level. Econometric modeling undertaken by Department of Foreign Affairs and Trade (DFAT) in 2003 pointed to the substantial gains for both Australia and for Japan from liberalization likely to flow from such an agreement.

This paper investigated Australia-Japan trade issues with special reference to recent developments in market liberalization and its impact to two countries. The trade liberalization between Japan and Australia expects considerable economic benefits to both countries. Such trade liberalization would enable Japanese producers to strengthen their activities in the Australian market, and at the same time it would improve the competitive position of Australian agriculture and livestock in the Japanese market. There are some positive developments in the negotiation process of the trade liberalization between Japan and Australia. But a comprehensive free trade agreement is not an easy task for both countries. Japan's protection policy of domestic agriculture is a major obstacle to open its market for Australian agriculture. Policy makers in Japan believe the agriculture and livestock in Japan will have a negative impact if the market is liberalized for Australian agriculture. Australia aims to increase its export volume of agriculture and livestock with the liberalization of trade with Japan. However, this strategy is not acceptable for Japan. Japan's agricultural policy is to protect its agriculture and increase the domestic production. Compared to other developed countries like US and France, Japan's self sufficiency in agriculture is below 40 percent and it is further declining as a result of increasing aging population in Japan.

Therefore, liberalization of Japanese market for Australian exports will have major negative impacts on Japanese agriculture and economy. If the Japanese market is liberalized for Australian agriculture, per capita income in the agricultural sector will decline and many farmers will give up their traditional agriculture. Furthermore, Japan's self sufficiency rate in agriculture will decline further as a result of liberalization.

However, the liberalization of Australian market for Japanese industrial exports including motor cars and spare parts will have a positive impact for Japanese manufacturers and Australian consumers. As a result of liberalization of Australian market for Japanese products, the Australian general price index for manufactured products will decline and this will have a direct impact on the Australian consumer market.

Footnotes

- 1) Joint Ministerial Statement, Australia-Japan, 'Building a Comprehensive Strategic Relationship', Sydney, March 18, 2006.
- 2) Issue Paper 'Australia-Japan Free Trade Agreement Negotiations' Australia Chamber of Commerce and

- Industry, January, 2007.
- 3) Australia-Japan Trade and investment Links Chapter 2, p.23
 - 4) Issue Paper, 'Australia-Japan Economic and Trade Relationship' Australia Chamber of Commerce and Industry, January, 2006.
 - 5) Ibid p.1.
 - 6) Ibid p.2.
 - 7) JETRO Trade and Export Statistics, 2005. There are discrepancies between trade statistics between many countries, which reflect factors such as timing of shipments and exchange rates. As a result, values for Japanese exports and imports from Australia will not match exactly the corresponding Japanese data on imports and exports from Australia.
 - 8) Issue paper, Ibid p.8.
 - 9) Issue paper, Australia-Japan Economic and Trade Relationship, Australia Chamber of Commerce and Industry, January, 2006 p.2.
 - 10) Ibid p.2.
 - 11) Australian-Japan Relationship, Published by Australian Chamber of Commerce and Industry (ACCI Review No.76) – June 2001, p.1.
 - 12) Ibid p.2.
 - 13) Ibid p.3.
 - 14) Australia Trade Commission, 2004.
 - 15) Yoichiro Sato, Japan-Australia Relations: Friends But Not Allies, Special Assessment, Asia-Pacific Center for Security Studies, October 2004, pp.3–4.
 - 16) A report on "Toward a Stronger Economic Partnership between Japan and Canada: Interim Report of the Task Forces on the Japan-Canada Economic Partnership of the Committee on Canada, August 2004, p. 5.
 - 17) Hisane Masaki, Ohmy News, International World "Australia as Japan's Strategic Partner" Agriculture is the biggest obstacle to an FTA. P 2 April, 2007
 - 18) The modeling, which was conducted using the APG-cubed and GTAP/FTAP models, was based on the assumption of full and immediate liberalization across all sectors. While a useful forecasting tool, all economic models, be definition, are a simplification of reality and rely on numerous assumptions.
 - 19) 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
 - 20) Ibid p.8.
 - 21) Ibid p.7.
 - 22) Ibid p.10.
 - 23) Ibid p.12.
 - 24) Presentation in this part is based on the "Australia-Japan Trade and Economic Framework (Joint Study Report) 2003–2005, pp 165–175, and the report titled "Australia-Japan trade and investment liberalization: Assessment of the economic impact" published by the Center for International Economics, Canberra and Sydney, April, 2005. Report prepared for the Australian Department of Foreign Affairs and Trade, CIE, Sydney (Reproduced with the permission of the Center for International Economics, Canberra & Sydney)
 - 25) Australia-Japan Trade and Investment (Joint Study Report), 2003–05 Chapter 05, p.167. Reproduced with the permission of the Center for International Economics, Canberra and Sydney.

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