OBSERVATIONS ON THE PROSPECTS FOR JAPANESE-AUSTRALIAN TRADE

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In his foreword to a recent *Sydney Morning Herald* supplement on "Japan 1965", Mr. Yoshihiro Nakayama, Director of the Economic Affairs, Bureau of the Japanese Ministry of Foreign Affairs, took an optimistic view of the prospects for trade between Japan and Australia but also pointed to some of the difficulties:

"It is equally stimulating to look forward and to look back upon trade between Australia and Japan. Looking forward, we can expect to find in it even greater volume and diversity. Looking back, one can only describe the results as remarkable. In the past five years, the total amount of trade between our two countries has more than doubled. Viewing ourselves as trading partners, we find that Australia occupies the second position among the countries from which Japan imports; among the countries to which Japan exports, Australia occupies the third position—coming after the United States and Hong Kong.

"The robust development of trade between our two countries stems from Japan's increasing imports of raw materials from Australia—for example, 30 per cent of Australia's total exports of wool and 94 per cent of her total exports of coal are designated for Japan. We do not foresee any likelihood of a change in this trend. In addition to our imports of wool, coal, wheat and so on we have more recently added as major imports such items as sugar and mutton, and now iron ore. This import of iron ore is, of course, only in its infancy. It can be anticipated that the bulk of the iron ore exported from Australia will be going to Japan, and I am reliably advised that, five years or so from now, Japan's purchases of iron ore are likely to be worth £50 million a year to Australia ...

"The big gap between Australia's imports from Japan and Japan's imports from Australia is, we know, an old story. It doesn't appear to have improved to any great extent, but we have been pleased at the evidence, not only of some increase in the quantity of Australia's imports from Japan, but also of a movement beyond the traditional imports of textiles and sundry goods to machines, metal manufactures and chemical products.

"This trend away from an overwhelming consumer pattern to the building up of a market for goods which can perhaps best be categorised as capital goods (and which therefore aid Australia's own industrial development) opens a prospect of increasing Japan's exports to Australia ...

"We are well aware that the best way to expand trade is through multilateral

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relations and that we should not seek to secure perfect balance in bilateral trade. Nevertheless, unexceptional as the multilateral theory is, the realities are not so simple—especially for Japan. Our present position is that 50 per cent of our overseas markets are in developing countries all of which are exerting the strongest pressure on Japan to adjust trade balances which are unfavourable to them. This background may explain our efforts to persuade Anstralia to reduce a trade balance unfavourable to us to a margin more appropriate to Japan's imports from Australia.

"Fortunately, in recent times there has been a better understanding in Australia of the quality of our industrial output and an increased strengthening of direct relationships between our respective industrial structures. This is found in joint ventures and in the export of know-how as well as the exchange of commodities ...

"In turn, this will contribute not only to the strengthening of the ties existing between our own two nations but to the promotion of the stability and therefore the prosperity of the Asian area as a whole. It will also promote the success of another role which is our shared responsibility as the only advanced industrial countries in this region ..."[1]

There is no need for me to set out in detail what Mr. Nakayama describes as the "remarkable results" achieved in Japanese-Australian trade in recent years.[2] I propose instead to take Mr. Nakayama's admirable exposé as my "text" for a discussion of some of the more important issues in the trade partnership between Japan and Australia.

(i) *Vertical or Horizontal Trade?*

"Japan and Australia are often, and not wrongly, called *natural* trading partners. Each produces most efficiently, and exports, those commodities which the other cannot produce efficiently, and imports."[3] Mr. Nakayama implicitly endorses this view when he stresses Japan's demand for raw materials from Australia as the chief engine of past and future growth of trade between the two countries. The fact that Japanese-Australian trade is now, and looks like remaining for the foreseeable future, in the main a straightforward case of exchange of primary products for manufactures is perhaps the first point that should be made. Though obvious, it conflicts with much sophisticated thinking about future patterns of international trade both in Australia and in Japan.

Australia has traditionally been one of the world's major primary producing and exporting countries. In Australia, this dependence on exports of primary products has long been felt as a weakness which must be remedied by industrialisation. Well into the post-war years, the emphasis in industrialisation was on production for the home market; dependence on unstable world markets for primary products was to be reduced by import substitution. During the fifties, earlier hopes for any substantial reduction in Australia's dependence on imports were increasingly recognised as illusory. At the same time, a drastic decline in Australia's terms of trade underlined a general pessimism about the prospects facing agricultural products in world markets. For both these reasons, it came to be thought imperative for Australia to export manufactures. It is fair to say that, in recent Australian thinking, hopes for expansion of Australian export trade have rested as much on her new manufacturing

[1] *Sydney Morning Herald*, Supplement on "Japan 1965", April 12, 1965, p. 1.

[2] See Peter Drysdale, "Japanese-Australian Trade", in *Papers on Modern Japan 1965*, Research School of Pacific Studies, The Australian National University, Canberra, 1965.

[3] *Ibid.*, p. 83.

as on her traditional primary industries.

These considerations arising directly from Australian experience have been reinforced by inferences widely drawn, not least by Japanese economists like Professor Kojima, from analysis of structural changes in the pattern of world trade.[4] Nineteenth century trade, argues Professor Kojima, was mainly "vertical" trade, exchange of manufactures for raw materials and foodstuffs, based on differences in factor proportions—land and natural resources, on the one hand, and labour and capital, on the other—between different parts of the world. With economic development, more and more of international trade has become "horizontal" trade, mutual exchange of manufactures among industrial countries; and this trend is likely to continue. Professor Kojima therefore foresees the future of trade between Japan and Australia (and between both and the industrialising countries of South-East Asia) as increasingly taking the form of "horizontal" trade, primarily exchange of "light" against "heavy" manufactures, based on differences in the capital/labour ratio in different countries.[5]

The difference between this stress on horizontal trade and Mr. Nakayama's assessment of the present and future of Australian-Japanese trade is clearly one of timing. In the longer run, the emphasis in trade even between Australia and Japan will certainly shift towards mutual exchange of manufactures. But this longer run seems quite a way ahead.

The pessimism of the nineteen-fifties about the future of Australia's export trade in primary products was probably in any case excessive because it rested almost entirely on the dubious prospects for foodstuffs and agricultural raw materials like wool and did not take into account the then quite unexpected vast new discoveries of mineral resources in Australia —especially iron ore, bauxite and copper. Even with this new potential for primary exports, Australia would have been under much more pressure to move towards the horizontal pattern of trade had it not been for the "happy accident" of finding in Japan, relatively close by, a very large and enormously rapidly growing market which, with a huge manufacturing complex and few natural resources, had a voracious appetite for industrial raw materials. It is arguable that the emergence of Japan as a major trading partner has, almost fortuitously, given the "vertical" pattern in Australia's trade another very substantial lease of life.

Even this, however, is unlikely to halt or reverse the necessary trend towards horizontal trade, towards an increasing share of manufactures in Australia's exports. Does this mean, then, that Australia and Japan will gradually become less "natural" trading partners, less complementary and more competitive economies? The common assumption that vertical trade is more natural than horizontal trade, that scope for trade depends on countries specialising in primary products and manufactures, or in light and heavy manufactures respectively, derives partly from a failure to visualise the endless opportunities for specialisation among the vast range of products of modern manufacturing industries and partly from an oversimplified picture of international trade as based on differences in the ratios between the conventional "factors of production" of economic theory, land, labour and capital. Mutual exchange of manufactures among industrial countries accounts for a large, and much the most

[4] See Kiyoshi Kojima, "Japan's Trade Policy", in *Papers on Modern Japan, 1965*, and references given there.

[5] "Increases in world trade today are mainly determined by different L/C endowment ratios between industrial countries" (Kojima, *op. cit.*, p. 101). It should be explained that Professor Kojima in his statistical analysis defines horizontal trade much more narrowly in terms of exchange within any arbitrarily defined commodity category which can be made as small as one likes.

rapidly growing, part of international trade; and this exchange rests not so much on comparative advantage in "light" or "heavy" industry based on differences in the relative abundance of labour and capital in different countries (though this plays some part) as on comparative advantage in the production of specific products based sometimes on availability of raw materials but mainly on having been first in the field, and particularly on technical innovation, reinforced by patent rights and economies of scale.

Compared with the developing countries of South and South-East Asia, both Japan and Australia are *relatively* capital-rich, high-wage countries. Each of them will therefore find it increasingly difficult to compete with the labour-intensive manufactures of these lower-wage countries either in export markets or, without tariff protection, in its own domestic market. Each will increasingly tend to exchange the products of its heavy industries—steel, machinery, vehicles, chemicals—for the light consumer goods of the developing countries. But this does not mean that there will be no scope for horizontal trade in manufactures between Japan and Australia or that, in trade with South-East Asia, their interests will clash. While Australia is obviously well behind Japan as an industrial exporting country, Australian manufacturers will find outlets for all sorts of things in the vast and growing Japanese market if they look for them. Similarly, while some Australian and Japanese industries, steel and motor cars perhaps, may find themselves competing with each other in South-East Asian markets, there may be scope here, too, for what Professor Kojima has called "agreed specialisation".[6]

An economist cannot contemplate without misgivings the sort of market-sharing arrangements under which producer interests from two countries get together to exploit consumers in a third. But provided consumer interests are safeguarded or, better still, brought into a scheme for regional economic co-operation, "agreed specialisation" may secure a better use of economic resources than the play of competitive market forces.

(ii) *Export of Capital Goods without Export of Capital?*

The trend in Japanese exports to which Mr. Nakayama refers, "from an overwhelming consumer pattern to the building up of a market for...capital goods", is a constant theme in current discussion of commercial policy in Japan. "Our comparative advantage is experiencing significant changes mainly due to the approach of full-employment and a rapid increase of the wage level. Tremendous structural change of our economy is needed. Our foreign trade, too, has to be reorganised."[7] Much progress has been made. Whereas before the war and in the early 1950s light industrial products, such as textiles, foodstuffs and sundry goods, predominated in Japanese exports, by 1963–64 heavy and chemical products are estimated to have accounted for 54 per cent of total.[8] "But the component ratio of the heavy and chemical industries' products to total exports is still low as compared to the advanced countries of the West. Specifically, machinery exports (exclusive of vessels), even if light machinery is included, account for barely 20 per cent of total exports. Again, machinery exports to the advanced countries, apart from vessels, consist mostly of light machines, while items of general industrial machinery are largely shipped to developing areas, such as South-east Asia and South America. It is evident that the international competitive power of Japanese-made general industrial machinery is yet to be developed."[9]

[6] Kojima, *op. cit.*, p. 119.
[7] *Ibid.*, p. 100.
[8] *Japan Times*, Supplement on "Japanese Industries in Review 1965", April 1965, p. 7.
[9] *Japanese Industry 1964*, The Foreign Capital Research Society, c/o Bank of Japan, Tokyo, p. 12.

Two special obstacles are said to confront Japanese producers of capital goods in trying to compete in the Australian market. One is the British preferential tariff. The other, the fact that much of Australian industry is overseas-owned and tends naturally to buy its capital equipment in the country of the parent company. Of the two, the latter obstacle is certainly much the more serious. It would probably require a very substantial preferential tariff margin *in favour* of Japanese machinery to induce the management of a British subsidiary in Australia to switch from its traditional, proved and familiar British supplier of machinery to a Japanese competitor. Moreover, the British preferential tariff has already greatly declined in significance in Australia and will undoubtedly vanish over the next five to ten years. What remains of it now will gradually be traded away by Australia in return for Japanese concessions to Australian exports. British entry into the European Economic Community would no doubt hasten the process.

The other problem is much more difficult. It is one instance of a more general problem which is commonly said to confront Japan in its present phase of economic development. Japan has now reached the stage when its comparative advantage is shifting from labour-intensive consumer goods to heavy industrial products such as capital equipment. But Japan, it is said, is not yet rich enough to be a net exporter of capital. Yet so imperfect is the world market for capital equipment that it is problematical how Japan can hope to compete in the export of capital goods unless she also exports capital. The Australian case illustrates the point.

The problem is one of the most difficult facing Japanese commercial policy to-day, but it is by no means intractable. (It is, incidentally, also beginning to face Australian exporters to South-East Asia and New Zealand.) Three main lines of approach suggest themselves.

First, a country can be a net importer of capital and yet undertake quite a lot of (gross) investment abroad. This has in fact been Japan's position in recent years. There has been an increasing flow of Japanese direct investment, usually in joint ventures, in South-East Asia, Latin American and elsewhere. But the volume of such investment has so far been held within very narrow limits by private and official caution. The most obvious way in which more resources (capital and foreign exchange) for such direct overseas investment by Japanese companies could be made available would be through a more liberal official policy concerning a reverse flow of private investment of overseas capital in Japan. This has hitherto been severely restrained for fear that powerful foreign companies establishing themselves in Japanese industries would push the existing Japanese-owned firms out of business. The time has perhaps come to reconsider this policy. In most modern industries Japanese companies are now quite strong enough to hold their own against such competition. Nor is it easy to see why Japanese managements should be so fearful of allowing overseas capital some minority equity participation, or of borrowing abroad by the issue of debentures (bonds), which would add to their financial resources without endangering their control of the enterprise. Both for the individual Japanese heavy engineering company and for those concerned with national policy, a reconsideration of the benefits to be obtained by being able to support Japanese exports of capital goods through the export of capital, on the one hand, and the costs of importing private foreign equity or portfolio capital, on the other, might well lead to a new attitude.

Some Japanese capital has been coming to Australia in the last few years, mainly in the form of joint ventures with Australian or American interests and almost entirely for the development of Australian mineral resources for export to Japan, especially iron ore, copper and coal.[10] There is hardly any evidence so far of Japanese direct investment in manufacturing in Australia.[11] The establishment of branches or subsidiaries of Japanese manufacturing companies would undoubtedly be as welcome in Australia as American, British and European direct investment has been, although the administration of Australia's restrictive immigration regulations may still place difficulties in the way of Japanese firms which American and European firms would not encounter.[12] In the years to come there will be increasing interest in Australia in joint ventures which will enable Australian manufacturing firms to take advantage of the technological dynamism of Japanese industry. There has also recently been much discussion in Australia of the possibility of interesting Japanese capital in investment in the Territory of Papua and New Guinea and thus getting it to share with Australian enterprise the costs and opportunities of developing New Guinea economically for political independence.[13]

A second approach which may deserve more attention than it has yet received in Japan is the technique of the "management contract". Under a management contract, a private company (or public enterprise) is formed in the "borrowing" country and lets a contract to an overseas engineering firm for the construction of a factory and its management for a five or ten year period. The overseas company is paid a substantial fee but the equity in the enterprise remains throughout in the hands of the borrowing country and at the end of the contract period the latter also takes over the management.

The technique has been used successfully in quite a number of cases involving American engineering firms in Brazil and other Latin American countries, in Iran and Pakistan. Some years ago, it was suggested as a way by which Australia might continue to secure American technical know-how without committing itself to paying dividends to American investors in perpetuity.[14] The suggestion fell on stony ground in Australia, partly because it was doubted whether it would be possible to find American engineering firms who could be interested in such an arrangement, but mainly because Australian entrepreneurs with the initiative and capital to form new enterprises generally believe themselves to possess all the technical and management know-how they need.

On paper at least, the management contract would seem to be an ideal answer to Japan's problem of breaking into overseas markets for capital goods without exporting capital. Any

[10] Thiess Peabody Mitsui Coal Pty. Ltd. (a triangular joint venture for coal mining in Queensland) and a Mitsui investment in a West Australian copper mining venture (Ravensthorpe Copper Mine) were the only such cases known before the recent large agreements for joint development of Western Australian iron ore deposits. Three such joint ventures involving Japanese capital have been reported, with Mitsui, Mitsubishi and Sumitomo participation respectively.

[11] Two textile firms (Tennyson Textile Holdings in which Toyo Rayon holds a 15 per cent interest and Yarragon Textile Mills for which Shikishima is supplying 50 per cent of the capital and technical assistance), one joint venture with Humes (Hume Eslon) and one company in the electronics field (Olims-Hayakawa Electronics Pty. Ltd.) are the only instances known to the author.

[12] There is more to be said about this, but demands for reform are more appropriately addressed to an Australian audience.

[13] The Australian Minister for Territories, Mr. C. E. Barnes, announced in Port Moresby recently that "if it can be shown that a joint company operating with substantial Australian—or better still Territory—participation is developing, I think the Government would consider admitting Japanese technicians and allowing them to live in the Territory" (*Canberra Times*, May 18, 1965).

[14] Cf. H. W. Arndt, "Overseas Borrowing—The New Model", *Economic Record*, August 1957, p. 261.

plant constructed under a management contract between a Japanese engineering company and an Australian (or Indian or Brazilian) private firm or public enterprise will normally be equipped with Japanese machinery, without the need for investment of Japanese capital, and will provide a continuing market for Japanese spare parts and new machines for replacement. It is difficult to see why such propositions should not interest some of the bigger Japanese engineering firms. Nor need they necessarily sit back and wait to be approached by Australian interests; they might well take the initiative in looking for Australian (or Indian or Brazilian) private or public entrepreneurs with ideas and capital.

The response to such initiative in Australia might be better now than it would have been some years ago. Government and business opinion has become more conscious both of the relative technological backwardness of Australian industry, not least compared with Japan, and of the dangers of continuing indefinitely the policy of a completely open door to American and other overseas direct investment capital. The management contract technique may be as much in Australia's as in Japan's interest.

Of course, there are difficulties. Perhaps the most serious is that, while Australian industry has much to learn from Japan in matters of *technical* know-how, it is doubtful whether Japanese techniques of business management provide a suitable model for Australia; indeed whether Japanese management of any predominantly Australian enterprise, with Australian workers and in the very different Australian industrial environment, is feasible. It may be that Japanese-Australian management contracts would have to provide for mainly Australian management, with Japanese engineers in charge of technical operations.

This in turn suggests the third line of approach to the problem of exporting capital goods without export of capital. Clearly, a tie-up with management of overseas industrial enterprises, whether through direct investment or through management contracts, is not the only way to sell capital goods abroad. However imperfect the market, price and quality count. But price and quality are rarely enough. Job orders for highly specific and expensive pieces of machinery are secured only through personal contact and careful organisation which establish a reputation for custom-made quality, technical advice, and after service. Germany, and on a smaller scale Sweden, have shown how much can be done by such methods to develop export markets for capital goods without a great deal of capital export.

One wonders whether Japanese industry is yet sufficiently aware of the change in marketing techniques required by the shift from export of consumer goods to export of capital goods. In particular, it is difficult to see how the traditional reliance of Japanese manufactures on export marketing through the great trading companies can be reconciled with the need for direct contact between manufacturer and customer in the case of export of capital equipment. How far do the prospects for Japanese motor car exports depend on the establishment in the major overseas markets of servicing and spare parts organisations? How far can Japan hope to sell turbines for power stations or elaborate machine tools or electronic computers without direct or indirect representation of the manufacturers in the major markets? Have Japanese manufacturing companies personnel with the technical and business training (and language qualifications) for this job? How serious are the difficulties arising from immigration restrictions imposed by Australia and other countries? Progress in all these directions in the next few years would make an important contribution to the tasks facing Japanese commercial policy.

(iii) *Problem Industries*

Mr. Nakayama in his brief summary was tactful enough not to mention at all the delicate issue at which the Australian Minister for Trade and Industry, Mr. McEwen, hinted in his article in the same *Sydney Morning Herald* supplement when he warned that continuing long-term expansion of trade between Australia and Japan will be achieved "only if both countries continue to recognise the other's problems".[15] To put it more crudely, each country has an industrial "tail" of high-cost industries which, for political and social as much as for economic reasons, it feels it must protect from foreign competition. In the case of Japan, the main problem industries are in the rural sector, dairying, meat, fruit and other food producers, though fairly high tariffs still protect major manufacturing industries such as the motor car industry. In the case of Australia, the problem industries most relevant to trade with Japan are a wide range of manufacturing industries, especially the textile and other relatively labour-intensive industries, but also some modern capital-intensive industries such as production of transistor radios and sections of the chemical industry.

There is really little more to be said about this. In each country, the vested interests concerned use good arguments and bad to persuade governments and the public that protection is in the national interest. In Japan, it is argued plausibly that until the dairy farmers of Hokkaido, the beef cattlemen of Kobe and the orchardists of Nagano and Aomori Prefectures are enabled, through consolidation of holdings, mechanisation and other technological improvements, to achieve much higher levels of productivity, protection from foreign competition is the only way of avoiding a vast social problem of rural poverty. It is argued quite implausibly that the problem is somehow an aspect of Japan's status as a "half-advanced" country still saddled with a "dual economy"—as though the possession of a high-cost agricultural sector were not the hallmark of any self-respecting advanced industrial country. In Australia, it is argued plausibly that the country cannot hope to attract migrants at the desired rate unless it finds employment at something like the present high level of real wages for a considerable proportion of them in manufacturing industries and that, given Australia's limited supplies of capital, this is possible only by ensuring the survival for some time yet of some relatively labour-intensive manufacturing industries through tariff protection. It is argued quite implausibly that this justifies the present policy of treating mere proof that an industry has been established and that its high costs are not significantly due to managerial incompetence as constituting a prima facie case for tariff protection.

In both countries academic economists tend to feel that the national interest would be served by more selective protection and by using tariffs and subsidies more systematically to induce and help high-cost producers to *get out of* rather than stay in their industries. But they also realise that politics is the art of the possible, and that progress towards trade liberalisation—in the widest sense—is necessarily slow.

(iv) *The Bilateral Balance of Trade*

Mr. Nakayama's "old story" of the "big gap between Australia's imports from Japan and Japan's imports from Australia" remains a source of misunderstanding between the two countries.

As it happens, the improvement in the position from Japan's point of view, of which Mr. Nakayama could see little evidence when he wrote, has since then taken place on quite a

[15] *Loc. cit.*, p. 1.

spectacular scale. If the trend over the first nine months is maintained during the rest of the current Australian fiscal year (ending June 30), Australian imports from Japan will have increased in 1964-65 by 58 per cent over 1963-64, while Australian exports to Japan will have fallen by 9 per cent.[16] Japan's import surplus will have declined from £163 million to £92 million. But this sharp movement is in part due to temporary factors, particularly on the side of Australia's exports. The problem, such as it is, therefore remains.

The Australian attitude to the problem might fairly be summarised as follows. Australia is anxious to promote trade with Japan. She is keen to expand her exports to Japan; but she is also happy to buy more from Japan so long as her imports do not threaten Australian industries, and she is steadily moving towards the elimination of all forms of trade discrimination against Japan.[17] If supply and demand conditions happen to produce a pattern of trade which, for the time being, results in a bilateral trade balance adverse to Japan, this is not Australia's fault. Nor need it worry Japan; for provided her overall trade with the world as a whole is in balance she should always be able to finance her import surplus vis-à-vis Australia from the proceeds of export surpluses with other countries. Australia can hardly be expected to hold back her exports to Japan, or to step up her imports beyond her needs, or at the risk of damage to her own industries, just to achieve something nearer bilateral balance. Nor need Australia take too seriously any implied threat by Japan to cut back her imports from Australia, or to divert her purchases to other countries, since Japan needs the materials she buys from Australia and could not obtain them from other sources at the same price or quality.

Japanese will answer that this is fair enough as far as it goes but that it ignores a crucial aspect of Japan's position. As Mr. Nakayama points out, "our present position is that 50 per cent of our overseas markets are in developing countries all of which are exerting the strongest pressure on Japan to adjust trade balances which are unfavourable to them".[18] The problem is at present particularly acute in Japan's trade with the countries of East Africa. A recent news report quoted Kenya's Minister of Commerce and Industry, Dr. Kiano, as threatening to restrict Japanese imports unless Japan showed willingness to buy more from Kenya: "We have decided to make one more approach to try and bring home to Japan that she must stop exploiting the developing countries in this way. If she does not respond by buying more from us we shall have no alternative but to discriminate against her by restricting Japanese imports." The Japanese Ambassador in Nairobi was quoted as commenting that he was aware of the trade imbalance between the two countries and was making every effort to correct it. "At the moment I am trying to find a product which Japan requires and which Kenya produces."[19]

Here lies the rub. The import surpluses of many developing countries with Japan reflect their inability to produce enough goods that Japan wants, enough goods which are competitive in quality or price. Their bilateral imbalances with Japan are part of their overall imbalane, of the "export gap" of the developing countries which was the theme of UNCTAD. It so happens that the overall deficit of many developing countries is heavily concentrated on Japan,

[16] Commonwealth Statistician, *Monthly Bulletin of Overseas Trade Statistics, March 1965*, Canberra.

[17] For one exception, new preference to be granted to products of developing countries, see below, p. 87.

[18] The figure of 50 per cent, it should be pointed out, already reflects a marked decline from nearly 70 per cent in 1953 (cf. Kojima, *op. cit.*, p. 110).

[19] *Japan Times*, April 12, 1965.

so that any attempt on their part to restore overall balance by cutting back imports would fall disproportionately on imports from Japan. To put the same point in another way, it may be true that Japan has no need to worry about her import surplus with Australia so long as her external accounts are in overall balance. But Japan's present overall balance is precarious in that it depends to a considerable extent on the continued ability of many developing countries to finance large trade deficits through external assistance.

Clearly, this is not a problem that can be solved by Japan alone, or by Japan and Australia. The export gap of the developing countries presents a challenge to the whole world, including both developed and developing countries. Something more will be said below about the contributions Japan and Australia might make, separately and jointly. The more effectively the developing countries are assisted, through measures of aid and trade, in financing their overall import requirements, the less is the risk that they, by restricting imports from Japan, will unsettle Japan's balance of payments and push Japan into a restrictive bilateralism in her trade with Australia.

If, as seems unfortunately only too likely, the overall balance of payments problems of many developing countries are not adequately overcome, pressure from some of them on Japan may continue. In the short run, Japan may respond in some cases by diverting her purchases from developed to developing countries. In the longer run, she may think it worth her while to go beyond her proper contribution to the general problem of "trade and aid" and help particular developing countries, through capital and technical assistance and perhaps also through long-term contracts, to develop new export industries.[20] It is for Japan to assess the relative benefits and costs of such trade diversion measures—and in this context this simply means benefits and costs to her own trade and balance of payments, taking into account all indirect repercussions on trading partners like Australia as well as on markets in the developing countries. Australia can only hope that such a calculation will not too often support measures contrary to her own interests.

(v) *Co-operation in Trade and Aid*

We come, finally, to Mr. Nakamura's last point, Australia and Japan's "shared responsibility as the only advanced industrial countries in this region". Can expressions of goodwill of this kind be translated into any practicable and useful policy measures?

The first point to note is a discouraging one. Since both Japanese exports to Australia and Australian exports to Japan are, to some extent, competitive with actual and potential exports of developing countries, any measures adopted by either country to assist developing countries through trade preferences are liable to operate so as to discriminate *against* the other country.

Japan, it has been pointed out, still has a "great many workers employed in small and medium enterprises in the labour-intensive sector of her textile industry"[21] and other industries competitive with exports from China, Taiwan, Hong Kong, Korea and other developing countries in Asia. For Japan, therefore, "enforcement of a general preference system" in favour of developing countries, such as was proposed at UNCTAD, "would have meant the heaviest blow among all the advanced countries".[22] No such general preference arrangement has yet

[20] This has been suggested to the author by Professor Kojima; see also below, p. 88, for a similar proposal by Mr. Okita.

[21] T. Kawata, "UNCTAD and Japan", *The Developing Economies*, September 1964, p. 298.

[22] *Ibid.*

been found acceptable to the advanced industrial countries. But at the GATT meeting in February 1965, amendments were adopted under which member countries would agree not to impose tariffs on products of present or future interest to developing countries and gradually to eliminate existing tariffs on such products. Australia refused to sign these amendments, mainly on the grounds that she could not accept so sweeping a commitment without risk of damage to some of her own industries and that *non-discriminatory* elimination of tariffs on the products of developing countries (on which the United States insisted for general doctrinal reasons) would benefit primarily the corresponding export industries of the advanced industrial countries. Since then, however, Australia has announced that she will unilaterally grant preferential tariff treatment to selected imports from 118 less-developed countries and will apply to GATT for a waiver of the prohibition of new preferences.[23]

The Australian Government has explained that an initial list has been drawn up of products of special interest to developing countries on which duties could be reduced "without serious detriment to Australian industry"; and that imports under preferential rates would be subject to tariff quotas which will serve as "an additional safeguard for Australian industry and will ensure that the preferences do not disrupt or cause serious damage to the trade of third parties".[24] One of these third parties is Japan. It seems likely that Japan will wish to discuss with Australia what, if anything, needs to be done to ensure that this progressive and imaginative step by Australia to help the developing countries does not incidentally inflict serious injury on Japan's export trade with Australia.

The converse problem would arise if Japan were to adopt measures of aid to developing countries such as those recently suggested by Mr. S. Okita:

> "It may be possible to import [raw materials] from Asian countries on an appropriate commercial basis, provided [Japan] is able to make effective long-term import contracts combining such capital and technical assistance as are deemed necessary in the fields of production, storage and transportation."[25]

Long-term contracts for the purchase of raw materials such as coal, iron ore or copper from developing countries, or preferences granted by Japan to exports from developing countries of foodstuffs such as sugar. fats and fruit, might be highly detrimental to Australian exports to Japan.

These difficulties should not be insuperable. They arise from the fact that both Australia and Japan are not perhaps "midway" countries but not yet wholly "advanced" in their industrial structures. As Mr. Okita has pointed out in commenting on UNCTAD,

> "the Conference did not take much account of the fact that there are different stages of development and different levels of income among both the developed and the developing countries: it treated members of each group more or less on equal terms. There will, of course, be times in the future when a country attains rapid economic growth and crosses the line from a developing to a developed country. Judging from the discussion at the Conference, developed countries are 100 per cent on the giving end and developing countries are 100 per cent on the receiving end. Therefore, when a country crosses

[23] *Canberra Times*, May 20, 1965.
[24] *Ibid.*
[25] Saburo Okita, "Regional Economic Co-operation in Asia", *Contemporary Japan*, October 1963, pp. 613f.

the borderline, its international environment will change suddenly and dramatically. For example, such a country will lose the benefit of special access to the markets of developed countries which it enjoyed as a developing country... In future meetings of the Conference or of the Trade and Development Board, it will be necessary to define more clearly what constitutes a developing or developed economy and to provide arrangements for the transition from one to the other, or for borderline cases. It may even be doubted that it is appropriate to classify all the countries of the world into just two categories and to apply the same rules to all members of each group."[26]

No similar risk of conflict of interest arises in relation to aid by Japan and Australia to developing countries.[27] Indeed, there is obvious scope here for co-operation between Japan and Australia, both at the governmental and at the business level.

Japan and Australia (together with New Zealand) are the only advanced (well-to-do) countries in the ECAFE region. Some of the responsibilities which this status confers on them might well be exercised jointly. One example might be the establishment, on joint Japanese-Australian initiative, of regional centres for research and specialised training in certain branches of agricultural and industrial technology in which one country or the other is outstanding. The International Rice Research Institute at Los Baños near Manila is model which might be followed in other fields.

Another more important example is the ECAFE scheme for an Asian Development Bank. Both in Australia and in Japan this proposal has so far met with a lukewarm reception, especially in the respective Ministries of Finance on whom the burden of finding the money for capital contributions would fall. A measure of scepticism about any schemes for starting new international institutions is certainly desirable. Such institutions absorb scarce resources of highly skilled manpower, and if they are not run by persons of the highest skill they may squander most of the financial resources entrusted to them. It needs to be demonstrated that a regional development bank would not duplicate the work of the World Bank, on the one hand, or of national financial institutions, on the other. Particularly delicate problems arise in the ECAFE region from the ideological and political divisions among the countries of the region.

Yet, in the face of all these very reasonable doubts and objections, a good case for an Asian Development Bank has by now been made out in the reports of two groups of experts and in subsequent discussion. Without excluding from the scope of such a bank the finance of developmental expenditure in primary or manufacturing industries in individual member countries, the chief raison d'être of a regional development bank must be seen in multinational projects within the region. The wide geographical scatter of the likely participant countries makes this a much more difficult objective in the ECAFE region than (say) in Latin America. But there is much scope even here. Apart from the two old ECAFE concerns, the Asian Highway and the Mekong River Project (both of which, despite all difficulties, are still worth pursuing), the most obvious and worthwhile "project" is intra-regional specialisation and trade.

For the many relatively small countries of the region it is immensely important that

[26] S. Okita, "Japan and the Developing Nations", *Contemporary Japan*, March 1965, pp. 4f.

[27] See K. Kojima, "Japan's Foreign Aid Policy", in *Papers on Modern Japan 1965*, and H. W. Arndt, *Australian Foreign Aid Policy*, University of Adelaide, 1964.

their new and developing manufacturing industries have access to the wider market of the region. By linking capital (and technical) assistance for specific industrial projects in several countries of the region with agreements among these countries to give one another's new industries access to their domestic markets, the Asian Development Bank could give a valuable incentive to regional specialisation and co-operation, besides helping with expert advice in the inevitably difficult negotiations and bargaining which such co-operation involves.

There has been a tendency in both Japan and Australia to regard an Asian Development Bank primarily as an instrument for attracting additional outside (i.e. mainly American) capital funds into the region and to dismiss it as useless in the absence of American support. With the strong support to the proposal recently given by President Johnson, this objection has lost most of its force. But it never seemed to be well taken. Provided Japan, Australia and New Zealand are prepared to make the contributions provisionally assigned to them, an Asian Development Bank could usefully begin operations on a modest scale; as it gains experience, and its soundness is demonstrated, it might be able to raise funds by floating its own bonds in American or other capital markets, or attract capital contributions from governments outside the region.

Whether there is really any scope as yet for co-operative action between Japanese and Australian private enterprise in developing countries (other than perhaps New Guinea) is more doubtful. The idea of joint ventures—two-sided (Japanese-Australian) or triangular (e.g. Japanese-Australian-Malaysian)—in the establishment of new industries in developing countries sounds attractive, but is probably not very realistic.[28] It is doubtful whether the Australian or (more often) Japanese company that has the enterprise, technology and capital to move into a developing country would believe itself to have much to gain from joining up with a Japanese or Australian competitor—unless it was for the purpose of market-sharing arrangements which would probably not be well received by the developing country concerned. But where opportunities for joint action to the mutual benefit of all three sides present themselves they should certainly be welcomed.

In conclusion, just a few words about "Pacific Common Markets" and suchlike notions. Regional economic groupings among neighbouring countries at approximately the same stage of economic development are eminently desirable, especially if the individual national units are too small and poor to be economically viable on their own. Where the individual countries are already rich, as in the case of the European Economic Community, a common market may still offer great advantages to its members but possibly to the detriment of non-members. But whether anything would be gained by a regional economic grouping of a heterogeneous and scattered collection of countries, even as a defence mechanism in a world of huge regional blocs, is very doubtful.

The idea of a Pacific Common Market embracing Japan and Australia, or both of these and the non-Communist countries of South-East Asia, or all of these as well as New Zealand and Canada (and even the United States!) is obviously absurd. As the executive director of the Australian-Japanese Business Co-operation Committee commented recently, "it might be worth considering in 20 years or so, but we were not working that far ahead".[29]

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[28] The idea attracted some attention at the recent Tokyo meeting of the Japanese-Australian Business Co-operation Committee; see *Canberra Times*. May 17, 1965.

[29] *Canberra Times*, May 17, 1965.

At the Committee's recent third annual meeting in Tokyo, some of the Japanese businessmen present were reported to be thinking in terms of the "unlimited development potential in the combination of Japan's technical knowledge and the agricultural and mineral natural resources of Australia and New Zealand, plus the manpower of South-East Asian countries". This met the obvious retort from an Australian representative that "Australia did not consider itself simply a supplier of raw materials to Japan and, in its own interests, had to continue developing its own secondary industries".[30]

What the Committee did at its meeting was to invite the United States, Canada and New Zealand to send observers to the next meeting of the group in Canberra in May 1966. Even this may do more harm than good if it is interpreted among the developing countries of the region as a ganging-up for the formation of an exclusive club of the rich countries of the Pacific. Nor can it serve a very useful purpose if it is envisaged, in the words of one Japanese newspaper, as a counter to America's "self-centred plan of aid to South-East Asia, with President Johnson's offer of one thousand million dollars worth of assistance to the area intended purely as a means of settling the Vietnam problem".[31] If, on the other hand, the object is merely to promote between these countries "exchange of information about technical, economic and cultural situations",[32] the proposal is innocuous enough though hardly exciting.

There is just now so much that is promising and worth doing in relation to Japanese-Australian trade that it seems unnecessary to go chasing rainbows all over the Pacific.

May, 1965

[30] *Ibid.*
[31] *Yomiuri Shimbun*, quoted *Canberra Times*, May 17, 1965.
[32] *Japan Times*, April 17, 1965.