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ECONOMIES IN TRANSITION

Economies in Transition

The bilateral relationship expanded dramatically after the signing of the Australia Japan Agreement on Commerce of 1957. As Japan's economy was rapidly industrialising, Australia became its number one supplier for energy – coal – and steel making raw materials and other base metals such as bauxite, alumina, lead and zinc and a major supplier of copper as well as various agricultural commodities. As observed by the Hon Denham Henty MP, Minister for Customs and Excise, and Acting Minister for Trade, in his 'Message' to the First Joint Meeting in Tokyo 1963, Australia's exports to Japan in the five years following the signing grew fivefold.

Japanese purchase commitments and direct investment into the iron ore mines of the Pilbara and coalfields of Central Queensland sustained double digit growth in Australia's bilateral exports throughout most of the 1960s and 1970s. Australia's rising standard of living resulted in Australia becoming a prime export destination for Japan's automobiles, innovative consumer electronics and construction equipment. The '*complementarity*'of the two-way commerce became a much utilised descriptor.

In 1966-67, Japan surpassed the United Kingdom to become Australia's largest export market and for over forty years until 2009-10 Japan became Australia's largest two way trade partner.

The United States learnt that it had lost its exclusive independence of the global economy when in 1973 the Arab members of the Organisation of Petroleum Exporting Countries – OPEC – decided to '*punish*' it for its resupply of Israel following the Yom Kippur War. The subsequent oil embargo – October 1973 – March 1974 – sharply increased the price of oil. This led to hyper-inflation with wage pressures to cover what were often double digit cost increases that were rippling through the global economy. Following the lifting of the embargo, the price was about quadruple the suppressed historical price.

Neither Australia nor Japan was immune from such external happenings. Domestic policies could also have a bilateral impact. The ideological driven social reform agenda of the Whitlam Government that led Sir James Vernon, then President of the AJBCC in his 1973 Annual Address reporting on the exchanges at the 11th Joint Meeting and 6th Pacific Basin Economic Community (PBEC) meeting held concurrently in May in Melbourne to state that *"The Japanese delegates feared that the Australian Government might turn to nationalisation in some areas, but we told them that that was most unlikely, although the Government probably would be anxious or willing to take some direct equity ownership in certain enterprises.*

"The Japanese are seriously concerned about the problem of how to secure a steady flow of raw materials for their economy. The immediate needs are to concentrate on seeking under developed resources and new mining undertakings and to develop their technological standards to make the most economical use of materials."

Whilst the above exchanges occurred prior to the OPEC embargo impacts, by 1977 Japan found that its 1960's and 1970's economic restructuring, production systems and labour practices had enhanced its capacity for flexibility, and thereby, increased its competitiveness. The Japanese economy was growing at over 6.5 per cent per annum and was the second largest economy in the world. The Joint Communique issued by the 15th Joint Meeting after the October 1977 conference in Brisbane noted the world steel industry was suffering from a recession more prolonged than expected sothat new large scale projects were unlikely for the foreseeable future as the sector considered how to achieve a reasonable balance in supply and demand and consequent price stability.

The Communique mentioned some statistics that evidenced the strength of the Japanese Economy, namely:

Japan's imports (million tons)

Item	1977 Actual	1985 Est	1990 Est
Steaming Coal	1	16	40
LPG	11	20	25
LNG	6	30	44

It was noted that new operations would be required in Australia to help satisfy these levels of growth in demand. The North West Shelf would be contributing to the LNG supply by 1990. Additionally, nuclear power as a percentage of Japan's national power requirement would grow from 7% in 1977 to 25% by 1990. Australia had approved Ranger in 1977 and other development approvals were expected to supply this demand which was 210,000 tonnes in 1977. The Australian economy, the Communique noted, was experiencing a structural adjustment in its manufacturing sector because Australia's residual high inflation and wage costs discouraged the exports of its manufactured goods.

The Joint Communique of the 16th Joint Meeting held 1978 in Osaka summarised the economic conditions of Australia and Japan to be:

- Australia: Inflation declining to single figures with a prospect of 5% by mid-year 1979.
- Japan: unemployment higher than normal; low levels of capital expenditure and a sharp reduction in corporate profits were leading to the slowing of economic growth.
- The Communique stated that Japan was taking 32% of Australia's exports and was the source of 19% of its imports.

This Joint Communique reported: *"Speakers from the Japanese delegation pointed out that the Japanese philosophy on long term contracts tends to emphasise mutual inter dependence and mutual prosperity by co-existence, although this does not mean that the provisions of the contract should be disregarded. The philosophy leads to the idea that, in the case of hardship, both parties to the contract should help each other. Nevertheless, it was acknowledged that appropriately structured long term contracts have a reasonable and proper place in trade between the two countries."*

This discussion was propitious given that in 1979 OPEC initiated dramatically lower production quotas that resulted in another sharp rise in the price of crude oil and caused another round of high inflation and a substantial recession in most of the developed economies. Of the latter, Japan was least effected and its economy remained on a significant growth curve. In the early 1980s, '*Japan as Number One*', was setting records for sales of non-fiction in Japanese bookstores. Unsurprisingly, the book explained how Japan had developed into the world's most competitive industrial power, solving many of the structural economic problems which continued to inflict the United States.

The author, Harvard Emeritus Professor Ezra Vogel, also predicted positive GDP growth through to the year 2000, contrasting favourably with his prediction for the United States economy over the same period.

However, a decade on, Japan was struggling with the inflation genie, non-existent or poor prudential regulatory regimes and dangerously inflated property prices, which at their height, valued a square metre in some parts of Tokyo at US$1 million.

The United States economy reached the turn of the millennium very securely as the largest eco omy in the world. The 1970's post-Vietnam War economy and oil shocks witnessed periods of inflation and in 1981-82 and 1990-91 recessions, but the West German and Japanese manufacturing challenge had necessitated a response. This came in the form of a '*re-engineered*' economy where productivity was driven by the application of information technology and communications. Not evident at the time of Professor Vogel's book, this ICT adoption spawned unprecedented productivity improvements and innovation in manufacturing that underpinned new industries and a rapid growth in the services sector.

In Australia, a reformist Hawke Government floated the Australian dollar, deregulated the financial sector, and undertook industry reform in the automotive, footwear, clothing and textile sectors, and the steel industry that phased out tariff protections. Survivors of this restructuring became globally competitive enterprises. A productivity boost was the dividend. This helped the Australian economy through the bursting in 1989 of our nation's property bubble and the sharp 1990-91 global recession.

From the mid-eighties there was a heightened interest in the value to be gained from exporting of Australia's goods and services. As the '*Asian Tigers*' of Singapore, Hong Kong, Taiwan and Korea and the ASEAN markets were essentially only a day flight away, these destinations became the focus of the investment of marketing and manufacturing resources. By the time of the '*Asian Financial Crisis*' in 1997, twenty per cent of Australian employment was either directly or indirectly engaged in exporting of Australian goods, services and investment. The Australian corporate response to the crisis was essentially to retain '*In market*' presence, but wary of the risk to '*shareholder value*', Australian investment dollars tended to be spent in European countries and the United States where contract protection and a lesser risk of arbitrary political decision making and corruption existed, or China.

The liberalisation of the Chinese economy resulted in its substantial demand for Australian resources, particularly iron ore and LNG, and the stretching of production capacities and regional infrastructure. Demand driven sharp price increases generated an enormous expenditure on mine expansion and commitment to new mine development. The combined impact assisted the Australian economy to weather the 2008 Global Financial Crisis as witnessed by it being one of the few to avoid a '*recessionary*' two consecutive quarters of negative growth.

When Japan's property bubble burst in 1989-90, the consequences were shaped initially by denial of the causes, lack of comprehension of the systemic failure and deflation that lasted most of the 1990s and 2000s.

Nevertheless, whilst Japan's domestic economy grew at lack lustre rates compared to the region in the 2000s, one or two per cent growth was still significant for a US$5 trillion economy. Over the same period, exports increased from five to fifteen per cent of GDP, reflecting corporate Japan's move to secure its manufacturing base by capitalising on the abundant resources of the Asian region, particularly low cost labour, by '*hollowing out*' a significant percentage of its manufacturing capacity to ASEAN countries and China.

On the eve of the Global Financial Crisis, or the '*Lehman Shock*' as it is referred to in Japan, the Japanese corporate sector had benefitted from seven years of continuous growth and restructuring to possess very healthy balance sheets and engage in substantial M&A activity, particularly to secure growth to offset the officially declining and rapidly ageing population.■

50 Years of Australia-Japan Economic Cooperation

50 years of the Australia-Japan economic relationship map a history of complementary trade. The next 50 years will be driven by regional, political and economic synergies as Japan and Australia engage with a vibrant Asia, demographic challenges and the dividends of their longterm strategic partnership.

The stable and mutually-beneficial economic relationship between the two nations served as both a template and driving force for much East Asian regional integration and cooperation. The challenge for the future is to deepen private and public sector engagement; to repeat the successes of the past.

The willingness of both nations to make strategic economic engagement a priority across successive political generations has largely driven these economies, even though – or perhaps because - they occupy differing points along the production network.

Very strong bilateral trading relationships, such as that between Australia and Japan, are typically well-predicted by gravity models where distance, culture, language, legal heritage and political ties are major drivers of consistent trade. Although Australia and Japan share few of these factors, the relationship developed strength from early and consistently-applied demonstrations of strategic engagement. The 1957 Commerce Agreement and the 1976 Basic Treaty of Friendship and Cooperation drove trade by supporting mutual lowering of tariff barriers (withsome notable exceptions) and deepening capital flows.

The establishment of APEC in the 1980's enabled further cooperation. This closeness was further strengthened from 2001 when the AJBCC and JABCC commenced calling for an FTA and gained the Keidanren's policy support, through the 2003-decision for a feasibility study and the end of 2006 decision to initiate free trade negotiations and highlighted in the optimism demonstrated in the G20 and ASEAN+6 forums.

The fruits of these political ventures were quickly visible in trade figures. From the early 1960s Australia was Japan's leading source of quality raw materials, a popular tourist destination, an important investment market and an enthusiastic consumer of manufactured products. A reciprocal economic synergy developed with Australia's exports of large and steady flows of iron, copper ore, natural gas, oil, woodchips and aluminum feeding the Japanese manufacturing base. In the post-war environment, imports such as these supplied the basis for rapid industrial growth. Today the mature consumption market of Japan is the largest international buyer of Australian cheese, beef, seafood and is a growing market for services. Before the earthquake and tsunami disasters of March 2011, Japan sourced most of its energy requirements from Australia largely in the form of natural gas, coal and uranium. In the post-Fukushima energy environment the nuclear trade will likely fall greatly, potentially to be matched by expansion in gas and thermal power generation imports.

Away from the highly visible trade in goods, cross-investment between the nations has been a major driver of productivity growth and development; whilst Australian direct investment into Japan remains relatively small, portfolio funds, financial services and the implicit value of reliable resources have made significant contributions to Japan's extra-ordinary decades of economic growth. In terms of finance, Australian superannuation has been a keen buyer of Japanese corporate bonds and Australian banks helped alleviate the credit crunch of 2008 via '*samurai*' listings in Tokyo.

The largest trade agreements on the horizon for both nations, the Australia-Japan free trade agreement and the Trans-Pacific Partnership, are increasingly mired in domestic politics and international intransigence.

Despite the lack of political progress over the past six years, both Australian and Japanese business communities remain loud and enthusiastic supporters of these agreements and all the reform and integration they imply. In the past, where trade networks grew, regional cooperation followed.

The Trans-Pacific Partnership may be a blunt and unlikely instrument, but it is the target of much business enthusiasm on both sides of the economic relationship. This suggests that structural challenges within each country may be more easily dealt with under the aegis of a cooperative regional relationship; future international shocks may be more easily ridden by better-cooperating economies.

The support of the business communities is a positive and vital part of the ongoing relationship; Japan and Australia face major challenges which will be more easily dealt with by leveraging their commercial synergies. Japan's ageing population requires new insights on immigration policy, financial market reform, international trade integration and high-tech manufacturing substitution. Australia's rapid regional integration demands cooperative engagement, resources, research and reliable strategic partnerships.

The past two decades provided radically differing patterns of trade and development in Australia and Japan; one avoiding severe global shocks via an unprecedented resource boom, whilst the other's demographic and sectoral vulnerabilities sawthose same shocks evolve with depressing local impacts. The perceived importance of this mutual relationship has fallen in both countries, but 50 years of economic cooperation and development ought not be so easily overlooked. Whilst other countries and crises may hold the headlines, 50 years of Australia-Japan business cooperation continues to deliver great and important benefits to each nation; a vital template for the future.

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