

# Trends in Australia-Japan trade and potential gains from a free trade agreement

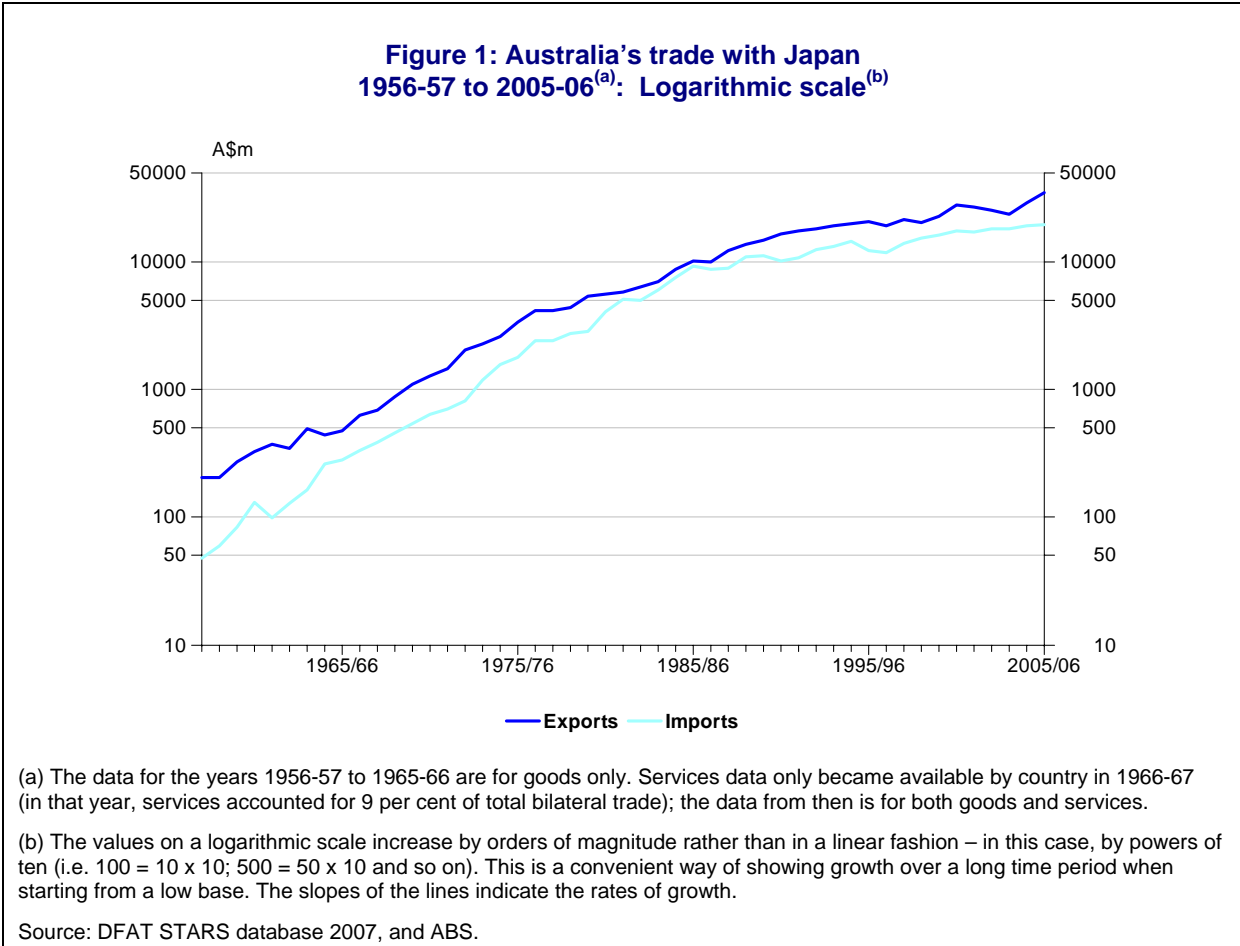
*Japan remains by far the largest market for Australian goods, a position it has occupied for the past 40 years. Even throughout Japan's 'lost decade' (from 1990-2002), the bilateral commercial relationship continued to grow. Economic recovery is now underway in Japan, and Australian exports have been particularly strong in the past two years, bringing an enhanced focus in Japan on the importance of Australia as a reliable source of energy and inputs for its own export industries.*

## 1957 Agreement on Commerce

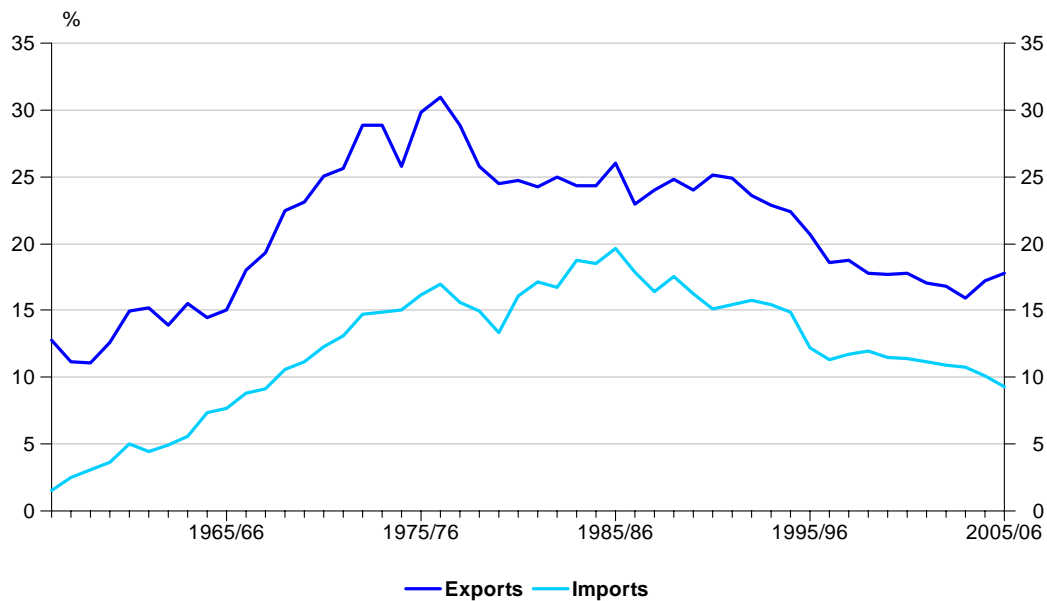
2007 is a symbolic year in what is a truly remarkable bilateral trading relationship. It marks the fiftieth anniversary of the Agreement on Commerce between Australia and Japan, signed on 6 July 1957. The signing of that agreement signalled the beginning of a shift in Australia's trade from reliance on Great Britain, with Japan quickly becoming Australia's most important trading partner. The deep commercial links which have grown between Australia and Japan, based on a strong economic complementarity, have underpinned growth and development of both countries over the past 50 years. Australian commodities provided the raw materials for Japan's modern economic development. The

expansion of trade between Australia and Japan was also accompanied by the rapid growth of Japanese investment in Australia.

Since the signing of the Commerce Agreement, Australia's total exports to Japan have increased by an annual average rate of over 10 per cent and total imports from Japan have grown by around 15 per cent each year (**Figure 1**). Exports to Japan as a share of Australia's overall exports peaked at 31 per cent in 1976-77. With the diversification of Australia's export base, this declined to under 16 per cent in 2003-04, but has since risen to over 17 per cent. Imports from Japan as a share of Australia's overall imports peaked at 20 per cent in 1985-86, but have since fallen to 9 per cent in 2005-06 (**Figure 2**).



**Figure 2: Japan's share of Australia's exports and imports  
1956-57 to 2005-06**



Note: The data for the years 1956-57 to 1965-66 is for goods only. Services data only became available by country in 1966-67 (in that year, services accounted for 9 per cent of total bilateral trade); the data from then is for both goods and services.

Source: DFAT STARS database 2007, and ABS.

### Merchandise trade

In 2006, Australian merchandise exports to Japan totalled \$32.4 billion, an increase of \$3.9 billion or almost 14 per cent on the previous year (**Figure 3**). While Australia's second largest export market, China, is catching up, with growth of over 22 per cent a year over the five years to 2006, Australia's merchandise exports to Japan remain significantly higher (\$32.4 billion compared with \$20.4 billion in 2006) and grew by over 7 per cent a year (**Figure 3**). Australia's exports to India, too, are growing rapidly – on average by over 33 per cent each year over the past five years – but at \$8.8 billion in 2006 remain well below Japan. Despite the large growth in exports to these other major markets, Japan's share in Australia's total merchandise exports was steady over the five years to 2006, at around 20 per cent. Australia is Japan's fifth most important source of goods, reflecting Japan's large trade ties with China and the United States and the increase in the value of imports from the Middle East.

In 2006, Australia's merchandise imports from Japan reached \$17.3 billion, up by \$153 million (0.9 per cent) on the previous year. Over the five years to 2006, imports grew by an average of around 3 per cent a year. Japan is Australia's third most important import source, having been overtaken by China in 2004. Australia ranks tenth in Japan's export destinations, with a share in total Japanese exports in 2005 of just over 2 per cent.

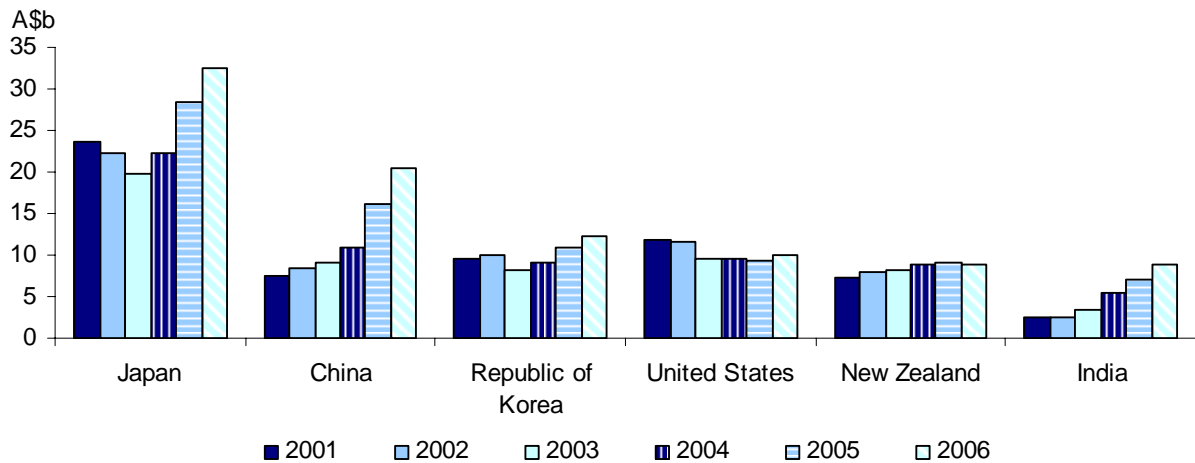
This figure has remained fairly constant, falling from 3 per cent in the early 1980s.<sup>1</sup>

### High level of complementarity in merchandise trade

The bilateral trading relationship reflects a high degree of complementarity in the commodities traded, reflecting each economy's comparative advantage. Australia's exports to Japan comprise mainly primary products (i.e. energy, minerals and agricultural products), which accounted for around 72 per cent of exports in 2006 (**Figure 4**). Australia is Japan's largest supplier of primary energy. Australia also contributes to Japan's food security, supplying around 9 per cent of its food imports. Japan is the largest destination for Australian exports of coal, liquefied natural gas, aluminium, copper ores, woodchips and agricultural products, including beef and dairy. Over the five years to 2006, minerals exports to Japan grew by 17 per cent a year and processed food by 5 per cent. Over the same period, exports of elaborately transformed manufactures (ETM) and unprocessed food fell by 8 per cent each year. The main commodities exported to Japan include coal (\$9.6 billion in 2006), liquefied natural gas (about \$5.4 billion), iron ore (\$4.2 billion), beef (\$2.2 billion), aluminium (\$1.9 billion) and copper ores (\$1.4 billion).

<sup>1</sup> IMF, Direction of Trade Statistics 2006.

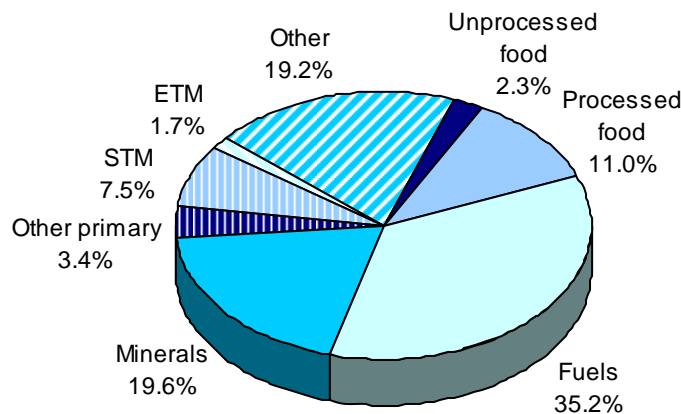
**Figure 3: Australia's top six merchandise export destinations 2001 to 2006**



Note: 2006 figures are preliminary.

Source: DFAT STARS database 2007.

**Figure 4: Composition of Australia's exports to Japan by major commodity group 2006**



Note: 2006 figures are preliminary. 'Other' includes liquefied natural gas.

Source: DFAT STARS database 2007.

In contrast, manufactures account for the major share of Australia's imports from Japan. In 2006, manufactures imports totalled \$16.4 billion and were 90.5 per cent of merchandise imports from Japan; ETM accounted for 87 per cent of total imports. The share of manufactures in imports from Japan is very high, peaking at almost 98 per cent in 2004. Between 2001 and 2006, imports of ETM grew by 2 per cent in trend terms each year. Australia is Japan's second biggest market for passenger motor vehicles. Japan is also the third largest foreign investor in Australia,<sup>2</sup> with

total investments of \$53.3 billion in 2005. Japanese investments in Australia are concentrated in mining, real estate and services.

### Services

Services trade has also grown significantly; between 1966-67<sup>3</sup> and 2005-06, services exports to Japan grew at an annual average rate of 14 per cent and services imports from Japan grew by over 11 per cent. Services exports to Japan grew strongly throughout the 1980s, largely due to travel services exports, which increased

<sup>2</sup> After the United States and the United Kingdom.

<sup>3</sup> Services data became available by country from 1966-67.

dramatically over the decade in line with the increase in Japanese tourism to Australia. Between 2001-02 and 2005-06, bilateral services trade was flat. In 2005-06, services exports to Japan totalled \$3.4 billion, a decrease of almost 9 per cent on the previous year and of 3 per cent a year over a five year period, reflecting declines in personal travel and transportation services exports. At 63 per cent of the total in 2005-06, travel services account for the majority of services exports to Japan. In 2005-06, services imports from Japan were \$2.1 billion, increasing by 6 per cent on the year before and by 1 per cent a year over the previous five years. In 2005-06, transportation services accounted for 60 per cent of services imports from Japan.

Services are an important component of the trading relationship, with Japan being Australia's second largest services export market and fourth most important import source, even though the bilateral trading relationship is weighted heavily towards merchandise trade. In 2005-06, the share of services in total bilateral trade was 10 per cent, down from a high of around 18 per cent in 1996-97. This compares with 35 per cent for the United States and 28 per cent for the United Kingdom, the other two main services trading partners. The increasing reliance of each economy on services in national income suggests substantial potential to increase this trade, especially through a free trade agreement (FTA).

### Launch of Australia-Japan FTA negotiations

On 13 December 2006 the Prime Ministers of Australia and Japan agreed that the two countries would commence negotiations on an FTA in 2007 – the 50<sup>th</sup> anniversary of the landmark Agreement on Commerce. This decision followed the conclusion of a joint government study on the feasibility of an FTA. The study was conducted at the request of Australian Prime Minister Howard and then Japanese Prime Minister Koizumi in April 2005. It built on a 2005 joint study into the costs and benefits of trade and investment liberalisation, which was undertaken as part of the Trade and Economic Framework between Australia and Japan signed in July 2003.

The 2005 joint study used two models to estimate the gains from liberalisation. Both models assumed full and immediate trade and investment liberalisation between Australia and Japan from 2005. Under this scenario, the model with the more conservative estimates concluded that by 2020 Australia's GDP would be 0.66 per cent larger than would otherwise have been the case, and Japan's 0.03 per cent greater. Over the 20 years from 2005 to 2025, the GDP gains would

be \$38.7 billion to Australia, and \$27.4 billion to Japan.

The joint study for enhancing economic relations between Japan and Australia concluded that an FTA would be feasible, and that a comprehensive, WTO-consistent agreement would deliver significant benefits to both countries. It also noted that there were sensitivities on both sides, which would be best handled through negotiations with all products and issues on the table.

Australia will strive through the FTA negotiations to address tariff and non-tariff barriers facing Australian companies in Japan and create new, commercially meaningful opportunities across all industries. Australia will also seek to secure and expand export opportunities in our largest agricultural market; include measures to promote two-way investment; improve opportunities for our services exporters; secure and enhance our relationship with the largest buyer of Australian minerals and energy; and address the discrimination Australian exporters and investors currently face as a result of Japan's FTAs with other countries. The FTA negotiations should, in addition, have an important 'head-turning' effect, increasing awareness among Australian businesses of the potential of the Japanese market. As it is, a number of Australian companies are already taking advantage of the opportunities available in Japan (**Box 1**).

#### Box 1: Some success stories

Some Australian companies that have taken up opportunities in the Japanese market include:

- Australian office services firm *Servcorp*, which has established itself in 15 locations in Tokyo, Osaka and Nagoya;
- *ResMed*, the 2006 Australian Exporter of the Year, which has a presence in 65 other countries, is also well known in Japan for its sleep therapy equipment. Japan is by far *ResMed's* single largest export market in the Asia Pacific;
- *Flight Training Adelaide*, which in 2006 signed a \$30 million contract with JAL Express;

### Box 1 - continued

- *Amarok Estate*, a wine producer from the Margaret River, which has been successful in exporting its boutique wines to Japan. Winning a gold award in 2006 at the Margaret River Wine Show, *Amarok Estate* bases its success in Japan on its distinctive, fruity, easy-drinking flavours and its focus on friendly relations in business, having built a relationship with the Ikari Supermarket chain; and
- Fashion house *33south*, which in 2005 delivered the first shipment of its premium surf fashions to one of Japan's leading fashion stores, Beams. Since its initial success, *33south* has exported to other boutiques in Japan and is launching a new line, to be released in Japan's 2007 summer.

### Conclusion

The success of bilateral commercial relations between Australia and Japan over the last 50 years has been remarkable, and the future is promising. Japan remains of paramount importance for Australia as a large export market and supplier of manufactures. And Australia, with its long-standing business relationship with Japan, is, if anything, an increasingly important supplier of raw materials for Japan's industries as competition for these commodities is intensified by the emergence of China and India. There may also be scope to broaden commercial ties into other areas. This issue will be examined in a report to be published by the Department of Foreign Affairs and Trade's Economic Analytical Unit later in 2007.

An FTA would deepen the strategic partnership between Australia and Japan as two democratic, developed countries sharing many common values and interests. By strengthening the ties between Australia and the most advanced economy in East Asia, it would further foster integration in the region. It would also provide the foundation for the Australia-Japan economic relationship over the next 50 years, just as the 1957 Agreement on Commerce has done for the last 50.

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