

### ***Research Focus***

#### ***An Australia–Japan Free Trade Agreement: prospects and pitfalls***

***Ann Capling\****

The Australian and Japanese governments are in the final stages of a feasibility study that is likely to recommend the negotiation of a comprehensive free trade agreement between the two countries. In the past such a prospect would have been unthinkable due to the domestic political sensitivity of Japan's highly protected agriculture sector. When Australia first raised the possibility of an FTA with Japan in 2002, opposition from Japan's Ministry of Agriculture, Forestry and Fisheries (MAFF), from farm politicians in the ruling Liberal Democratic Party, and from producer groups meant the idea went no further. Since then Japan's choice of FTA partners has been limited to countries that have very limited agricultural exports to Japan. Nonetheless, the terrain is rapidly shifting and there is growing evidence to suggest that Japan and Australia could negotiate an FTA that included agriculture.

Japan's FTA policy is driven by pressing domestic and regional considerations. At the domestic level, reform-minded politicians and bureaucrats see FTAs as a useful tool for leveraging foreign pressure to reduce protectionism in the face of internal opposition. This has become especially important given the decline of liberalising pressures from external actors such as the United States and the World Trade Organisation. In the regional context, Japan is seeking to use FTAs to strengthen economic relations with key trade

partners. But Japan's FTA policy is also driven by defensive concerns, especially in relation to growing competition from China.

The rapid rise of China is central to Japan's interest in securing an FTA with Australia. The Japanese economy is heavily dependent on imports of raw material and energy and Australia has been a key supplier, providing 60 per cent of Japan's coal and iron ore imports, and other important items such as liquefied natural gas, petroleum and alumina. As China becomes an important customer for these commodities, Japan has become increasingly concerned about its security of supply and sees an FTA with Australia as an important mechanism to ensure its energy and mineral needs into the future. An FTA which granted the same exemptions from foreign investment review procedures as those secured by Washington in the Australia–United States FTA (AUSFTA) would provide Japan with increased opportunities for foreign investment in Australia's energy and minerals sector.

Japan faces similar problems in relation to food supply. Traditionally, Japan has argued that its 'food security' depends on protecting domestic agricultural production from import competition. However, this notion of food security is rapidly changing in light of Japan's declining ability to feed itself

### ***Events***

**5–8 December**, GDLN training workshop for the East Asian Region, Canberra

**7 December**, Pacific Islands–Australia Update, Canberra

**11 December**, Broadband Development and Public Policy, workshop, Canberra

**12–15 December**, Institutional Strategies for Improving Microeconomic Policy foundations, workshops, Jakarta, Kuala Lumpur and Hanoi

### ***Publications***

*The Turning Point for China's Economic Development*, Ross Garnaut and Ligang Song (eds)

*Power and Pork: the political life of a Japanese politician*, Aurelia George Mulgan (forthcoming)

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and its growing reliance on food imports. Australia has been a key source of food imports for Japan, but rising demand for a wide variety of food products in China and India could see a shift in Australia's export markets. Thus Japan sees an FTA with Australia as an important part of its food security arrangements.

Japan is also concerned about threats to its market share in Australia's automotive industry sector. Australia is Japan's second most important customer for automotive exports, but Australia has granted preferential access to the United States in cars and car parts, and could do the same for China. This is likely to lead to significant trade diversion away from Japan unless it secures similar preferential access in an FTA with Australia.

Australia has political and economic motivations for seeking an agreement with Japan. While Japan has been Australia's most important trade partner for forty years, there is a feeling in Australia that Japan has taken this relationship somewhat for granted in recent years. Much as the AUSFTA was originally conceived to reinvigorate Australia's relations with the United States, an FTA negotiation with Japan could serve a similar purpose. There is also pressure on the Australian government to make a success of its FTA policy, given the meagre economic returns to date from its other bilateral agreements, the proliferation of FTAs in the Asia-Pacific region, and the likely demise of the WTO Doha Round.

Despite strong drivers on both sides, some experts believe that agriculture will be a stumbling block to securing a deal, especially

in light of the Koizumi government's weak record on agriculture reform. However, within Japan there is growing acceptance of the need for domestic reform of the farm sector and FTAs are seen as a more politically palatable way of achieving this than either unilateral reform or comprehensive reform through the WTO. Moreover the Prime Minister's office has assumed central coordination of FTA policies, effectively removing MAFF's traditional veto power in Japanese trade policy. Finally, Prime Minister Shinzô Abe and Japanese industry are likely to put heavy pressure on the agriculture sector in order to secure an agreement with Australia.

For its part, Canberra will be pressing for an agreement that includes significant improvements in market access for key Australian exports such as meat, grain and dairy products. Both the government and the National Farmers' Federation insist that an FTA with Japan include comprehensive liberalisation of agriculture within a reasonable time frame. But Australia settled for far less in its FTA negotiation with the United States, effectively conceding the argument that agriculture should be treated differently from manufacturing. This precedent will certainly undermine Australia's ability to demand significant liberalisation from Japan. As a result, agriculture is not likely to be an obstacle to the successful negotiation of an Australia-Japan FTA.

While the prospects of an agreement are good, there are also significant pitfalls. First, there are a number of problems related to FTAs in general. FTAs are generally sub-

optimal instruments for advancing economic welfare. To be sure, they can create deeper liberalisation, but their preferential and discriminatory provisions can also be trade-diverting, which is economically inefficient and welfare-reducing. FTAs can also entrench protectionist interests. Indeed, these deals more often take the form of 'negotiated protectionism' rather than deeper integration. Second, the proliferation of FTAs in the Asia-Pacific region raises a number of problems. The Asian Development Bank is critical of the proliferation of these agreements, their potential to divert trade, marginalise peripheral countries with small markets, and polarise the region over the longer term. It is also evident that FTAs are undermining institution-building in the Asia-Pacific region more generally. Despite rhetoric to the contrary, there is very little political impetus for the evolution of FTAs into regional arrangements and governments show a distinct preference for bilateral rather than regional negotiations. Finally, FTAs have clearly dampened the momentum for multi-lateral trade liberalisation.

For all these reasons, FTAs are very much a second-best solution to trade problems and they potentially create new problems. In that sense, it would be better for Australia and Japan to concentrate their efforts on pressing for regional and multilateral negotiations, rather than contributing further to the mess that we are all in.

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*Publications (contd.)*

***Pacific Economic Papers***

360 *Agriculture and Political Reform in Japan: The Koizumi Legacy*

Aurelia George Mulgan

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