Minerals Council of Australia

16 January 2007

Mr Peter Baxter
Japan FTA Task Force
Department of Foreign Affairs and Trade
John McEwen Crescent
Barton ACT 0221

Dear Mr Baxter

MCA Submission Australia-Japan Free Trade Agreement

Thank-you for your correspondence of 20 December 2006 inviting public submissions on an Australia-Japan FTA. The Minerals Council of Australia restates it support for the negotiation of a comprehensive FTA with Japan and we refer the Task Force to our submission of October 2005 for our detailed views (attached).

The Australian minerals industry has an enduring and profoundly significant trading relationship with Japan. Indeed, behind China, Japan is Australia's second largest minerals export partner, consuming approximately 17 per cent (A$9 billion) of Australia's total minerals exports in 2005/06 (source - ABARE). In nominal terms, this is approximately A$3.6 billion higher than in 1995/96. The four principal minerals export items from Australia to Japan in 2005/06 were:

(1) Metallurgical coal valued at approximately A$6 billion;

(2) Thermal coal valued at approximately A$4 billion;

(3) Iron ore valued at approximately A$3.5 billion; and

(4) Aluminium valued at approximately A$$1.5 billion.

Australia's traditional trade in energy resources with Japan is set to grow as the country's demand for energy rises.

Japanese investments in the Australian mining sector are strong and have been focussed on the coal industry, with agreements taking on varying degrees and methods of ownership. Some include joint ventures with 50 per cent ownership through to stakes less than 5 per cent.

Notwithstanding this strong relationship, there is room for improvement with significant gains to be made. This is because:

- an FTA will add a new and formal dimension to the bilateral political and strategic relationship, the benefits of which will inevitably flow through to stronger economic ties;
- while Australian and Japanese companies are already investing in a long term partnership, there will be greater certainty in security of supply and market access for both partners under a formal trade and investment agreement; and
- a bilateral FTA provides the opportunity to remove practical obstacles to two-way trade and investment in the exploration, production, processing, and trade in minerals and related technology and services.

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As outlined in our submission of October 2005, the MCA strongly encourages negotiators to address the following five priority items to advance the interests of the Australian mining industry and the Australian community generally:

(1) the few remaining formal barriers to the export of minerals products to Japan should be addressed as they are a cost of doing business. Further, the FTA should clear away the remaining barriers in other and related sectors. This will strengthen both economies, thereby assisting minerals trade indirectly;

(2) the agreement should ensure that Japanese investors are provided with treatment no less favourable than that granted to competitors from other Australian trading partners, including the United States and (prospectively) China. This should be said of Australian investors also;

(3) the FTA should provide assurance that the Japanese market will remain a central element in Australia's minerals export profile as nations continue to sure up their long-term energy needs;

(4) given that the economic architecture of East Asia is evolving, an ambitious and comprehensive agreement should serve as a rules based template for economic integration in the region that is both complementary to the global trading system and can be emulated by other nations in Asia; and

(5) the pursuit of closer linkages between Australia and Japan may provide an additional measure of assurance and support to Japan as they assess the policy merits of ineffective policy options such as punitive carbon taxes and similar instruments.

We trust that these comments will assist the Task Force over the ensuing period. We would welcome the opportunity to meet with the TaskForce as negotiations progress and issues arise.

Please feel free to contact myself, or David Rynne, Assistant Director Economics on (02) 6233 0600 if you have any queries in relation.

Yours sincerely

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MITCHELL H. HOOKE
CHIEF EXECUTIVE

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Minerals Council of Australia

SUBMISSION TO THE DEPARTMENT OF FOREIGN AFFAIRS AND TRADE

AN AUSTRALIA-JAPAN FREE TRADE AGREEMENT

THE MINERALS INDUSTRY CASE

OCTOBER 2005

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EXECUTIVE SUMMARY

The Australian minerals sector strongly supports the negotiation of a free trade agreement with Japan. Japan is a natural economic partner for Australia, and has been Australia's leading export market for nearly 4 decades. The trade in minerals commodities has been a mainstay of this relationship, and continues to account for more than 40 per cent of Australian exports to Japan.

A comprehensive free trade agreement, addressing all elements of the bilateral trade and investment relationship will help further deepen this relationship.

To date, Australia has concluded free trade agreements with its 5th largest trading partner (New Zealand), its 7th largest (Singapore), its 12th largest (Thailand), and its 2nd largest economic partner (United States). At present, it is negotiating free trade deals with its 4th largest trading partner (China), its second largest destination for exports (ASEAN), its 13th largest trading partner (Malaysia) and its 20th largest trading partner (United Arab Emirates). It is therefore logical, and even overdue, that Australia pursue an even closer economic relationship with its most important economic partner.

Such an agreement has much to offer both economies.

First, it would underline the ongoing importance of the Australia-Japan economic, political and strategic relationship. The two nations have been strategic and commercial allies for many decades, and a free trade agreement would acknowledge, reinforce and reinvigorate the significance of the bilateral relationship.

Second, it would promote more intense trade and investment flows between the two nations. While there are few formal barriers to the export of minerals products to Japan, a FTA could clear away remaining barriers in a number of other and related sectors, and build a stronger broader, economic relationship. Although Japan endured 3 recessions and weak economic growth since 1990, it has regathered much-needed momentum in recent years. Demand for Australian minerals exports is strong, and continues to dominate the bilateral economic relationship. But an agreement which removes the remaining barriers to trade in the bilateral trade will strengthen both economies, and thus indirectly assist the minerals trade. Such an agreement could also ensure that Japanese investors are provided with treatment no less favourable than that granted to competitors from other Australian trading partners, including the United States and (prospectively) China.

Third, it would provide reassurance to Australia's most important minerals market that Australia will remain a reliable and consistent supplier. Although the global minerals market is undergoing significant change driven by strong demand from China and India, Japan will remain an indispensable market for the Australian minerals sector. In 2004, for example, Australian minerals exports to Japan were more than double the value of Australian exports to China.

While China's demand for Australian minerals commodities will continue to expand, Japan – which currently absorbs 46 per cent of Australia's coal exports, 40 per cent of its iron ore exports, and 30 per cent of its aluminium exports – will remain a major market for Australian minerals exports in the medium and long term. At a time when there are concerns about long-term energy security, a free trade agreement can provide additional assurance that the Japanese market will remain a central element in Australia's minerals export profile.

Fourth, an FTA with Japan will further anchor Australia within the emerging East Asian community. The economic architecture of East Asia is in the process of evolution, and it is in the interests of both Tokyo and Canberra to play a leading role in shaping that community. An ambitious and comprehensive bilateral FTA between the two nations can provide a rules-based template for economic interaction in the region that is both complementary to the global trading system and can be emulated by other nations in East and South Asia.

Finally, a bilateral FTA can assist by reinforcing the depth of cooperation that has developed in other areas. A striking example is Australia's partnership with Japan, and other leading nations on climate change. While these discussions will run parallel to, rather than as part of any FTA negotiations, the closer linkage of Australian and Japanese economic interests will provide an additional measure of assurance that Japan will resist the embrace of blunt and ineffective policy options, including punitive carbon taxes and similar instruments.

A Closer Australia/Japan Relationship : The Backdrop

The Japanese economy

Despite extended setbacks during the 1990s, Japan's economy has recovered some momentum over recent years. Japan's $AUD6.3 trillion dollar economy grew by 2.6 per cent in 2004, and it is expected to expand by 2 per cent in 2005 and 2006.[1] Structural advances on many fronts have strengthened the economy's resilience. Japan's corporate sector has made considerable additional progress in de-leveraging and shedding excess capital and labour. In addition, banks have further reduced non-performing loans and labour markets have become more dynamic.[2] As the International Monetary Fund recently concluded:

> Over the past few years, Japan has made progress in addressing deep-seated weaknesses. Notwithstanding some risks, prospects are good for a moderately paced expansion over coming quarters.[3]

In its annual assessment of the nation's economic outlook in July 2005, Japan's Cabinet Office also concluded that the main causes of Japan's decade of slow growth had finally been addressed:

> The three excesses which have been the major growth constraining factors since the collapse of the Bubble economy – excessive employment, excessive capital stock and excessive debt – have been largely eliminated through restructuring (reduction in the number of personnel), the disposal of aging equipment, and debt repayment and the disposal of non-performing loans.[4]

Japan's economic recovery has helped underwrite fresh new demand for imported goods, including from Australia. In 2004, Japan was the world's fourth largest importer, and its purchases of foreign goods and services amounted to $US455 billion, an increase of 19 per cent on the previous year, after a 13 per cent increase the previous year.[5] Japan's imports too have grown steadily as a share of its economy, growing from 9.8 per cent of GDP in 2001 to 10.2 per cent in 2003. Australian exporters have also benefited from stronger demand in Japan, with export sales increasing from $14.9 billion in 2003 to $18.8 billion last year.

[1] International Monetary Fund, *World Economic Outlook*, September 2005.
[2] International Monetary Fund, *Japan : 2005 Article IV Consultation – Staff Report*, August 2005. p.3.
[3] Ibid.
[4] Cabinet Office, Japan, *Annual Report on the Japanese Economy and Public Finance: No Gains Without Reforms V*, Tokyo. July 2005.
[5] World Trade Organisation, *World Trade 2004 ; Prospects for 2005*, 14 April 2005. p.6.

Australian minerals exports (excluding natural gas and petroleum) were a major contributor to this expansion, growing by 23 per cent, from $9.37 billion to $11.57 billion in 2004.[6]

Two important contributors to Japan's improved economic performance have been a powerful increase in its exports to China, and the new business investment to provide the capacity for this expansion. The global pickup in manufacturing, particularly in electronics, and the ongoing growth in Japanese exports to China and emerging Asia motivated much of the investment. This growth Japan's exports, as a percentage of Gross Domestic Product (GDP), increased from 10.4 per cent to 11.8 per cent by 2003. This export boom is fed by a long-term shift of production abroad by Japanese multinationals, as well as by demand from Asia for energy-saving manufacturing equipment from Japan.[7]

In 2004, Japan's exports to China increased by 16.1 percent, while imports from China grew by 17.9 percent. Trade with China, including Hong Kong, now amounts to approximately 20 percent of Japan's total trade, while trade with the U.S. amounted to 18 percent of Japan's total trade. But to the relief of Japanese officials and observers, Japan's dependence on China as a growth engine is contracting. As the IMF noted in its recent *World Economic Outlook*, the main drivers of Japanese growth in the first half of 2005 were domestic consumption and business investment, while net exports contributed little to growth. The IMF noted that this 'marked a turnaround from earlier in the cycle when exports – particularly to China and the rest of emerging Asia – were the main growth engine.[8]

Energy Security in East Asia

But Japan's renewed economic strength, China's rise and India's prospects have raised concerns about the sustainability of the region's energy supply. The gap between Asia's energy consumption and its production is wide and growing wider. Oil demand in Asia is expected to rise from 21 million barrels per day between 2001 to 38 mbbd per day by 2025, while regional oil production is likely to stagnate at around 8 mmbd, according to the U.S. Department of Energy. To put this in perspective, Asia's expected increase in oil imports of 17 mmbd by 2025 will exceed today's total oil exports from the entire OPEC Persian Gulf region.[9] As the gap between consumption and production levels in Asia grows, so is anxiety about energy security, driven by concerns that tight supply and consequent high prices may constrain economic growth.

[6] Data provided by Department of Foreign Affairs and Trade based on Japanese Customs data.
[7] Adam S Posen, 'What Went Right in Japan', *Policy Briefs in International Economics*, Institute for International Economics, No. PB4-6, November 2004.
[8] IMF, *World Economic Outlook*, p.30.
[9] Mikkal Herberg and Joseph Ferguson, 'Asia's Energy Insecurity is a dilemma for the US', Pacific Council on International Policy, March 24, 2005.

According to Japan's Institute of Energy Economics, the world's primary energy consumption will increase by 1.5 times from 9.1 toe to 13.6 toe in 2020. Half of this increase will be attributable to Asia, with China accounting for 25 per cent and India 8 per cent. Fossil fuels will account for 90 per cent of the increase by 2020, with coal accounting for 40 per cent, oil 38 per cent, and natural gas 13 per cent.

In 2004, China surpassed Japan to become the second-largest oil consumer in the world after the US, and the fifth largest oil importer. China and India (at number six) have now joined Japan and South Korea (at number two and four, respectively) on the list of the globe's biggest oil importers. China's surge in commodity imports is not confined to energy imports, with Beijing overtaking Tokyo as the largest importer of Australian iron ore. Demand for other commodities has also grown strongly. The result has been a strong increase in the price of most commodities, a long overdue development for Australia's minerals producers.

In Japan's case, however, China's voracious demand for resources has had an even more direct impact. In recent years, China has halted oil and coal exports to Japan, the latter move contributing to a sharp spike in prices. These moves, coupled with Beijing's aggressive strategy to acquire resources assets abroad, have heightened concerns in Japan about its energy and resource security.

The dangers of a regional contest for resources

There are significant dangers in an intense regional contest for finite and wasting resources in the Asia-Pacific region. The result, some analysts warn, is a profound and deepening sense of energy insecurity in Asia that will inexorably have significant, and potentially dire consequences.[10] A recent report prepared by the (US) Congressional Research Service warned that the possible implications of the surge in energy competition are wide-ranging, and will either provoke "military conflict among great powers" or spur "unprecedented regional co-operation'.[11]

So far the signs are not especially encouraging. Analysts note that China, Japan, South Korea and increasingly India, are boosting economic and diplomatic ties and are aggressively buying up stakes in energy and resource fields within and without the Asian region.

The pursuit of free trade agreements is seen as a part of this scramble for resources. In Japan, for example, China's motivation for a free trade agreement with Australia is seen as part of an broader ranging effort to secure access to minerals and energy resources. A

[10] Ibid.

[11] Emma Chanlett-Avery, 'Rising Energy Competition and Energy Security in Northeast Asia : Issues for US Policy,' *CRS Report for Congress*. February 9, 2005. See also David Zweig and Bi Jianhai, 'China's Global Hunt for Energy', *Foreign Affairs*, September/October 2005.

recent article in Japan's biggest selling daily newspaper, the *Yomiuri Shimbun* canvassed the findings of a recent study by Japan's Centre for Safety and Security Research (CSSR):

> China's powerful energy diplomacy seems to indicate Beijing is heading toward the battle for natural resources described by the CSSR in its crisis scenario. Chinese leaders are also proposing FTAs to countries rich in resources to deepen its economic ties with them.[12]

Japan's energy needs and concerns

These concerns about energy security are keenly felt in Japan, the world's fourth largest energy consumer. Dependence on imported energy sources is a defining feature of Japan's economy, with its energy self-sufficiency rate at 4 per cent. This compares with that of Canada at 146 per cent and the United States at 104 per cent. A recent report by Japan's Agency for Natural Resources and Energy has highlighted Japanese concerns about its vulnerability to scarcity and price rises:

> Because Japan is poor in resources and remains dependent on oil and other fossil fuels for the majority of its energy supply, it could be extremely sensitive to changes in the global energy situation.[13]

As the region's two largest economies, it is not surprising that tensions between China and Japan are sharpest. As the CRS study noted:

> China's growing need for energy has already contributed to a degree of intra-Asian tension, particularly in Sino-Japanese relations.[14]

In similar vein, the chairman of Japan's Institute of Energy Economics, Masahisa Naitoh recently warned:

> China's demand increase is posing a long-term problem not only for oil, but for energy in general. Since energy demand has continued steadily in India and other Asian developing nations, as well as in the United States, there are growing concerns for a future imbalance in energy supply and demand.[15]

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[12] *The Daily Yomiuri Online*, 13 April 2005.
[13] Agency for Natural Resources and Energy, *Energy in Japan 2005*, Ministry of Economy, Trade and Industry. 2005.
[14] Ibid.
[15] Masahisa Naitoh, Chairman and CEO of the Institute of Energy Economics, 'Long-term Energy Perspective and Challenges for Japan and Asia', *Keynote Address at the World Energy Council Asia Pacific Regional Forum*, June 27, 2005.

Mr Naitoh went on to warn about the consequences of 'single-minded' efforts by Asian nations to secure energy supplies:

> However if a country's behaviour becomes too exclusive as a result of excessively pursuing stronger energy security, it could give rise to conflicts and tensions over control of energy resources or competition for resources and become a destabilising factor for the international energy market.[16]

In the next two sections, we will demonstrate how an even closer economic relationship between Australia and Japan, combined with a substantial expansion of Australia's minerals production capacity, can help ameliorate some of the concerns felt in Japan over the security of its long-term energy requirements.

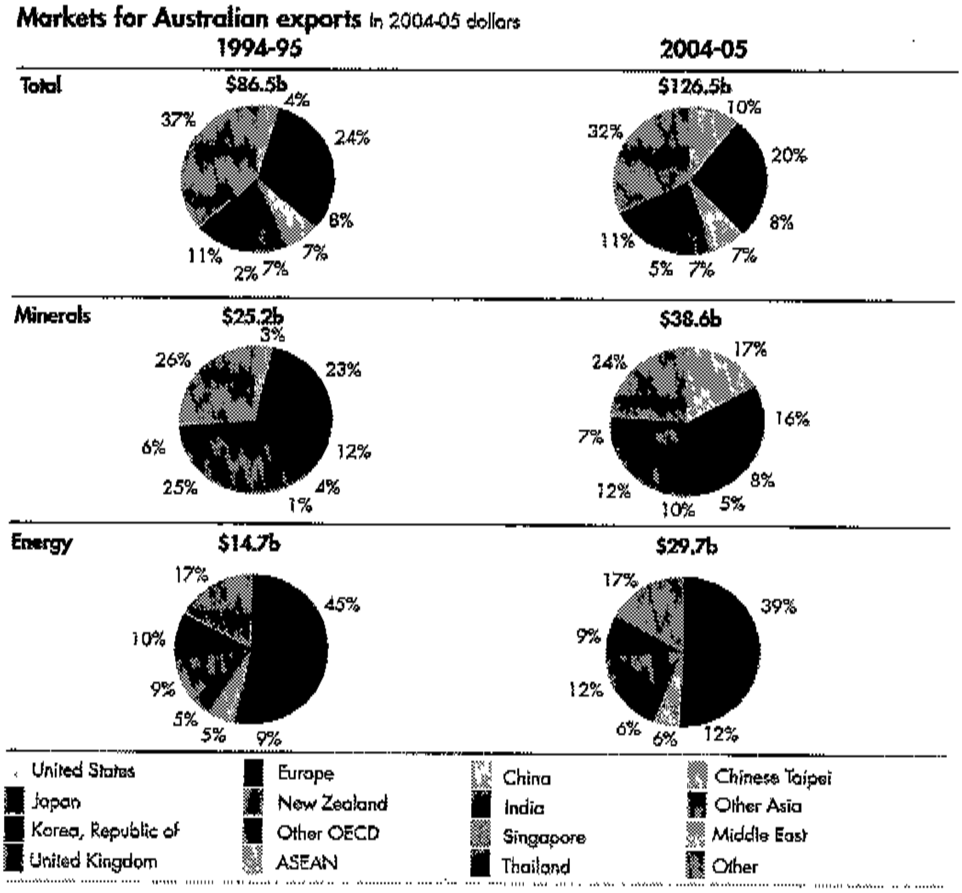
[16] Ibid.

The Bilateral Trade and Investment Relationship

Trends in Australia's trading relationship with Japan

In overall terms, the significance of Japan in Australia's overall export profile has fallen from approximately 24 per cent in 1994/95 to 20 per cent in 2004/5. The minerals share has drifted down from 23 per cent to 16 per cent, while the energy component (including coal) remains very significant at 39 per cent, though marginally lower than the 45 per cent share in 1994/5. This largely reflects the shift in industrial productive capacity in East Asian nations over the last two decades, and in particular, the emergence of China as a manufacturing powerhouse. China's share of Australian minerals exports, for example, have risen from 3 to 17 per cent over the same period.

Figure 1.1



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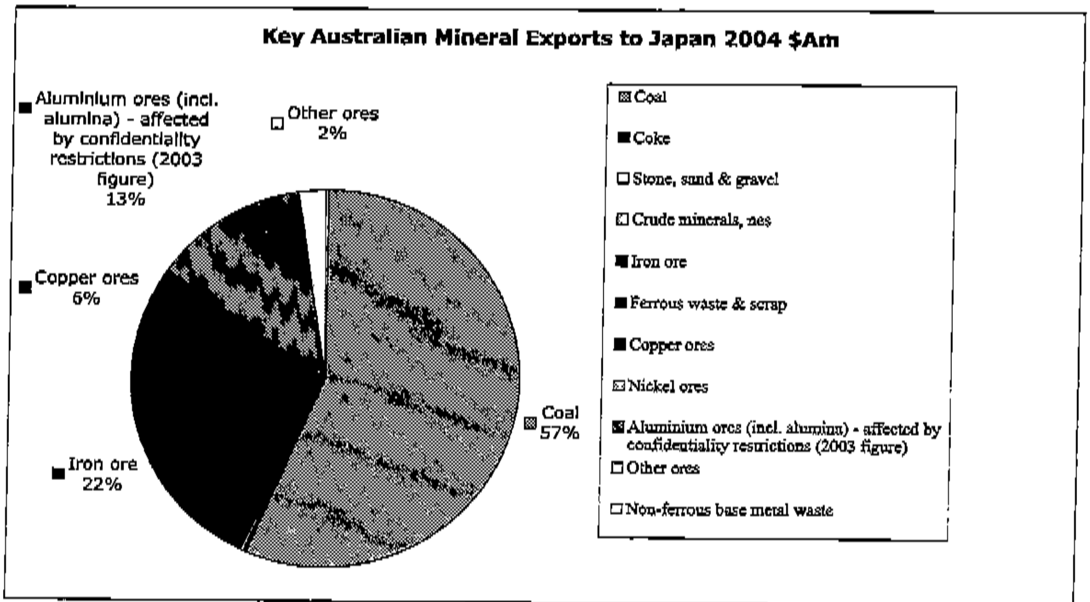
The Nature of Australia-Japan Trade

Minerals exports have been, and remain the mainstay of the Australia-Japan trading relationship. In 2004 Australia sold $25.5 billion worth of goods and services to Japan, with minerals exports accounting for 34.7% of the total. In 2004, coal, iron ore and aluminium were the three most significant mineral exports accounting for more than AUD$9.4 billion.

Although Japan's share of Australia's overall export effort has slowly contracted, the importance of minerals commodities has not diminished. In 1990 coal exports were 23.3 per cent of Australian exports to Japan, today coal accounts for 26 per cent of Australian exports. Fifteen years ago iron ore made up 9.1 per cent of Australian exports. In 2004, that share had edged up to 10.1 per cent.[17]

Within the minerals export trade, thermal and coking coal remain the dominant commodities, and together account for around 57 per cent of minerals exports. Iron ore is another major contributor, accounting for more than 22 per cent of all minerals exports. Until 2004 when it was overtaken by China, Japan was unchallenged as Australia's leading destination for Australia's iron ore exports.

Figure 1.2

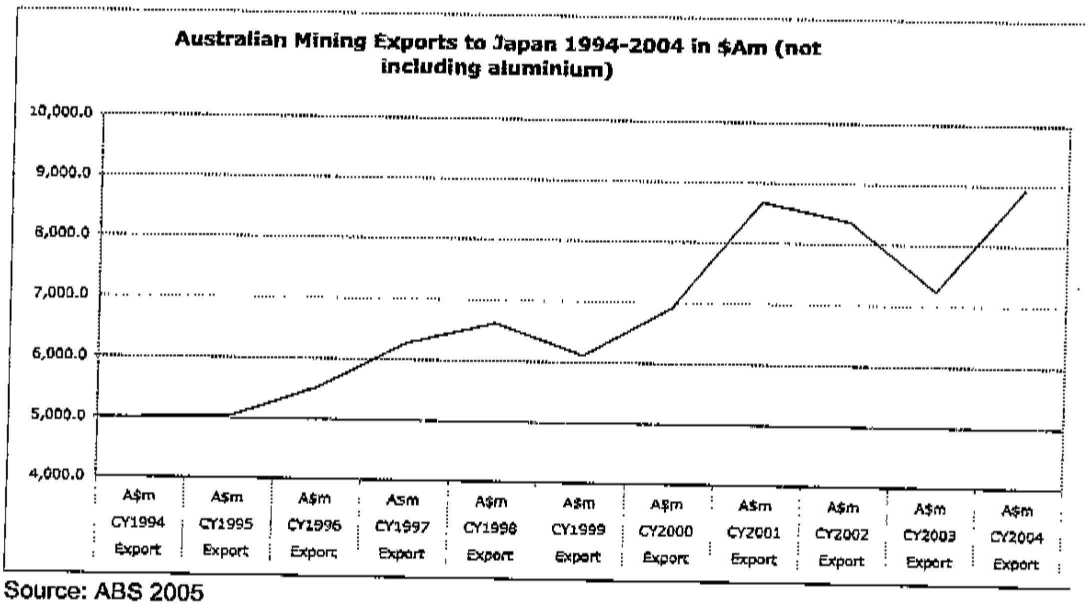


Source: ABS 2005

[17] Ministry of Foreign Affairs (Japan), Department of Foreign Affairs and Trade (Australia), *Joint study into the costs and benefits of trade and investment liberalisation between Australia and Japan*, April 20, 2005.

Despite Japan's tepid growth rates over the last decade, the value and volume of Japan's demand for imports of Australian mineral commodities has remained strong (see figure 1.3 below).

Figure 1.3



Source: ABS 2005

According to most forecasts, Japan's imports of iron ore, coal, aluminium and uranium will remain firm over the medium term.

Australia's role in supplying Japan's minerals needs

Japan's reliance on Australia as its most important and reliable, supplier of minerals commodities is likely to continue for the medium and long term. According to Japanese data, Australia supplies:

- 60.6 per cent of Japan's coal
- 55 per cent of Japan's iron ore imports
- 27 per cent of its aluminium
- 22 per cent of its uranium

> 13 per cent of its natural gas, and

> 7.5 per cent of its LPG.[18]

The intensity of this relationship is mutual, and Japan absorbs an outsized proportion of Australia's minerals exports, including:

> 46 per cent of Australian coal exports.

> 40 per cent of iron ore exports, and

> around 30 per cent of aluminium exports.

Australian industry gearing up production

To meet the ongoing demand from traditional markets in Japan, Korea and Taiwan as well as new demand from China and India, the Australian minerals industry is sharply expanding minerals production and investment.

The gross value of mine production grew by 30 per cent in 2004-05 to reach $69 billion, and is expected to grow by a further 22 per cent to reach $85 billion in 2005-06. The Australian Bureau of Agriculture and Resource Economics estimates that there are 74 minerals and energy related projects at an advanced stage – either committed or under construction, with total estimated investment of around $24.3 billion. This includes 43 minerals sector projects worth around $13.6 billion.

This expansion has been illustrated by the decisions by BHP Billiton and Rio Tinto to commit to multi-billion dollar expansions of their iron ore operations in the Pilbara.[19]

At the national level, new capital expenditure grew by 10.5 per cent to reach $10.3 billion in 2004-5, and is forecast to grow by a further 11.8 per cent in the 2005-6 fiscal year.[20] If the latter forecast is realized, capital expenditure in the minerals sector will have grown by $31 billion in 3 years.

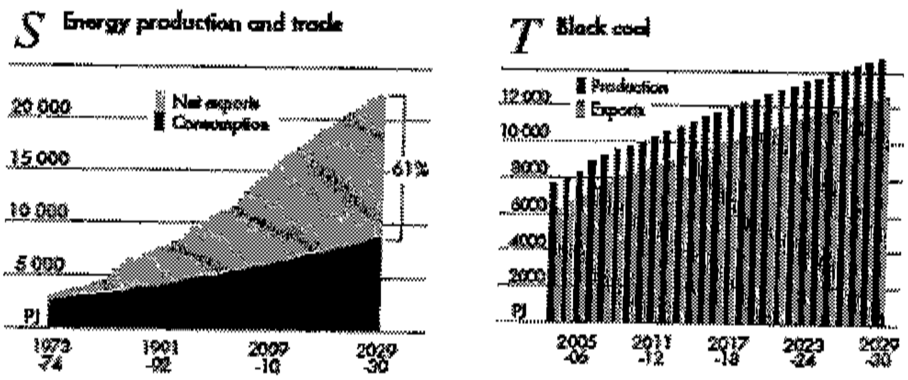
[18] Agency for Natural Resources and Energy, *Energy in Japan 2005*, Ministry of Economy, Trade and Industry. 2005.
[19] See BHP Billiton, 'BHP Billiton to expand capacity at Western Australian Iron Ore Operations', *Press Release* October 20,2005. Rio Tinto, 'Rio Tinto commits to new phase of iro ore expansion,' *Press Release*, October 18, 2005.
[20] Ibid.

The spending on associated infrastructure projects is also growing robustly, and is now 50 per cent higher than it was in 1997. The capacity of Australia's coal export infrastructure is expected to increase by 20 per cent by mid 2007, and a further 10 per cent by the end of 2008. A reflection of this expansion is the 14 per cent increase in employment in the minerals industry over the last year.

Security of supply and free trade agreements

The expansion of Australia's mine production capacity will be no short-term phenomenon. Australia's commodity forecaster, ABARE expects Australian coal exports to grow by an average of 4.7 per cent per annum to reach 287 million tonnes by 2009-10. Over the subsequent 2 decades, Australian coal exports are expected to increase by a further 50 per cent to 443 million tonnes.[21]

Fig 1.4



This expansion demonstrates Australia has both the capacity and intent to maintain its dominant role in the supply of minerals and energy commodities to North Asia.

To this end, Australia has clear commercial, economic and political interests in a stable North East Asian economic and political environment free of corrosive and damaging competition for energy resources. In the MCA's view, a bilateral free trade agreement with Japan is one of a number of initiatives that Australia can pursue that could help to advance its long-term commercial interests while dampening the nascent competition for resources in the East Asian region.

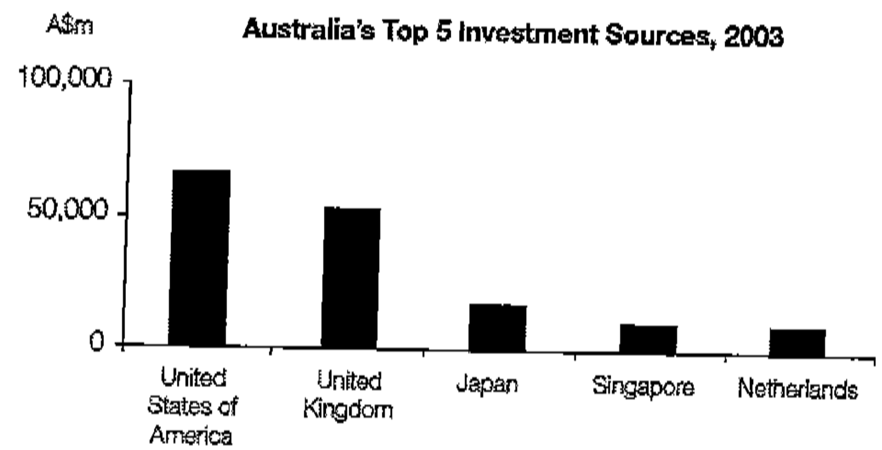
[21] ABARE, *Australian Energy : National and State projections to 2029-30*, October 2005.

It is neither possible nor desirable that a government-to-government free trade agreement specifically address the issue of commercial supply arrangements between, in this case minerals producers and their customers. Those are issues rightly left to the market. But the negotiation of an ambitious FTA will help reassure Japan that Australia (and the Australian minerals sector) is not overlooking Japan in favour of China.

The bilateral investment relationship

Japan is Australia's third largest source of investment, although the scale of the investment does not match the importance of the bilateral trading relationship. This investment, valued at $A48 billion in 2002, is concentrated in the real estate, mining, commerce and the service sectors. Estimates suggest that investment in the minerals sector accounts for about one-quarter of this investment, with notable examples including the 50 per cent share held by Mitsubishi Development Pty Ltd in the BHP Billiton Mitsubishi Alliance, which owns and operates a number of coal mines and associated infrastructure in Central Queensland. Other examples include the iron ore joint venture between Rio Tinto, Mitsui, Sumitomo Metal Industries and Nippon Steel Corporation at Robe River in Western Australia.

On October 10, 2005 zinc and lead miner Zinifex announced it will work with Mitsubishi Development Pty Ltd and junior miner Haddington Resources in the search for tantalum. Japanese trading houses, Mitsui and Itochu also have taken a 15 per cent stake in the $2 billion expansion of BHP Billiton's Pilbara iron ore operations announced on October 20.



Data source: ABS (2003)

An Australia Japan Free Trade Agreement : The Minerals Industry Case

The MCA has been a consistent and forthright supporter of the launch of negotiations on a bilateral free trade agreement between Australia and Japan, and welcomed the decision made by both governments earlier this year to launch a feasibility study into an FTA. Importantly, the minerals sector considers that an Australia-Japan FTA offers substantial potential benefits well beyond those traditionally associated with free trade agreements.

In addition to the welfare gains that will result from the further liberalization of trade between the two nations, the MCA considers that an FTA will provide an important additional sign that Australia will remain a reliable and substantial supplier of minerals commodities for decades to come. Given the emerging concerns about energy security in East Asia, this is a potentially critical and significant rationale for the pursuit of the FTA.

Border Barriers

Japan maintains a generally open trade policy regime, though with substantial peaks in barriers in certain sectors. Japan's simple average applied MFN tariff was 6.3 per cent in 2004, down from 6.9 per cent in 2002. But some sectors, especially agriculture, remain heavily protected, with the simple average tariff on farm imports averaging 17.7 per cent compared with 3.7 per cent for non-agricultural products.[22] There are few, if any, formal obstacles to the sale of Australian minerals commodity exports to Japan.

Services and Investment barriers

Given Japan's tiny mining industry, Australian exports of mining services are limited by lack of opportunity rather than significant barriers. That said, though it is one of the world's largest economies, Japan has the lowest inward foreign direct investment as a proportion of output in any major OECD nation. Foreign participation in mergers and acquisitions activity, which accounts for up to 80 per cent of FDI in other OECD countries, also lags in Japan.[23]

[22] World Trade Organisation, *Trade Policy Review – Japan : Report by the Secretariat*, 17 December, 2004.
[23] United States Trade Representative, *National Trade Estimates Report 2005*, Washington DC April 2005.

Liberalising Australia's investment regime

A bilateral FTA offers the prospect of promoting expanded Japanese investment in Australia's minerals sector. Currently, the Foreign Investment Review Board (FIRB) screens all large foreign investment proposals to determine whether they are contrary to the national interest. Presently all investments over $10 million are examined. If a takeover is announced (an announcement must be made if more than 19% of a company is acquired) the threshold is A$50 million. When screening takeovers, the FIRB seeks comments from a number of outside parties, including the target company. The federal government may then approve or reject the proposal outright, or subject it to certain conditions necessary to protect the national interest.

A revision of this process could hold significant advantages for the Australian minerals sector. In this respect the provisions contained in the recent US-Australia FTA has set a new and very positive benchmark. Changes have been significant and include:

> All US investment other than in specific industries reserved in the agreement - and where there is no takeover - are completely free of scrutiny by the Foreign Investment Review Board.

> In a case where a takeover is proposed, the threshold has been increased to $A800 million.

The Australian Government should consider extending this investment concession to Japan. In fact, existing treaty obligations suggest that Australia should grant this concession to Tokyo as a natural consequence of the investment related concessions in the FTA deal with Washington.

While there has been substantial upgrading of production capacity in Australia's minerals sector (see above), additional investment in the sector, and especially in exploration is important.

The former chief executive of Western Mining Corporation, and former Chairman of BHP Arvi Parbo said recently:

> "There have been no large mineral discoveries in Australia since the end of the 1970s...Australia should be discovering the ore bodies which could come in 20 to 30 years from now." If we do not prospect successfully enough, "the industry will run down and its present importance as a supplier of minerals to the world will decrease [and] its contribution to the Australian economy".

The East Asian Community

The regional architecture in East Asia is in the process of evolution. Australia's Prime Minister, John Howard will attend the inaugural East Asian Summit in Kuala Lumpur in November, along with the leaders of many East Asian nations. Over the next 15-20 years, a new East Asian economic 'community' may emerge based on the membership of this grouping which includes the 10 nations of ASEAN, Japan, China, Korea and India, all of which are critical markets for Australia's minerals industry.

The shape, structure and operating principles of this grouping are still to be defined. But it is in Australia's interest to be part of, rather than any such new economic, commercial and institutional architecture emerges in East Asia. It is just as important that we are able to influence that evolving architecture in ways that protect and promote our vital long term interests in the region.

An FTA with Japan that has broad sectoral coverage, covers substantially all trade and which extends beyond current WTO commitments in areas like services, investment, intellectual property protection, and dispute settlement, would be a key element in linking Australia more securely to the region. Building on Australia's participation in the East Asian Summit, the existing FTAs with Singapore and Thailand, and agreements under negotiation with ASEAN, China and Malaysia, an FTA with Japan would help Australia to play a more effective role in developing the form and institutional basis of an East Asian trading entity.

Co-operation in addressing global climate change

The Minerals Council of Australia does not advocate the inclusion of 'non-trade' issues in the scope of a proposed Australia-Japan free trade agreement. But a deeper and broader political and economic relationship between the two nations will provide a climate even more conducive for discussions on matters of common interest.

One of these issues is the question of how the nations respectively respond to the challenge of managing the reduction of greenhouse gas emissions. The readiness of the two nations to work together on climate change is demonstrated by both nations' participation in the Asia Pacific Climate Action Partnership launched in June.

While the development of the latter will run parallel to, rather than as part of any FTA negotiations, the closer linkage of Australian and Japanese economic interests will provide an additional measure of assurance that Japan will resist the embrace of blunt and ineffective policy options including a punitive carbon taxes and similar instruments.

As the host of the meeting that launched the protocol, Japan remains But Japan has fallen well behind its Kyoto target to reduce emissions to 6 per cent below 1990 levels in the first commitment period. As a result some groups, including in the Japanese Environment Ministry, support the introduction of a carbon tax in Japan as part of that country's efforts to reduce its greenhouse gas emissions. In a 2003 discussion paper, an advisory panel to the ministry proposed two tax levels: ¥3,400 and ¥45,000 per ton, both of which would hit Australia's exports of coal heavily. Both options would, however, be ineffective and counterproductive.

According to research and modelling undertaken by ABARE[24] the adoption of a Y45000 per ton higher carbon tax rate would reduce Japanese GNP by 0.46 per cent or US$20 billion by 2010. Consumption of steaming and coking coal would fall by 32 per cent and 20 per cent compared with a 'business as usual' scenario. Under such a scenario (Figure 1.5) Australian coal exports to Japan would fall by nearly 23 per cent. ABARE further project a rise in the price of coking coal would have serious downstream impacts on the Japanese iron and steel sector, which it estimates would contract by nearly 14% (see Fig 1.6). In turn, Australian exports of iron ore would fall proportionally. Under this scenario, Australian GNP would be reduced by 0.09 per cent or $A870 million annually.

Fig 1.5

Change in Australia's energy exports to Japan – under a ¥45,000 tax, 2010

Relative to the reference case

	High carbon tax		Emission target	
	Deviation	Change	Deviation	Change
	Mt	%	Mt	%
Steaming Coal	-15.0	-26.5	-14.5	-25.8
Coking Coal	-8.3	-18.3	-8.2	-18.0
Total coal	-23.3	-22.9	-22.7	-22.3

[24] ABARE, *A Possible Japanese Carbon Tax, implications for the Australian energy sector*, abare eReport 0.413, August 2004.

Fig 1.6

Change in output of selected sectors in Japan – alternative policy scenarios, 2010

Relative to reference case

	Low carbon tax	**High carbon tax**	**Emission target**
	% difference from reference case		
Iron and steel	-1.41	-13.97	-13.62

There is no strong evidence that the punitive carbon tax options have significant support within the Japanese Government. Indeed Australian concerns about the carbon tax are shared by a number of influential Japanese industry groups especially including the iron and steel sectors. The Japanese Keidanren (Japan Federation of Economic Organizations) has argued that the tax would "hollow out industry and put a damper on" the recovering economy.[25] These concerns are borne out by ABARE estimates that even a low carbon tax scenario would reduce annual Japanese GNP by around 0.003% (US$2 billion).

Australia and Japan's participation in the Climate Change Partnership suggests that the focus of collaborative work will be on technology-based solutions to managing climate change. This is a welcome development. An ambitious and comprehensive free trade agreement that further demonstrates and reinforces the complementary nature of the two nations' economies can only deepen this co-operation.

Ends.

[25] *Japan Times*, Nov. 19, 2004