Reflections on the Relationship with Japan

Peter Drysdale

It was just over twenty-five years ago that the Japanese Studies Association of Australia held its first biennial conference at the Australian National University in Canberra. Around the same time the foundations were also being put in place for the establishment of the Australia-Japan Research Centre at the ANU.

That was during the heyday of the burgeoning economic relationship with Japan. Two years before, Australia had concluded a comprehensive and innovative Treaty of Friendship and Co-operation with Japan. There was a huge awakening and growth of community and intellectual interest in a country that was already then by far our largest export market. That interest grew headily in the years of Japanese ascendancy through the boom of the 1980s.

Many of the enthusiastic young scholars who organised that first JSAA meeting attended the presentation of an earlier version of this paper at the Thirteenth Biennial Conference of the JSAA at the Queensland University of Technology (QUT) on 2 July 2003. They were the architects and builders of the expanding and deepening relationship between our two countries and they and their followers were the foot-soldiers who delivered the precious human capital, to our public service, our universities, our schools, commerce and industry upon which its foundations were built.

These were the years of ambition for the relationship and, while that ambition may sometimes have disappointed, there is no doubt that the achievements were great.

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For me, and for others, it is a very personal story.

Almost forty years ago, at the celebration of Tanabata, my first incredible period of fieldwork in Japan, as a Ph.D. scholar from the ANU at Hitotsubashi University in Kunitachi, came to its sentimental end. Those were warm and wonderful times and they have sustained a lifetime of professional and personal commitment over all the years that have slipped away in between.

A Vision Realised
In July 1957, over forty-six years ago, Australia and Japan concluded an historic Agreement on Commerce, normalising relations after the Pacific War and establishing for the first time a basis for equality in trade dealings between the two countries (Drysdale, 1965). On my personal journey, that was the occasion for my first essay on the trade relationship with Japan.

That Agreement was a remarkable watershed in the relationship, little more than a decade after the bitterness of the war. It laid the foundations for the huge trade growth that saw Japan become Australia’s largest trading partner and Australia among Japan’s most important suppliers of foodstuffs and of a raft of strategic raw materials – coal, gas, uranium, iron ore, bauxite, alumina, aluminium, nickel, almost everything with the exception of oil. It was not just an economic agreement but also a political settlement of enormous significance, made possible under the umbrella of American security arrangements with both Australia and Japan.

The vision and courage of policymakers and political leaders like Crawford, McEwen, and Menzies (in Australia) and Ushiba and others (in Japan) still stand as beacons when we reflect on where the relationship has come from and where it might go to now. They effected a profound political change that would drive the growth and deepening of the relationship in the years that followed.
Australia and Japan have achieved so much together not despite but because of their differences – through the economic relationship – and also in the perspectives we came to share in the international community and our work in building regional cooperation through APEC. The relationship that has grown since the 1950s is one of the most remarkable diplomatic and political achievements in the past half century. It has been critical in building a vision and exemplar for how the huge plurality of people in the Asia Pacific region might live on good terms and in prosperity.

Japan is Australia’s most important export market by far. Australia sold A$26.3 billion worth of goods and services to Japan in 2002. That is a quarter more than was sold to all of Europe, two-thirds more than was sold to the United States. Despite the economic stagnation in Japan, Australian exports of goods and services to the Japanese market have grown by 44 per cent over the past decade.

Both countries have also brought a strategic dimension to the economic partnership, working together to support cooperation and development in East Asia, most notably in getting APEC off the ground.

And there is increased familiarity in the relationship – through the programs in Japanese studies at almost every university in Australia, through Japanese tourism, through school and community exchanges, through the 300,000 young Australians learning Japanese today. The Australia-Japan Research Centre, with the cooperation of the Japan Foundation, is about to commence another quinquennial survey and review of all that is happening in Japanese studies in our universities. These developments were the stuff of dreams when I was a boy growing up in a time of bitterness that was a product of the war.

This is an immensely important bilateral relationship, not merely because it has brought trade, economic prosperity and amity to the two societies. It is the leading edge of Australia’s economic and political relationships in East Asia. Getting the relationship with Japan right is a key element in getting our relationships in East Asia right. This is why the shared endeavours and achievements in Asia Pacific cooperation were so
important to both countries, beyond their hub-and-spokes security relations with Washington.

_Drift and Neglect_

Yet despite all the achievements, there is reason to be worried about the drift in the relationship over the last several years.

Two weeks after the JSAA Conference in Brisbane, Prime Minister Howard went to Japan. The headline agenda was discussion of the security situation in Northeast Asia and how to deal with the North Korean problem. But there was also a critical interest in the discussion of economic affairs, in the negotiation of a modern bilateral arrangement, in forging a new partnership in the region, and in working to shift the logjam in the Doha Round of global trade negotiations. These are issues that had been neglected, yet they are central issues to Australia's national interests in Japan and in East Asia.

Mismanagement of the North Korean issue would put at jeopardy over half of our external trade, and has the potential to de-stabilise the whole region politically for many years to come. Mismanagement of the economic and trade issues would put at jeopardy our externally-dependent economic prosperity, at the same time weakening seriously the political and security asset of outward-looking strategies towards regional economic cooperation and dialogue.

There remains a significant divide between Washington and the East Asian capitals on how to handle North Korea, at the same time as Japan is seeking to build new defence systems against the North Korean threat and play a more active defence role globally. Seoul and Beijing want negotiation of North Korean reform in exchange for assurances on de-nuclearisation, and acknowledge that assurances from Washington on North Korean security and economic access are central to a deal. Tokyo is inclined to the same view but ambivalent, partly because of the abductee issue. Washington insists on priority for de-nuclearisation.
There remains deep confusion in trade policy strategy. There has been an elevation in Washington of discriminatory bilateralism as the primary instrument for negotiating trade deals as the global round has been let languish. There has also been a lurch in East Asia towards discrimination in trade policy, with fear in each country that it will be left out of others' discriminatory blocs recently driving new initiatives involving Japan, China and Korea in East Asia (Garnaut, 2003). The Australian Government chose to put priority on the negotiation of a so-called 'Free Trade Agreement' (FTA) with the United States. The implementation of the FTA that has now been negotiated with Washington will have the effect of discriminating against Japan and our other major trading partners in East Asia.

The truth is that there have been enormous changes in both countries and their circumstance in East Asia and the Pacific. These changes demand reassessment of the arrangements that have governed the relationship between them for more than a quarter of a century, since the signing of the Treaty of Friendship and Cooperation (the Nara Agreement) in 1976. They also demand rethinking the agenda for cooperation in regional affairs.

Instead, the relationship has been marked by neglect: Prime Ministerial visits cut short; Ministerial Meetings that do not meet; absence of diplomatic focus; retreat from commercial initiative. This neglect is a product of factors on both sides. There has been obsession with the problems of the Japanese economy over the last decade rather than the opportunities they present, and there has been associated political disengagement in Australia. There are perceptions in Japan that Australia is not relevant to inventing its new economy. There has been a reorientation in Japan towards East Asia commercially and politically. There has been ambivalence in the Australian political leadership over Australia’s East Asian role. And September 11 and preoccupation with the war on terrorism have come to justify the new primacy given to Australia's relations with Washington.

These high policy developments have impacted upon the resources, and the pay-off from effort, put into the relationship with Japan and the rest of East Asia at all levels.
Consistent and strategic support and high level encouragement of the professional endeavours of Japanese studies specialists in Australia is an essential ingredient in getting the focus right in our relations with Japan and the region. The rhetoric from Australia’s political leadership is wanting and empty. The environment is unsupportive. The signals point in another direction. The closure of the National Asian Languages and Studies in Australian Schools program in 2002 is a notable example. More and more of the scarce time of the Australian leadership seems to be spent on cultivating the relationship with the United States (Tipton, 2002); East Asia is on hold.

The last decade was a time for strategic re-positioning, and for laying the foundations for a new and deeper relationship with Japan. That was a decade lost, not only for Japan. The job is still waiting to be done.

A strong bilateral relationship with Japan is important because of the large economic opportunities and political leverage it offers in its own right. Despite its slow growth Japan is a huge economy now subject to immense pressures for change that can yield benefits for Australia. The relationship is also important because it is a critical element in the strength of our broader relationships in East Asia.

State of the Economic Relationship
Japan is not only our biggest export market; by one measure it is also our largest trading partner overall. We have a large trade surplus with Japan. The United States is our largest import supplier, taking 18.0 per cent of Australia’s import market, and we have a huge trade deficit with America.

One method of measuring our total trade with Japan and the United States adds export trade (usually valued fob, exclusive of freight and insurance costs) to import trade (usually valued cif, inclusive of such costs). It suggests the US is our largest partner. That is like comparing apples and oranges, and distorts the truth about our major trading relationships.
The total trade shares reported in the publication of the Department of Foreign Affairs (DFAT, 2003), *National Interest*, of 14.7 per cent for the United States and 14.3 per cent for Japan in 2001-2, correspond closely with those calculated using this fob/cif method. In that publication, DFAT makes no specific reference to which particular ABS statistics it uses for this purpose.

These figures have been widely cited by the Prime Minister and Government as evidence of the primary importance of Australia's economic relationship with the United States ahead of that with Japan.

DFAT explains that in actuality it adds exports (valued fob) to imports on a customs-value basis. This approach is to be preferred over the fob/cif method, although it is not the only internationally accepted method of measuring the relative importance of total trade flows.

If trade shares are calculated in this way using published Australian Bureau of Statistics (ABS) data, the results are different from those in *National Interest* – 14.5 per cent for the United States and 14.3 per cent for Japan in 2001-2. It turns out that the discrepancy between these two sets of figures results mainly from DFAT's use of a figure for trade in services with the United States that is A$0.6 billion larger than that published by ABS in February 2003. This appears to be an error. Mystery solved, but transparency in quantifying and ranking Australia's overall trade remains incomplete.

Another way to measure total trade is to add exports and imports, both including freight and insurance costs. This method shows Japan as our largest partner, with a trade share of 15.0 per cent compared with 14.4 per cent for the United States. It also consistently weights the trade of our largest source of imports, the United States, alongside our largest export market, Japan. It involves the complication of using trading partners' as well as our own trade data. But it is conceptually an equally valid way of assessing the
importance of countries in our trade – superior perhaps, given the considerable problems in measuring bilateral services trade noted by ABS.

By this measure, Japan remains our most important trading partner ahead of the United States.

These statistics are important. Getting them right informs Australia's strategic trade policy choices. Importantly because our trade partnerships with Japan and the United States are so equally matched and the particular geographic structure of our trade, multilateral arrangements have long been, and still remain, critical to efficient Australian trade specialisation in East Asia, across the Pacific with America, and around the world.

There is no denying that Japan’s era of high growth is at an end. But Japan is still a huge market, our largest market and the second largest single market in the world. And the challenge of restructuring the Japanese economy and lifting productivity performance is opening up new opportunities for Australian business in Japan. Suppliers of traditional raw material exports to Japan have had to lift competitiveness to hold and gain market share, and to shift to other markets in East Asia, now notably, China. But there is strong trade growth driven by structural change in Japan towards imports of services and processed and manufactured goods.

Australian exports to Japan grew at 4.6 per cent a year over the last ten years. Australia’s exports to the whole world grew at 8.7 per cent over the same decade, so that while Japan is still by far our largest export market, its share of Australian trade has shrunk. The fastest growing market alongside Japan is not the United States: it is China, and with the gas deal signed in 2002, China’s share of Australian trade will continue to grow. China (including Hong Kong) is already a larger market for Australia than is America. China itself is fast becoming Japan's largest trading partner. But China is unlikely to overtake Japan as our major trading partner for a little while yet.
Raw materials exports to Japan grew modestly over the last decade; slower than average growth of these exports has been the main dampener on the Australian export market in Japan. But exports of processed food, highly transformed manufactures and services to Japan grew at between 12 and 26 per cent annually. These goods and services have more than doubled their share in Australia’s exports to Japan and now account for almost a third of our total export earnings there.

The old trading relationship, based on the strategic raw materials trade, remains important, but a new relationship built on human capital and people-to-people business will be more important in the coming decades. There are different sorts of challenges in these new markets – in the form of institutional and regulatory systems to be negotiated. And there is need for a new framework of arrangements between the two countries to support the growth of the new trade relationship.

*Regional and Global Realities*

There is now more fluidity in foreign economic policy and diplomacy in East Asia and the Pacific than there has been for a very long time. Japan still faces huge problems in the reform of its economy and in managing industrial and demographic maturation. But Japan remains overwhelmingly the most important economy in East Asia, although other economies in East Asia (especially China) are on the rise. The import of these changes was underlined by the impact of the East Asian crisis. One consequence was the emergence of a new regionalism in East Asia. The crisis shook East Asia’s confidence. Japan was notably on the back foot. China appeared to be occupying the stage. Washington oscillated between being neglectful and being triumphalist. Groping around for new ways forward within the region seemed the natural response (Drysdale and Ishigaki, 2001).

Outside East Asia, the terrorist attacks in the United States in 2001 and the conflicts in Afghanistan and the Middle East have reduced confidence in international transactions, especially in the travel-related service industries. Over the two years ears 2001-2002,
world trade shrank (Garnaut, 2003). The war on terror has also created a 'them-and-us' atmosphere in international politics.

One important development in East Asia was the emergence of the ASEAN + 3 group. At this stage the ASEAN + 3 group is not a regional trading arrangement, and cannot easily become one, but rather seeks to provide a framework for demonstrating East Asian leadership and influence in regional and international affairs. The focus was initially on financial cooperation. China and Japan have come together politically in this arrangement and this is a very positive development. Despite our problems with Malaysia and Indonesia, Australia needs to position itself with Japan and other countries in the region as an insider not an outsider in this arrangement. Particularly in the area of regional financial cooperation, we have a great deal to contribute.

Another development was the proliferation of proposals for FTAs. Aping FTAs elsewhere in the world appeared attractive despite the fact that discriminatory trade deals are likely to damage rather than promote East Asian economic and political coherence and exacerbate regional tensions (as Singapore’s negotiation of bilateral trade deals has already done in Southeast Asia). This is why APEC committed to open regionalism and non-discrimination in trade policy. There was a shift in policy mood on discriminatory trade arrangements in Japan, where the principle of non-discrimination had been embedded in the approach to international trade diplomacy since Meiji times. The cornerstone of the Australia–Japan Agreement on Commerce was non-discrimination in trade treatment and the Nara Agreement extended that principle to other issues, such as investment and people movement.

None of these shifts in policy direction were subject to serious debate in Japan nor the occasion of any high level political dialogue between Australia and Japan. At best this is casual treatment of the national interest in Australia’s most important bilateral economic relationship.
Rather, the Howard Government exerted all its diplomatic energy toward establishing 'a comprehensive free trade' arrangement with the United States. The result of the negotiations with the United States is a limited arrangement that excludes critical Australian agricultural interests such as sugar and sets a dangerous precedent for pressing our interests in agricultural market access in Japan and East Asia. If implemented it will nonetheless introduce new discrimination in trade against Japan and our East Asian partners not only in trade but also in access to Australia's market for investment.

_Future Directions_
So where do we go from here?

Prior to Prime Minister Koizumi's visit to Australia in 2002, the Australian Government proposed an FTA with Japan. Prime Minister Howard insisted on publicly canvassing an FTA with Japan, one can only surmise, so that he could clear the way for an FTA with the United States.

An FTA with Japan would be bad in principle and impossible in practice. It would impose trade discrimination against other key partners like China, Korea or the United States and there is no way that Japan would negotiate freeing up agricultural trade with Australia and exclude the United States or China. An Australian FTA with the United States will have the same effect on Japan in other areas. The problem with FTAs in general, and these FTAs in particular, is that they divert trade from efficient to more costly trading partners, costing consumers and compromising national interest in important relationships.

Some within Japanese business and government circles do think that FTAs with Japan’s partners including Australia might be an instrument for prising Japan’s markets open. Connivance in this tactic is a mistake, because an FTA with Japan cannot deliver what Australia wants on agriculture or in other areas and is contradictory of Australia’s own strategic trade policy interests.
How could Japan make deep cuts in agricultural protection that favoured Australia alone and left the Americans out? How could Japan deliver Australia privileged access to its huge services markets while the rest of the world looked on? Why would Japan provide access to Australian agricultural exports now that the Australian Government has caved in on pressing access to agricultural markets in the United States?

In Singapore in January 2002 Japanese Prime Minister Koizumi called for the building of an East Asian community that is open and consistent with the region’s broader interests in APEC and with global arrangements. An East Asian community would involve cooperation in social, educational, scientific and economic affairs. Mr Koizumi then, and again on his visit to Australia in 2002, embraced Australia and New Zealand in his conception of an East Asian community. FTAs that discriminate in favour of particular countries over other East Asian nations are inconsistent with this vision.

The dangers in moving down the path of preferential bilateralism into which the Howard Government has stumbled have been underlined recently by Ross Garnaut and Chairman of the Productivity Commission, Gary Banks (Garnaut, 2003; Banks, 2003). As Banks notes: 'As one 'spoke' on the USA's hub, Australia cannot overcome through an AUSFTA the perils of bilateral and regional arrangements among our other trading partners and competitors – including other countries attached to the US hub…… (S)ome of our suppliers, like New Zealand and China, will see their exports eroded to some extent and this may adversely affect our trade relations with them.' This is a vital interest in our biggest trading partner, Japan. Moreover, as major investors in Australian industry, Japanese firms like Toyota will be encouraged to relocate manufacturing capacity in the United States away from Australia if the US FTA goes ahead (Australian, 19 June 2003; de Brouwer, 2003).

A serious negotiation between Australia and Japan or the United States would have to include the big issues in agriculture. But agriculture can only be dealt with seriously in a
multilateral negotiation involving the United States, as well as ASEAN, China and others, including Europe.

The answer is to link the bilateral negotiation of these difficult trade issues tightly into the Doha Round in the WTO, as one element in the negotiation of a new but non-discriminatory arrangement between Australia and Japan. Some, but not all, elements of services can be dealt with in the same way. The outcome will not be an FTA, but something of real and positive value. Yet not once has the Prime Minister, despite his new-found access and influence in Washington, taken this national interest forward with President Bush.

The foundation for regional cooperation with Japan rests on the strength of our bilateral relationship. But, as I have suggested, it is a relationship that has outgrown the framework that gave birth to it. A new framework is required to encompass interests in investment, services, the information economy, education and research, as well as trade in commodities and merchandise. A Comprehensive Economic Integration Arrangement (CEIA) between Australia and Japan, with no border trade discrimination, can attend to the newer elements in the relationship, while also addressing issues of trade liberalisation that remain between the two countries (de Brouwer and Warren, 2001; de Brouwer, 2003).

Conclusion

The issues I have raised might seem merely technical things, of remote interest to the broader Japanese studies profession. These are not merely technical matters. They are at the heart of conceptions of our interest in the relationship with Japan and the priority Australia as a nation attaches to Japan and its economic and political future in East Asia.

When Mr Howard traveled to Japan last July, he was never likely to return with the prospect of an Australia-Japan FTA, and he did not. What he returned with was
commitment to a Trade and Economic Framework Agreement (Australian Financial Review, 23 June 2003) which falls short of the Comprehensive Economic Integration Agreement proposed by de Brouwer and others but keeps open the prospect of progress in that direction. This is the good news.

But the bad news is that the failure to secure an FTA with Japan will not deter the Prime Minister from pushing ahead with the FTA with the United States. If eventually successful in that objective – and there are still some hurdles in the US Congress and the Australian Parliament to be overcome along the way – that will establish preferment in our the treatment of the United States over Japan and our other trading partners in East Asia. It will change the basis of equality that was entrenched as its cornerstone by those who built the relationship throughout the postwar period and has served our relatively small nation well in the multilateral trading system. This is not just a technical economic matter: it is an important political fact.

Moreover there has been absolutely no work done with Japan and our other East Asian partners on the main trade game – working on building common strategies to make real and substantial progress in the global round of trade negotiations. It is unlikely that Mr Howard will ever raise this subject with Prime Minister Koizumi. He did not raise it with President Bush at the Crawford Summit. Pursuit of the hollow prize of a preferential trade deal with the United States has so distorted calculation of our real national interests. Yet a global settlement in the multilateral trade negotiations would have much greater benefits for our economy and is the best way to sort out the confusion of bilateralism in trade relations with our most important trading partners.

On political and security issues, Australia's strong ties with the United States and deep but independent engagement in East Asia have been assets to both the United States and East Asia in diplomatic initiatives that straddle our trans-Pacific interests. The work of Australia in launching APEC is one outstanding example. Less noticed, the earlier constructive work in the Cambodia settlement and, more recently, on developing
dialogue with North Korea are others. Now Australia's diplomatic and political role within the region is under question.

The messages Prime Minister Howard sends to Tokyo and the rest of East Asia will affect our standing and strategic interest in East Asia for many years to come.

Australia’s East Asian interests depend on a deep and active relationship with Japan. It may be understandable that the decade of stagnation in Japan, the development of East Asia beyond Japan and the US-led new-economy revolution have directed Japan's attention away from Australia. It may also be understandable that these developments and political events of the last few years have directed Australia's attention away from its long-term priorities in Japan and the region. But Australia’s challenge now is to recapture its place on the Japanese radar screen and set a course of strategic engagement with Japan in East Asia and the Pacific. That engagement must, of course, continue to comprehend our trans-Pacific economic and security interests but it is unwise to compromise those interests with special and exclusive economic or political arrangements on one side of the Pacific or the other.
References

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