AUSTRALIA'S TRADE WITH ASIA: SOME POLICY ISSUES

By KIYOSHI KOJIMA*

I. *Perspectives*

The successful industrialiation of the so-called newly industrializing countries (NICs), comprising South Korea, Taiwan, Hong Kong, and Singapore, and the ASEAN countries, has created expectations that their economies will grow to represent second and third generations of the Japanese economy. In addition, there are also prospects for the onset of economic growth in China given her modernising and industrializing activities. Such rapid success in the industrialization of the western Pacific region has stimulated Australia's interest, given her future role in accommodating the emergence of a large and growing market for agricultural and mineral products accompanied by an inundating flow of labour-intensive manufactured goods. The time has come when Australia's ambivalent attitude towards Asia's industrialization must be resolved. Thus the Australian economy has been driven into a narrow strait where, in looking towards the 1980s, industrial structural adjustment must somehow be realised. However, there are still important questions surrounding the strategies for attaining this goal.

This paper, using as evidence Australian research reports over the past few years, investigates the nature of the possible impact of Asia's industrialization on the Australian economy. Secondly, a survey is attempted of various papers regarding what kind of structural adjustment in the Australian economy is necessitated as a response to Asian industrialization. Thirdly, as the structural adjustment now being demanded (for the Australian economy) actually became necessary from about the beginning of the 1960s, when trade between Australia and Japan developed rapidly, the paper will then turn to examine briefly how this problem of the relationship with Japan came to be resolved and thus, to what extent relations with the industrializing countries of Asia ought to evolve differently. Then, finally, the prospects for what kind of pattern should evolve for the international division of labour in the western Pacific will be elucidated. This issue includes, particularly when considering the development of structural adjustment which reflects Australia's trade with the Asian industrializing countries, the question of how the trade and investment relationship between Japan and Australia ought to be changed.

II. *The Impact of Industrialization in Asia on the Australian Economy*

The energetic pursuit, during the past few years, of a considerable amount of notable research concerning the relationship between the Australian economy and the NICs of

* Professor (*Kyōju*) of International Economics.

Asia, ASEAN and China, is remarkable. There is even a pervasive feeling of a kind of tension. At a glimpse, there are as many as ten reports.[1] This paper deals primarily with Kym Anderson's recent thesis, "Australia's Trade with Resource-Poor Developing Economies of Asia, with Emphasis on Korea."[2] I have developed in a different paper, entitled "A Response to the NICs,"[3] an approach which was called, "The Integration of Japan-South Korea Manufacturing," or "The Formation of an Intra-Industry Specialisation Network," for Japan. Therefore a comparison with Anderson's paper will clarify the differences in the respective approaches of Japan and Australia.

According to Anderson's paper, Australia's pattern of trade has gradually shifted from traditional European and North American, to Northeast and Southeast Asian markets. The lesser-developed countries, called advanced developing economies (ADEs) by Anderson, of Asia, which incorporate South Korea, Taiwan, Hong Kong and Singapore, have achieved the highest growth rates in the world, and are highly complementary to Australia, due to resource deficiencies. Consequently Australia's trade with the lesser-developed Asian countries has been rapidly increasing, in a way similar to Japan-Australia trade in the 1960s. The trends in Australia's trade with South Korea have been analysed in particular, within the context of general trade patterns. Australia's exports to South Korea rose by 13 times between 1967/68 and 1975/76, and subsequently at an annual growth rate of about 50 per cent, to total Aust. $266.4 million in 1977/78. Agricultural goods accounted for 44 per cent of the total value of Australian exports to South Korea in 1977/78, while mineral

[1] (a) Anderson, K., *Australia's Trade with Resource-Poor Developing Economies of Asia, with Emphasis on Korea*, ANU Seminar Paper, 15 August, 1979.

(b) Bucknall, K.B., 'Japan-China trade and the implications for Australia,' in Crawford and Okita, eds., *Australia and Japan: Issues in the Economic Relationship*, Australia-Japan Economic Relations Research Project, Canberra and Tokyo, 1979.

(c) Bureau of Industry Economics Research Paper 1, *Industrialisation in Asia—Some Implications for Australian Industry*, Australian Government Publishing Service, Canberra 1978.

(d) Study Group on Structural Adjustment, *Report*, (Crawford Report) Vol. 1, Australian Government Publishing Service, Canberra, March, 1979.

(e) Edwards, C.T., *ASEAN-Australia Trade Relations: A Survey of Current Issues*, ANU Seminar Paper, 3 October, 1978.

(f) Findlay, C., 'Trade and Specialisation in Motor Vehicle Industry Policies,' in Crawford and Okita, eds., *Australia and Japan: Issues in the Economic Relationship*, Australia-Japan Economic Relations Research Project, Canberra and Tokyo, 1979.

(g) Garnaut, R., and Anderson, K., *ASEAN Export Specialisation and the Evolution of Comparative Advantage in the Western Pacific Region*, 10th Pacific Trade and Development Conference Paper, March 1979.

(h) Garnaut, R., 'The Importance of Industrialization in Southeast and East Asia to an Open Australian Economy,' in Drysdale and Kojima, eds., *Australia-Japan Economic Relations in the International Context*, Australia-Japan Economic Relations Research Project, Canberra and Tokyo, 1978.

(i) Smith, B., 'Prospects for the Australian Minerals Industry and Effects on the Australian Economy,' in Drysdale and Kojima, eds., *Australia-Japan Economic Relations in the International Context*, Australia-Japan Economic Relations Research Project, Canberra and Tokyo, 1978.

(j) Sutton, J., 'Structural adjustment policies for Australia: An overview,' in Crawford and Okita, eds., *Australia and Japan: Issues in the Economic Relationship*, Australia-Japan Economic Relations Research Project, Canberra and Tokyo, 1979.

[2] See note 1 reference (a)

[3] See Kojima, K., 'A response to the Newly Industrializing Countries,' (in Japanese) *Yūgin Kaigai Toshi Kenkyūjō Hō*, (Export-Import Bank, Overseas Investment Research Institute Report), November, 1979.

Kojima, K., 'The Economic Integration of ASEAN,' (in Japanese), *Kokusai Mondai*, (International Issues), December 1979.

products, which are required for South Korea's industrialization, accounted for 40 per cent. Needless to say, despite the dramatic increase, Australia's exports to South Korea in absolute terms are only about one-tenth of those to Japan.

On the other hand, Australia's imports from South Korea, predominately consisting of labour intensive products such as textiles, footwear, and toys, have in recent years rapidly increased to account for 4.7 per cent (1977/78) of Australia's imports of this type of commodity. Tobacco and fish imports from South Korea, being the only natural resource-based items, are negligible. Nonetheless the level of total imports from South Korea was as low as 1.1 per cent of Australia's total imports in 1977/78. Moreover it is clear that Australia enjoys a substantial bilateral trade surplus with South Korea as the ratio of Australia's exports to imports from South Korea in 1977/78 was 2.21 to 1.

Detailed analyses, similar to that of Australia's trade with South Korea, have been carried out in Australia for trade both with China[4] and with ASEAN.[5]

Anderson, in his noteworthy contribution, constructed a 'dynamic model of changes in comparative costs,' which he has endeavoured to support with empirical evidence, in order to elucidate trends in Australian-Asian trade. The model has the following characteristics:

Firstly, it is based on Harry Johnson's redefined concepts of production factors as being 'capital' which includes physical and human capital, and 'labour' which is the human labour time availability.

Secondly, the H-O goods, while being dependent on standardised technologies, are labour intensive goods produced relatively cheaply in a country with abundant labour.

Thirdly, in order to explain the comparative advantage for natural resource-based goods, an appropriate model has been constructed, in which there are two goods, (manufactures and natural resource-based goods), and three factors of production; 'capital,' invested only in the manufacturing sector, 'natural resources' confined to the natural resource-based goods' sector, and 'labour,' utilised in both sectors.

With the onset of economic development in a newly developing country, accompanied by capital accumulation, natural resource-based goods are exported and manufactured goods are imported. Thus, especially in natural resource-poor countries, an initial net trade surplus in natural resource-based goods is gradually transformed into a net trade surplus in industrial goods. Indeed this process corresponds to the 'Gan-ko Keitai Development' theory, which was elaborated upon with respect to the Japanese economy by Professor Kaname Akamatsu.[6] The 'Gan-ko Keitai Development,' or catching-up product cycle theory is most appropriate for natural resource-poor countries such as Japan, in addition to South Korea and other NICs. Yet Anderson seems to consider that the 'Gan-ko Keitai Development' theory is relevant for natural resource-abundant, labour-poor economies like Australia, and that such an economy should also promote a catching-up type of indust-

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[4] See note 1, reference (b).

[5] See note 1, reference (c), (e), (g).

[6] The most recently published reference is: Akamatsu, K., *Kinhaika to Kokusai Keizai*, (The Demonetisation of Gold and the International Economy), Toyo Keizai Shinposha, Tokyo, 1974, Chapt. 6. My development of the 'gan-ko keitai' theory is detailed in chapter 7 of: Kojima, K., *Nihon Bōeki to Keizai Hatten*, (Japan's Trade and Economic Development), Kunimoto Shobo, Tokyo, 1958.

The concepts of the 'gan-ko keitai' theory have entered into official use as in: *Shōwa 54 Nenban Tsūshō Hakusho*, (MITI White Paper 1979), pp. 300–301.

rialization; a point which remains debatable.

Next, Anderson constructs a model, which suggests a 'competitive Gan-ko Keitai type of industrialization between two countries' based on the following propositions:

Firstly, economic growth in Australia, indicated by industrial expansion through capital accumulation, induces restraint in specialisation in the export of natural resource-based goods, especially as the general labour factor tends to be redistributed more to the industrial sector.

Secondly, economic growth in the foreign country tends to strengthen Australia's specialisation in the export of natural resource-based goods, especially as the foreign country's increased demand leads to improved terms of trade for natural resource-based goods.

These two propositions present the dilemma, confronting the Australian economy. Fistly, due to low transport costs, Australia's export specialisation in natural resource-based goods is strengthened by economic growth in the countries of the Asian-Pacific region. While the improvement in the terms of trade can be welcomed, the desired expansion of industry is retarded and delayed. Secondly, export specialisation is strengthened, and so too, is import specialisation in goods where there is a comparative disadvantage in production. Consequently, goods with a comparatively high cost of production in Australia, particularly labour intensive products, will have to be imported in large quantities.

How Australia should resolve this dilemma is related to the issue of structural adjustment, and is dealt with in the following section.

Anderson's empirical evidence for shares of total exports from the NICs, Japan and Australia (Anderson, 1979, Table 3), demonstrates that while the share of natural resource-based goods as a percentage of total exports has been declining, and the share of labour intensive goods has reached a plateau, the share of exports of capital and knowledge intensive products has been increasing. Incidentally this conclusion has also been suggested by Watanabe and others.[7] Further evidence, (Anderson, 1979, Tables 4 & 5), indicates that while Australia's exports to the NICs and to Japan have implied increased specialisation in natural resource-based goods, the relative weights among Australia's imports from the same countries have been shifting significantly to labour intensive products. Other manufactured, and natural resource-based goods (excluding Singapore's petroleum products) were negligible.

Following are some comments on Anderson's model:

Firstly, economic aspects in Australia and Asian countries, including Japan, should not be explained by a single model. Secondly, Australia's overwhelming advantage in natural resource-based goods must be taken into consideration when comparing the take off point for industrialization and existing conditions with other countries. Thirdly, the significance of the country's size, should be incorporated into the model, especially when considering economies of scale.

III. *The Difficulties of Structural Adjustment in Australia*

Owing to a number of interrelated reasons, as was clearly illustrated in the Crawford

[7] Watanabe, T., ed., *Ajia Kōgyōka no Shinjidai,* (A New Age in Asian Industrialization), Nihon Bōeki Shinkōkai, Tokyo, 1979.

Report[8] the Australian economy must undergo a radical adjustment of its industrial structure. This section will review Janet Sutton's Survey[9] (which includes comments on the Crawford Report) of various Australian opinions concerning the problems of structural adjustment, and in addition, an article by Makoto Ikema,[10] which also deals with the Crawford Report.

Australia is regarded as a small, well endowed country with an area 21 times that of Japan, a population of only 14 million, and a *per capita* income at approximately the same level as the US ($7,000).

Up until the 1960s Australia's approach to industrialization was to increase the rate of self-sufficiency in a wide-range of manufactured goods. Such industrialization required policies including import quotas, customs tariffs and subsidies. Therein lies the reasons for the international uncompetitiveness of the Australian manufacturing sector. In sum, industrialization was promoted through protective policies to counteract import pressures arising from foreign countries where there existed competitive advantages.

On the other hand, what has happened in the agricultural and mining sectors where Australia enjoys international competitiveness due to export specialisation? There sectors occupy as little as 8 per cent of a total labour force of about 6 million. (In the manufacturing sector the proportion is 22 per cent, while in the services sector it is 70 per cent). Moreover, the agricultural and mining sectors represent only 12 per cent, while the manufacturing and services account for 25 per cent and 57 per cent respectively of G.D.P.

Thus, leaving aside for a moment the services sector, Australia as a small, well endowed industrial country has a dual structure, incorporating an inefficient industrial sector, which is large from the view point of employment, and a highly efficient agricultural and mining sector, which is specialised in exporting. Is an attempt being made to expand both sectors by means of a structural adjustment, or does a third option exist? This was also Anderson's contention, which was examined in the previous section.

Sutton also concludes that there is a need for structural adjustment in the Australian economy and suggests development of the mining sector, technological progress, and rapid growth and industrialization in the Asian economies.

The Advisability of Growth in the Mining Sector

Australia is regarded as a 'lucky' country. Not only is Australia endowed with agricultural products such as wool, wheat, sugar, butter, cheese, etc., but also, during the 1960s, there was rapid development in the exports of iron ore, coke, bauxite, etc. The potential for wider export specialisation is increasing given the large reserves of uranium, fuel coals and natural gas. However, there is a stream of thought emerging in Australia suggesting that the expansion of the mining sector is not necessarily beneficial, in general, for economic growth, and in particular for employment expansion. Gregory's model is representative. In this paper, it is not possible to discuss the question in detail but Sutton's paper suggests that from the late 1960s to the early part of the 1970s, the development of

[8] See note (1). reference (e).
[9] See note (1). reference (j).
[10] Ikema, M.,' Australia Groping for the Restructuring of Manufacturing—The Relevance of the Crawford Report,' (in Japanese), *Nichi-Gō Buretein*, (Japan-Australia Bulletin) no. 13, October 1976.

export-oriented large-scale mining brought about a substantial increase in incomes. As labour and capital were competitively attracted to this sector, they consequently received a rise in their rates of remuneration. In addition, both the inflow of foreign capital and the increased export earnings caused an appreciation of the exchange rate and an acceleration of inflation. All these factors have led to the weakening of the manufacturing sector.

A similar dilemma exists in Indonesia. Although endowed with strong advantages in primary product exports, industrialization has been a major objective. With the rapid increase in oil exports, industrialization has been retarded. The problem is that industrialization is impeded by the abundance of natural resources.

Technological Progress

Technological progress and rising wage costs have caused substitution into more capital intensive means of production. While this facilitates growth in productivity and real incomes, employment opportunities are reduced. Therefore one is confronted with the problem of where a new area of employment expansion should be sought.

Two additional results of technological progress are as follows. Firstly, the services sector would end up accounting for the main part of new employment opportunities in the future, particularly in services based on computers and electronic technology. Anderson and others all see the potential for increases in employment and in exports, owing to the emergence of new technology intensive industries. Secondly, and an issue which remains doubtful is that G.D.P. would have to be increased by even a higher rate than experienced in the past, in order to prevent increasing unemployment which would result from advances in technology. However, that would necessitate the expansion of markets for existing, and new goods and services, within Australia and overseas. In particular, advances in technology are essential for an export-oriented strategy.

Industrialization and Economic Growth in Asia

The rapid growth of production and trade and the industrialization of the countries of Northeast and Southeast Asia will become the principal outlet for Australia's trade, although Japan has hitherto played the major role. The increase in the range of specialised manufactures exported has already been analysed by Anderson. Sutton gives considerably more attention to the impact of manufactured imports from Asia. Australia's imports from the developing market economies rose by an annual rate of 24 per cent between 1968/69 and 1975/76 representing an increase from 5 per cent to 9 per cent of Australia's total imports, of which the largest share was manufactured goods.

Imports from the Asian developing countries are making an impact on all industries in Australia, but attention should be given to certain sub-sectors of goods where the effect is concentrated. These include labour intensive products, such as rubber footwear (the market share in Australia rose by 22.0 per cent from 1968/69 to 1975/76), cardigans and pullovers (15.8 per cent), headgear (23.2 per cent), leather and leather substitute products (19.5 per cent), plywood boards (8.7 per cent). If this trend continues, within ten years, developing Asian countries will be supplying 20 per cent of Australia's total imports.

Furthermore, South Korea, Taiwan, Hong Kong and Singapore are also not far off from moving into the production of goods, intensive in capital, know-how, design and knowledge. This will eventually add new competitive challenges to the engineering and metal working industries, in which Australia has been encouraging expansion.

The key economic policy issue for Australia is to reduce unemployment. However this is not a simple matter. According to Sutton, the following points should be considered. Firstly, the growth of the manufacturing sector through new investment tends to be capital and knowledge intensive. Secondly, due to technological progress the greater part of the services sector does not provide new employment opportunities at the same rate as has occurred in the past. Thirdly, the fall in the population growth rate will lower the demand level and bring changes to the pattern of demand. Finally, the administration of inflation management and macro-economic objectives will become increasingly complex.

Thus, the next question is in what direction can the Australian economy attempt to achieve a structural adjustment, and moreover, what kind of prescription does the Crawford Report offer?

It is clear that the Australian economy is being pressured into structural adjustment. However, there are four points worth noting.

Firstly, there is the issue of whether or not production and exports of the agricultural and mineral resource-based goods sectors should be increased. There is no dispute concerning the expansion of exports of agricultural products. Although export expansion of the mining sector would basically be the most advantageous, there is, along with Gregory's proposition, rather an air of vacillation and an antipathy towards making Australia into a 'quarry'. While employment will not be increased substantially, there is, on the contrary, a threat that wage rises and inflation will result. Indeed, such ideas are justified with respect to poultry production. However with regard to mineral products, the mined ore is not merely exported but instead processed so as to increase employment and value added. The latter opinion was prevalent 20 years ago, but it is now being re-emphasised. At the same time, no policy concerned with the destination of the exports of processed minerals is clearly indicated; an issue which remains unresolved. Although Australia is a 'lucky' country, it is not relying excessively on specialisation in the exports of natural resource-based goods. Rather the impression is that the goal is to become a sophisticated industrial country. Secondly, the existing inefficient process of industrialization cannot continue. Thus the composition of industry must be altered so as to have more competitive strength internationally by being more capital intensive and, moreover, more export-oriented. In short, specialised industries, with promising development potential, should be nurtured and expanded, through a shift to selective industrialization. The basic issue centres around whether promising industries can appear in the Australian economy with its small domestic market and high wages.

The Crawford Report has emphasised, in the following terms, the road Australia should follow.

> Alternatively, Australia may choose to exploit its rich resource base and to specialise in capital and skill intensive products destined for world markets. While this would not be without problems, it would launch the economy on a new growth path.[11]

[11] Crawford Report, *op cit*, p. 5.

This proposal is related to the processing of natural resource-based goods, as mentioned above, and is in accordance with recommendations made by myself. Ikema quotes from the Crawford Report on the type of processing industries as follows:[12]

> The Industries Assistance Commission pointed out in the 1973/74 Annual Report that Australia's export advantage lay in products which were capital intensive and with high labour productivity. Research reports indicate that there is a positive correlation between the degree of capital intensity and exports. According to the Department of Industry and Commerce, by processing domestic raw materials, the natural resource intensive industries will probably become the growth industries of the future. To be more precise, the following industries are said to offer opportunities not only domestically, but also in exporting: alumina/aluminium, petroleum refining, other mineral processing, petrochemicals, food processing, plus machinery related to the above, small ship-building, cement and concrete, plastics and leather products, paper and paper products, other non-tradeable goods and services related to leisure activities. In short, as mentioned above, it is considered that industries utilising local resources, and capital and skill intensive industries have promising future prospects.

Such heavy and chemical industries must have large scale factories which can realise economies of scale. The greater part of their output, up to about, say, 80 per cent, must be destined for the domestic market; but how could adequate local demand be expected to exist? The feasibility of this approach would depend on whether or not a large overseas demand is guaranteed.

In addition, since such heavy and chemical industries are capital intensive and are on many occasions plant industries, there is a fear that there will not be much increase in employment, even though a large part of Australia's investment funds would be diverted to these sectors. Although this resembles the mining industry, most of the opposition towards my proposals in 1963 was directed towards this point.

Thirdly, there is consequently interest in Australian specialisation in R & D services, which are both labour and capital intensive. There is an expectation that R & D services will make a contribution to increasing employment opportunities along with prospects for an expansion in exports. For example, Bucknall has pointed out the importance of technology exports to China."[13]

> The general area of *technology* offers scope to Australia for exporting to China. Clearly the area must lie where China has a need and Australia has the expertise. Unfortunately, this double coincidence is not all that common, but there are areas which promise mutual gain. China's program of agricultural mechanisation offers scope for agricultural machinery and know-how; Australia has already begun the process of establishing sales by exhibiting at the giant agricultural machinery exhibition in October 1978 in Peking, from which orders could be expected to flow later. China has indicated that it is interested in buying patents as well as machinery in the agricultural area. The field of mineral exploration, surveying,

[12] Ikema, *op cit*, p. 5. See, *Crawford Report*, *op cit*, pp. 5.1–5.4.
[13] See note (1) reference (b).

mining and processing is a promising area of mutual benefit, particularly for iron ore. In this area, Australia could provide technology for open-cut mining, blasting, and iron ore pelletisation. Transport of minerals is also an area of possible cooperation, by rail and road, as well as through bulk handling facilities at docks. A new port being built north of Shanghai for the import of iron ore is expected to be ready by 1980. Coal prospecting, mining and processing may also offer scope for technical assistance to China. Oil exploration, drilling and processing are areas of immense concern for China, which is soliciting international assistance, but it is not clear if Australia is in a position to provide technology here, especially in view of the Japanese, French and American technology available. Off-shore techniques would be in demand in particular. Deep harbour construction techniques might prove to be a viable technology export to China.

A similar policy in Japan of 'knowledge intensive industrialization' was formerly initiated by the Sangyōkōzō Shingikai, (Council for Industrial Structure) in "MITI's Policies for the 1970s" (May 1971). Nevertheless if Australia opts for 'software' knowledge intensive industrialization, (i.e., R & D services, etc.), the expansion of employment and exports is unlikely to be greatly facilitated. The dispute that also occurred in Japan was that the objective of producing sophisticated goods by more knowledge intensive methods in all Japanese industries, especially in manufacturing, does not imply that only 'software' is given priority.

Finally, aiming to expand exports of specialised natural resource-based goods, and also seeking to open overseas markets for promising industrial goods, will necessitate substantial imports of labour intensive goods from Asian countries. Thus it is likely that the inefficient and small scale light and consumer goods industries in Australia will be adversely affected by such structural adjustment. Although Australia's search for potential areas for export expansion is being accompanied by Asia's industrialization, there has been little reference to the costs of an import expansion policy, which requires a policy of curtailment in the relatively disadvantaged industries. Ultimately, would a policy of high protective tariffs be continued?

The sole relevant suggestion in the Crawford Report is that attention should be given to reciprocation in trade negotiations. Thus it is likely that corresponding to the other country's increase of exports from Australia, the question of increasing Australia's imports would be discussed. The outcome would be increases in Australia's natural resource-based goods exports and in imports of labour intensive manufactured goods. If that is not so, the objective would probably be to increase the level of horizontal trade in manufactured goods for both Australia and the other country. Policy measures for guaranteeing the realisation of the objective would need to be devised.

It has become clear that even the basic orientation of industry restructuring in Australia has not been defined, and in general, adjustment has been limited to hopeful designs. The question of whether the kinds of mechanisms and means for achieving a restructuring are being considered, still exists.

On the one hand there is a claim that if most of the trade and investment restrictions which are highly protective were abolished, the market mechanism would bring about a fresh dynamism which would facilitate restructuring. At the same time it is feared that, although this market-induced reorientation would strengthen specialisation in the export of natural resource-based goods, most other industries in the Australian economy would be affected, which would probably lead to greater unemployment.[14]

Instead of such a drastic step, the Crawford Report recommends the option of policy-induced reorientation, by which restructuring should gradually be achieved and offset with a number of government policies. In practice[15] these would include:

Firstly, encouraging the emergence of more competitive manufacturing sectors, including industrial development policy, (R & D, export development, tax privileges, measures for overcoming the difficulties of small enterprises, increased management efficiency, improving productivity), initiation and completion of large scale resource-based industries, stage by stage removal of high levels of protection, a trade policy for enlarging market access for Australia's exports, and provision of forecasting information; secondly, promoting flexibility and adaptability in the economy and labour force, including manpower policy, inflow of foreign capital, ensuring adequate funds for technological innovations, development, exports of small and medium-sized enterprises and rationalization; and thirdly, alleviating the pressure of structural adjustments, including policies for specific industries and specific areas, temporary incentives, industrial conversion assistance which would be reduced progressively to the degree that enterprises can adapt to levels of protection being lowered.

In other words, the recommendation is composed not only of positive dual policy measures for the cultivation of promising export industries and for advancing the flexibility, adaptability and dynamism of the whole economy, but also of a policy of industrial conversion assistance for attaining stage by stage removal of inefficient industries. However, if the latter policy is given priority, there would be considerable concern that, just as in the past, it would be a continuation of a protective trade system.

IV. *The Impact on the Japan-Australia Economic Relationship*

To sum up, the Australian economy has experienced the impact of rapid industrialization in Japan and now in many of the Asian countries, and is being compelled to undertake significant structural adjustment of the industrial sector. Nonetheless it can be said that failing to proceed in a definite direction, would adversely affect the Australian economy. As an economist, I would like to propose some of my own suggestions. Although fearing my opinions would be subject to antagonism, one can argue that a foreigner is in a position to be able to judge the situation more objectively.

Australia's comparative advantage in the natural resource-based goods sector, compared to the manufacturing sectors of the economy, is overwhelmingly strong in comparison to Japan, South Korea and other Asian countries. Progress in the industrialization of the latter group of countries and a resulting growth of Australian exports of natural resource-based goods would bring about considerable mutual trade benefits, which certainly should be welcomed by the Australian economy. It is undeniable that, as Gregory's proposition suggests, the rapid expansion of the mining sector, to a certain extent, would result in cost-push inflation. However, that proposition was expounded at the time of the boom in

[14] Refer to Kojima, K., *Japan and a New World Economic Order*, Croom Helm, London, 1977, chapt. 6.
[15] Sutton, *op cit*, pp. 24–25.

exports of natural resource-based goods up to the early 1970s. During that period, Australians were enjoying full employment and prosperity. Increases in exports of natural resource-based goods, a rise in incomes and a surplus on the balance of payments certainly brought about growth and prosperity for Australia's domestic industries. Thus, the present unemployment and difficulties in the Australian economy are primarily based on the stagnation in Australia's natural resource-based goods sector, which was caused by the world recession subsequent to the oil crisis of October, 1973. Based on those facts, there is no doubt that reassessment of Gregory's proposition is necessary.

The view of Anderson and other Australian academics is derived from the following two-stage considerations. When compared with the natural resource-based goods sector, which has an overwhelming comparative advantage, the industrial sector has a general comparative disadvantage and so exporting is not feasible. (Thus Gregory's proposition appears viable.) However, if one focuses only on the industrial sector, there may be industries or services with export potential, but simultaneously there will also be industries or services vulnerable to import competition whose existence is dependent on being highly protected. The preceeding approach is inadequate. The cultivation and expansion of 'internationally competitive industries with export potential' implies industries with a strong comparative advantage greater than that of natural resource-based goods. It is also clear that export expansion for both these industries and the natural resource-based goods should be attained, and indeed, this should be the basic aim of the Australian economic policies.

What are the likely industries with such export potential? Because the natural resource-based goods possess an overwhelming comparative advantage, the industries which are based on the natural resource-based goods are those which can maintain a strong comparative advantage. Thus the proposal which I made in 1963 becomes pertinent, and is as follows:

> I firmly believe that there is no reason why some heavy industries based on the rich resources of the country could not be established as specialised export-oriented heavy industries.[16]

This proposal is the recommendation of the Crawford Report, and suggests that the road which Australia should follow is 'to use its abundant natural resource base by specialising in capital and technology intensive manufactured products which are oriented to the world market.'

From this standpoint, policy objectives such as the processing of natural resource-based goods and the export of processed minerals or metals have been evident in Australia since the beginning of the 1960s. Nevertheless, there is the issue as to what extent processing will be carried out. As regards to iron ore, only a small amount of pellets has been exported, because larger profits can be accrued by mining companies through exporting the basic iron ore in large quantities. I suggest that, in addition to the existing 5 million tons of iron and steel output, Australia should construct a new blast furnace of 5 million to 10 million tons capacity.[17] Thereby, if high quality raw materials are produced, automobile, precision machine and general machine industries, which utilise those materials, would be able to

[16] *Ibid*, pp. 29–30.

[17] Kojima, K., (translated by E.S. Crawcour), 'An Impression of the Oceanian Economy,' *The Economic Record*, March 1964. This article was originally published in Japanese, in 1963.

develop, because they are based on high quality, low priced raw materials. Considering the expansion of industries with linkages, including the services sector, it is anticipated that the employment and income effects are considerable. Similarly, the linked series of machine industries are utilising bauxite, alumina and aluminium. Oil and natural gas developments would also offer similar benefits, but oil exploration has not been as successful as one would have expected. However, it is likely in the future that huge amounts of uranium and fuel coals can be developed.

Thus in the Australian economy:

> The first obstacle to the development of these possibilities is state interference and the sleeping entrepreneurial spirit which prefers stability to progress. The second is the smallness of the domestic market which prevents the development of heavy industry of optimum size. The third is the excuse put forward that capital-intensive heavy industry does not absorb much labour and thus does not contribute to the maintenance of full employment.[18]

There has been opposition and critism voiced towards the above proposals. The central argument pivots around my criticism to the preservation of labour intensive manufacturing and smaller scale enterprises.[19] Yet, the other issues must be adequately tackled; as I have suggested, "... if your sights are set on a vast export market, heavy industry is quite capable of large scale production."[20]

In order to develop this export market, specialization within manufacturing, in relation to the kinds of goods specialised in by Japan, the US, and the nearby Asian countries, is necessary.

> As for the second objection, it is true that capital-intensive heavy industry does not provide much employment per unit of capital. On the other hand, as we have experienced in Japan since the war, a rapid increase in heavy industry—10 or 15 per cent a year—can absorb a great deal of labour. This is particularly true if we include expansion of related industries. I asked why Australia too does not set up a plan for doubling heavy industry. Only in this way can labour be transferred from the inefficient consumer goods light industry sector into the efficient heavy industrial sector, and an efficient re-allocation of resources be achieved. Only in this way too can co-operation with Asia be achieved, by importing labour intensive goods from Asia and exporting investment goods.[21]

Although in the early 1960s the concept of a required structural adjustment reflected the above, by the mid-1970s, due to the prosperity resulting from exports to Japan, the fundamental structural adjustment of the Australian economy failed to be undertaken. The pelletisation of iron ore and the establishment of an alumina factory were about all that was done. Nothing was carried out to further the objective of large scale exports in the heavy and chemical industries. This issue underlines the failing and inactivity of the

[18] Kojima, K., 'A Japanese View of Australia's Economic Future—Develop Heavy Industry,' *The Australian Financial Review*, June 1966.

[19] For example, 'Japanese Economist's Blast at Industry,' *The Australian Financial Review*, April 21, 1964.

[20] Kojima (1964), *op cit*, p. 54.

[21] This was also written in: Kojima, K., 'Australian Tariff Protection and Industrial Structure,' *The Australian Quarterly*, December 1966.

entrepreneurial spirit of Australia, which includes the government.

> Nevertheless, the response was to ask timidly whether heavy industrial products could obtain adequate export markets. Japanese entrepreneurs would be confident that, if they went into large-scale production which reduced costs and went after exports, markets would be sure to become available. Australia and New Zealand, however, do not have much courage to face danger. But if Japan and Oceania promoted each other's heavy industry by supplying each other with markets, I feel that there is great room for expansion of horizontal trade in manufactured goods.[22]

The development of large scale mines was also initially undertaken with the inflow of capital, technology and managerial skills from US and British multinational enterprises, and by taking advantage of substantial demand guarantees from Japan, based on long term contracts.

Japan in the 1960s had a large trade deficit with Australia, (e.g. in 1962 the import and export value was US $435 and US $135 million respectively, or a ratio of 3 to 1). Although the import surplus ratio has been reduced, it is still considerable, and in 1978 the ratio was 2 to 1, or US $5,300 million to US $2,692 million. There has been pressure in Japan to find markets for manufactured goods to correct this trade imbalance, but since Japan recognises a trade deficit is inevitable, given the benefits of procuring natural-resource based goods from Australia, these pressures have been nullified. Because Australia continues to maintain high protective tariffs on manufactures, policy solutions have been reached whereby incentives are provided for Nissan and Toyota to engage in direct foreign investment behind the protective barriers. Consequently, objectives of establishing large scale heavy and chemical industries are impeded.

In this way, the Japan-Australia relationship has maintained reasonable stability by means of a two-pronged policy, which is approval of Japan's huge trade deficit and expansion of enterprises overseas instead of exporting. Nevertheless, Australia's response to industrialization in the NICs and ASEAN should not result in similar policies hitherto directed to Japan. A fundamental structural reorganisation must, in some way, be undertaken. Although a large impact on relations with Japan would probably result, the Japan-Australia relationship should still be acknowledged as playing a central role.

Australia's exports of natural resource-based goods such as mineral and agricultural products would increase in accordance with industrialization by Asian countries. Thus, instead of the situation whereby there is a suspicious feeling of being dominated by, and of being over-dependent on Japan, Australia would have the advantage of diversification of its export markets and consequently, the risks of demand fluctuations can be distributed and offset. This would also enable a strengthening of Australia's bargaining position. Such a situation should also be welcomed by Japan, since it would become possible to avoid baseless suspicions and accusations that only Japan's business fluctuations affect the Australian economy. However, the demand of the Asian countries, is small and marginal. Therefore, if Japan's demand, which has stabilised at substantial levels, were not assured, the profitable operations of existing large scale mines, and the development of new mines

[22] Kojima (1964), *op cit*, p. 54.

would certainly be impossible. In this way, it should not be forgotten that the key element is the continued trade in natural resource-based goods between Japan and Australia. Only under these circumstances would marginal exports to Asian countries become profitable.

If transportation and distribution were not just between Australia and China or South Korea, multilateral transactions in addition to those already existing with Japan would increase the scope for decreasing transportation and distribution costs. Such potential should be exploited.

Given the expansion in Australia's exports of natural resource based goods to the Asian economies, the persistent claim that large quantities of labour intensive manufactures should be imported from Asia is perhaps only natural. It would be unreasonable to expect the Asian countries, unlike Japan, to give tacit approval to a deficit in trade with Australia and to overcome Australian protective trade barriers with direct investment in Australia, which would be both uneconomic and impossible. Instead Australia should probably take advantage of this pressure as an opportunity to push forward with structural reorganisation in order to facilitate the rationalisation, reduction and restructuring of its inefficient smaller scale enterprises, and the nurturing of large scale specialised heavy and chemical industries.

Undoubtedly, the Japan-Australia relationship must be the basic mainstay for Australia to be successful in developing large scale specialised heavy and chemical industries and in forming an intra-industry specialisation network with nearby countries. This issue is similar to the one concerning the expansion of exports of natural resource-based goods. In short, the destination of the largest amounts of exports, from Australian specialised heavy and chemical industrial production would surely be Japan. By initially establishing intra-industry specialisation between Japan and Australia, international division of labour would inevitably result with additional output due to economies of scale and exporting opportunities would increase to Asian countries. Japan also should be encouraging similar arrangements such as Japan-South Korea industrial integration with Australia.

To cite an example, rather than Nissan and Toyota continuing their small scale existence behind Australia's high protective tariffs, they should aim to export specific types of vehicles to international markets by becoming more competitive internationally through specialisation. In short, Japan should attempt to engage in direct investment activities which would act as bases for Australian exports. In this way, Japan could contribute to the Australian economy and become the advance guard for structural reorganisation emanating from export oriented industrialization.