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CRES General Paper
R/GP3 (1976)

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SOME SENSITIVE AREAS IN THE JAPAN/AUSTRALIA RESOURCE AND TRADE RELATIONSHIP*

This is a good time to take a close look at some aspects of the interrelationships in resources and other trade matters between Australia and Japan for two important reasons. First, trade relations between our two countries at the present time are generally very good. Second, we have passed through a rapid period of change in the international economy, with major and wide-ranging consequences and implications for the Australia-Japanese trading relationship. While it is too early to be definitive about many of them, it is important that we develop a joint understanding about them before particular aspects become points of contention between us.

The history of the trading relationships between our two countries reflected a persistent but gradual development of complementarity between the two economies. From the initial cautious opening of trading relationships and the establishment of a formal trade agreement, the interchange in trade grew with the growth of the economies - and this was itself not unassociated with that trade. From this, a large and extensive trading relationship emerged.

The early lessons of expansion of trade, with the signing of the Trade Agreement and its subsequent operation, and the succeeding years of close consultation and greater understanding of the other's point of view, stood us in good stead as subsequent problems emerged from time to time.

This carefully developed and sustained mutual understanding was an important element in the give and take of our interrelationships. It was not easily maintained and it needed to be continually renewed as new people emerged with responsibilities at various levels.

Yet, since 1971, the pace of world economic developments has, by comparison, been immensely rapid. We have experienced a series of major economic events - the U.S. Economic Offensive of 1971-72; the soya bean shock; the energy supply cuts; a breakdown in previous international monetary arrangements; the OPEC oil price rise; a commodity boom of a magnitude unprecedented in our relationship; and, shortly after, a severe international recession, also of unprecedented size, including a major commodity price recession.

The world economic system is having considerable difficulties adjusting to these new circumstances and in reading the lessons from them; it is too soon to expect a balanced view to be possible and the creation of appropriate institutional arrangements will similarly lag. The pressures for the rethinking that is essential in the broader international context are at least as great, if not greater, in the Australia-Japan context because they are more important to us both.

Although the Australian-Japanese relationship is increasingly robust, misunderstandings can still emerge rather easily. In the past, the developments and adaptations in our thinking required to cope with what seemed then to be economic changes of particularly rapid nature were large, and were achieved only with considerable effort on both sides.

How much more important the effort necessary, then, when even more rapid changes of circumstances of a structural rather than evolving nature occur. Without care the confused assumptions and ideas that characterise the thinking in the international economic and trading scene at this time could be of critical importance to this relationship.

Whatever happens, the trading world has changed substantially. The era has ended in which the main trade negotiation gains came from tariff reductions; when exchange rates were fixed; when concerns about security of access to supplies of raw materials were largely forgotten; when raw material prices, and oil prices in particular, seemed likely to continue falling or at worst were unlikely to rise except at inconvenient and brief intervals; and when domestic price increases about 2 or 3% were regarded as both serious and domestically irresponsible. Other changes of less dramatic or of shorter term influence have occurred, including the continuing growth in influence of the developing countries; while important, these developments would have been easily absorbed in our thinking except for their interrelationship with these other problems.

In these circumstances, even greater care than normal is required in attempting to understand each other and each other's point of view; and in understanding some difficult and complex issues in the future of our international trading and economic relationships.

I propose to raise briefly a few issues that I think both important and, unless understood better, potentially disruptive of a continuing and developing trade relationship.

In doing so, let me make clear that I accept that I am necessarily seeing things more specifically from the Australian point of view. It is equally important to have expressions of views on specific trade and resource issues from the Japanese point of view. As a result of responses to this kind of approach, discussed in detail, free of a particular trading or negotiating situation, a clearer understanding of both our points of view might be possible.

Issues of this kind emerge in each of the important areas of our trading relationships: import policies, foreign investment and resources trade. There are undoubtedly others, such as, perhaps, differences in exchange rate policies, but I shall not attempt to discuss them here.

In looking at the trading relationships between our two countries, import policies are important and, in some respects, more complex than others. There exist, of course, a set of international rules and conventions which are reasonably well defined and understood and which have provided a basis for substantial trade liberalisation and growth in the postwar period. Yet, these rules are not adequate for dealing effectively with many of the new situations likely to be faced in our trading relationships.

Second, changes in import policies, much more than export policies, reflect internal political pressures and have important internal political consequences. They are therefore more difficult to affect in the direction of liberalising trade.

As far as the long run import protective systems of our two countries are concerned, the Japanese obviously have views about the Australian tariff and the way in which it is administered. Australians similarly have concerns about the residual import restrictions on agricultural commodities operated by Japan and the levels of protection on mineral processing.

Of course, both countries can say that these restrictions on imports comply with the existing international rules: but the strength of our relationship is such that we know that that is not good enough. We both know that such an approach would conflict with our common interest in a more liberal international trading situation; and with our long-term economic progress.

We can also recognise that to some extent the much greater freedom of exchange rates and the more highly variable movements in domestic price levels, make protection measures which are related to prices much less significant as variables in the trading situation. This does not mean that strong efforts should not be made to reduce existing protective systems further; obviously such efforts should be made since the discriminatory aspects of these systems, actual or assumed, remain important. Unless real efforts to reduce them continue, they will become an area of increased bilateral contention. Given acceptance of that broad proposition, however, the existing institutional arrangements and procedures are probably adequate to handle such differences as may arise.

The changes in the international economy, however, suggest two broad influences not adequately catered for. First, the structural changes which have occurred naturally in the post-war period have brought about many of those changes most easily accommodated - in many economies, further structural change in the agricultural, textiles, clothing and similar industries may well be more difficult. Second, it seems possible that economic activity in the future will be more variable and more unstable than over most of the last quarter century.

Consequently, imports may well be more variable, and some of the difficulties they cause domestically are likely to develop stronger political pressures. Unless these are handled more effectively than in recent years, not only can quite significant misunderstandings in our mutual relationship occur, but the effects on our joint trade could be severe.

To minimise such misunderstanding, closer consultation is important so that the reasons are better understood and unintended effects are avoided. Consultation, however, is not always possible before such actions, nor is it sufficient. Hence some principles need to be mutually accepted to handle these situations more effectively.

The important thing about such restrictions as may be inevitable in a cyclical downturn is that they should reflect a positive joint relationship and be as consistent as possible with the long term development of trading relations between the two countries.

An important principle in these circumstances would be to accept that the inevitable burden of adjustment should be shared by both importing and exporting countries.

I do not particularly wish to raise specific issues such as the Japanese import restrictions on beef but they do illustrate the point well. Australia currently applies restrictions on textiles and clothing and on motor vehicles in particular, as a consequence of the world trading downturn, which are regarded in Japan as severely affecting their trade position. Yet these restrictions do not prevent trade; they were designed quite consciously to share the burden of adjustment. Thus the annual import quota of 90,000 vehicles permitted into Australia, while less than the high level of 1974 imports, was much higher than any previous import level.

By comparison, the beef restrictions were seen in Australia as having the effect of passing onto Australia the whole of the burden of adjustment to a changed situation.

We obviously have to look to better ways of handling such emergency situations in the future so that the burden is shared, and that any interim measures are consistent with the way the long term trading relationships should develop.

A second area in which important misunderstandings could occur in the trade and economic relationships between Japan and Australia, arises from the flow of overseas investment from Japan to Australia.

A new policy on overseas investment will shortly be announced by the Australian Government and, until that time, it is possible to speak about the policy itself only in generalities. Nevertheless, there seems little reason to expect large changes of substance from the policy which has been in force from 1972 and liberalised in 1975. In substance there have not been great differences between policies of one government or another in the past except for the period immediately after 1972.

No difficulties need arise from the understanding that, as in all major countries, including Japan, Australia wishes to ensure some degree of control on its resources to ensure that the national interest is taken into account in their development. At the same time, foreign investment, including investment from Japan, will be welcome in Australia to assist in the development of our resources.

The links that investment from Japan provides with resource markets, and the fact that Japanese investment usually seeks only a relatively small proportion of the total equity in a project, tends to result in Japanese investment being regarded particularly favourably.

Before looking at specific bilateral foreign investment issues however, it is useful to consider some broader issues of the resources trade.

In the first place, the problem of financing resource developments around the world is likely to become increasingly complex. In the past, such developments tended to be financed, initially, from the internally generated funds of the mining companies themselves; as the need to use outside funding developed, this was often done on the financial security of the resource. Subsequently, with Government increasingly wanting some ultimate control over the use to which national resources are put, the resource itself became less acceptable as security; long term contracts became increasingly the basis for loan fund raising. This still is importantly the situation, although the character of contractual relationships is itself changing substantially.

The nature of this financing relationship also has important implications for the price relationships affecting the resources concerned and this is of critical importance.

The question of the price levels achieved in the trade in resources, and the manner in which these prices are formed are extremely complex issues. They are also extremely sensitive issues because they are not easily separated from other issues, such as the security, stability and predictability of supply; they consequently raise fundamental issues of a political and strategic nature. For this reason, they tend very easily to be discussed in a highly emotional context; yet because of this, it is essential that they should be looked at rather more dispassionately and the complexities recognised and discussed openly and frankly. It is particularly important that both parties should seek to understand more clearly the standpoint of the other.

It might be questioned whether this is necessary, on the grounds that these issues, and particularly the prices at which resources are traded, should be left to the interests involved to settle between themselves as part of the normal operation of the free international market mechanism. To a degree, this is undoubtedly true. But only to a degree is this possible, since it cannot be done completely without at times real concerns arising about both the short and long term consequences.

In the first place, political pressures both in Japan and Australia will not permit either government to stay completely away from some involvement in the importing or exporting of resources. The availability and the development of resources is too important for governments not to have at least a minimum involvement, and some continuing role is necessary if only to know when to intervene or not to intervene. The fact that part of the process of negotiation often involves public appeals to more general public attitudes in both countries, although partly a consequence of existing governmental involvement, also contributes to making such involvement necessary.

Second, we accept in most fields of economic activity that the market mechanism, however effective generally, does not always work efficiently in the face of short term disruptions in the market. Moreover, there is, in the aim of leaving the resolution of economic issues to the market, an assumption that there is a sufficient degree of competition in the market to ensure that it works both reasonably efficiently and reasonably equitably. If, however, there is an imbalance, or an apparent imbalance, in the competitive power in the market, then it is difficult for a government not to seek to rectify this imbalance. The absolute magnitudes of the import requirements on the one hand, and of the production and related processes on the other, also require some qualification to the assumptions underlying traditional concepts of free market interchange.

Third, it is not clear that the market necessarily reflects the appropriate social valuation of the long versus the short term. It is more widely accepted now, in regard to exhaustible resources in particular, that any government has to look consciously at the rate of development and use of these resources to ensure that the rate at which the market would use these resources does not differ significantly from that which meets the community's wishes.

The extent of existing government involvement in these various resource issues and the effect of that involvement is something that itself warrants closer investigation, discussion and understanding in both of our countries. This is also the case as far as a consideration of the contribution that governments can and should make to a greater stability and predictability of the resources trade is concerned.

Government involvement has always existed in the trade in resources, and in other goods, in both our countries and will obviously continue. To discuss these issues on any different set of assumptions does not seem very helpful. We ought to discuss and understand more clearly where this involvement should be best directed and what effects, beneficial or adverse, are likely from any particular form of involvement.

For such discussions to be fruitful, however, they have to take place in a context in which security and a broad predictability in supply is not at risk or in question. As indicated earlier, there must be complete acceptance, without qualification, that the kinds of actions that led to embargos on exports of soya beans and of oil are totally unacceptable internationally, and very particularly in the Australia-Japan trading relationship. This should not be in doubt. It may be recalled that very strong domestic pressures to reduce beef exports from Australia to all sources in 1973 were resisted very largely because of Australia's concern to assure Japan of continued security of supply.

A fundamental basis of Australian policies must be the fundamental and overriding proposition that in the trade in raw materials, irresponsible action which leads to arbitrary and unpredictable trade measures and which provides any basis for putting at risk the confidence of the importing country that security of supply will be maintained, must be totally avoided. This needs to be stressed very strongly because it is obviously of major concern to a country such as Japan; it is, of course, also critically important for Australia in some commodities.

At the same time, actions such as the OPEC supply restrictions and the U.S. soya bean export ban have created an atmosphere in which it is difficult to get rational discussion of a number of issues associated with trade in resources. Those whose supplies were endangered were necessarily severely concerned, while statements in a number of resource exporting countries suggested a more widespread politicisation of resources trade.

Partly, this is because discussions of resource trade issues frequently fail to distinguish between price issues and those of security of supply. The distinction is seldom drawn sufficiently, for example, between the OPEC action which reduced or cut off oil supplies for political and military reasons, and the price-raising activities of OPEC with their quite different motivations.

In addition, of course, any movement away from the completely free and unfettered operation of the market implies some interference with the free movement of goods - whether it is an interference with the free import of goods into Japan or into Australia; or the free movement of goods out of Japan or out of Australia. Yet, a completely free and unfettered market operation exists for no commodity traded between Japan and Australia.

Such interferences may be the result of a joint decision taken by a group of importers or exporters in either country. Alternatively, it may be a decision taken directly through, or as a consequence of, government action; even a requirement that a statistical return be lodged implies, ultimately, a restriction on imports or on exports if the return is not furnished.

To a degree, it might be argued that interferences that result from business decisions are of a different character than those which stem from governmental actions. It is true that business decisions are less likely to reflect extraneous and non-economic influences. Yet it is not possible to separate many government and business decisions in this way. Even in Australia this is true and, however inaccurate, there is a widespread view in Australia that government and business have traditionally been more closely integrated in their decision-making in Japan than has been the case in Australia.

Moreover, any decisions by an organised group of importers in Japan or of exporters in Australia may reflect short-term market objectives only, and be at the expense of the long-term benefit of perhaps both parties. This is particularly so, since competitive market situations in the short-run are complicated by the long lead times required for market adjustment, because market information is limited, and because uncertainty and risk are high.

Governments then will inevitably be involved, even though it may be only indirectly, in the trade between our two countries. We need to consider more specifically, therefore, the basis on which government involvement can best take place, so as to help ensure that within the normal constraints that any government must operate, such government involvement is consistent with the long-term development of the trade and other economic relationships of the two countries; and that, in addition, each country has a better understanding of the reasons for, and nature of, this involvement.

One conclusion that is unavoidable, however, is that it is difficult to establish precise and general guidelines for such government involvement. There must be a significant element of subjective judgement in each case. It is also necessary to recognise that the difference between regulatory action of an exploitative and arbitrary nature, which poses real threats to security of supply or of markets, and action to regulate imports or exports simply for, say, statistical purposes differs in degree rather than being totally and objectively different in nature.

The importance of this is that it places much greater emphasis on the consultative procedures in working out and understanding these guidelines, as well as on the existance of a close mutual understanding and confidence.

Let me look then at some of the questions that need to be considered in this context.

The future emphasis in the trading relationship between our two countries must be related, more specifically than frequently occurs, to the expected long-term situation. In the case of resources, we both gain if the basis of exchange does not depart too far from the long-run competitive market price.

It is not necessarily the case that the market acting alone will achieve such a price. Even if otherwise competitive, the information gap and associated uncertainty limit the market's ability in this respect. With the other factors limiting the traditional competitiveness of the market, it is even more possible that the market will not achieve it.

The consequences of relying on the market may well be a long period of under-investment, with consequent capacity shortages leading to exaggerated price swings and eventually, a corresponding over-investment. Given the long lead times in the resource industries, these swings could last for many years and the instability could be very pronounced. Stability is likely to be increasingly important in the new inflationary world since, given the lack of downward flexibility in prices, a period of low commodity prices may not go near to counter-balancing the de-stabilising effects of high commodity prices.

What governments should do specifically in these situations is difficult to say, but few would accept that they could stay completely uninvolved and risk the long-term break-down of the market or of the productive capacity of an industry.

Similarly, it may at times be legitimate and sensible for example, for a country to seek to ensure a reasonable degree of equality of bargaining strength in price or market access negotiations. One of the mechanisms that has been used for this purpose and which gives rise to some cause for concern are export controls or regulations.

The first objective in any government involvement would ideally be the removal of the barriers to competition where they exist so that equality of bargaining is achieved by way of increasing general levels of competition. In highly capital intensive industries, with very large capital investments involved, such a step may not be feasible, even if desirable.

In such circumstances, the appropriate policy may require achieving the balance in bargaining power by co-ordinating exporter or importer policies to counterbalance the corresponding coordination of importer or exporter market behaviour. Once a group of importers or exporters coordinate their policies, that group has at least some of the characteristics of a cartel. Such cartels or coordinated trading groups are common among Japanese importers and among importers in other parts of the world; they are common among shipping lines; they are not uncommon in various Australian contexts.

The issue, then, is not necessarily the fact of cartels as such, nor of export regulations and controls as such, but the nature of the action that cartels take, or the way that the export controls and regulations are operated. It is here that difficulties arise, since there are no objective guidelines that are available for judging the appropriateness of a particular set of actions.

Moreover, in a particular context, the short-run interests of Australia and Japan frequently do differ in this respect.

It is tempting at times of market weakness or of market strength for traders to think only of the immediate situation, with prices being pushed too high or too low.

The existence of cartels will often reduce the efficiency with which resources are allocated. This is not simply that they may misread the market. Quite clearly, the danger is strong that the existence of such a grouping on one side of the market could lead to a series of counter, defensive measures on the other; this might so limit trade that everyone would be substantially worse off.

In such circumstances, again the question of the role of governments is important. It may be logical for it to seek a counterbalancing of bargaining power. It may regard the existence of a sufficient balance in bargaining power adequate,although, alternatively, it may also have a concern to ensure that too much emphasis is not placed on the short-term. Again, the principles that should be followed are not clear.

The issue consequently needs to be handled with care and understanding since it will otherwise give the basis for disagreements of a more basic nature.

To some, it would seem that problems of long-term price and market instability are dealt with effectively by the use of long-term contracts. Undoubtedly, these have in the past, and will in the future, make an important contribution to the stability of the trading relationship.

The dilemma however, is that to avoid the difficulties that arise from a price level which appears to one or the other side as too high or too low, particularly given the changes in domestic price levels and variations in exchange rates, the prices in such contractual arrangements have increasingly been open to renegotiation every year or every second year. At times, the contract arrangements have provided for the price to be determined in the light of current world prices. The quantity provisions in many contracts have similarly become flexible. The problems of price inflexibility that emerged in many early contracts, and are still a problem in some older contracts, may be mitigated to this extent.

Yet the implications of this greater flexibility of contracts is that price, and to a degree quantity, stability is correspondingly reduced for buyer and seller. Negotiations on price will take place more frequently, and since they will cover only a short period, they could well give greater emphasis to short-term price and market considerations. To some extent, their frequency and flexibility may ease the pressures on governments to be involved. It may, however, make a government interest more necessary from the viewpoint of the long-term.

Second, the implication is that contracts will increasingly become less and less contracts as we know them in our legal system and more and more declarations of intent to purchase or sell. In this form, they are, of course, not without value in several ways, including the opening up of a continuing line of communication. Yet, as a basis of planning for investment and production - or for planning future supply sources - the more they have the flexibility the market seems to desire, the less they provide a basis for long term planning and development of production and use.

This has implications for the financing of Australian development projects and for foreign investment policies generally both of which are integrally related to resource pricing. I shall not do more than raise the issues here without evaluating them.

Generally, as I have already suggested, there are several reasons why foreign investment from Japan will be accepted as of particular benefit to Australia.

There are some aspects of this, however, which without care could provide a basis for future mi understanding. One of these concerns the possible conflicts of interest in a situation where an investor in an Australian resource development - say coal or iron ore - may also have an interest in Japan in the outcome of, say, price negotiations. The difficulty of achieving an arms-length negotiation on prices is readily apparent in such circumstances. The overseas investor may be indifferent about where profits on the investment are realised - indeed, particularly where the equity holding is relatively small, it may prefer lower prices to higher profits on its investment, particularly if it sees this investment in a broader context of obtaining a foothold in an industry to influence that industry's competitive or non-competitive stance.

For this reason, particularly where a significant Australian equity is involved, misunderstandings could well develop if there is a suggestion that in investing in Australian resource projects, Japanese companies are seeking only nominal profits. On the surface, such statements seem to, and no doubt do, reflect genuine concerns to avoid exploitative relationships. While this may indicate a priority of interest in securing access to supplies, it may also imply that the investor has different profit objectives than other investors; this would clearly be disadvantageous to other investors, and raise the earlier questions about the prices at which resources are transferred.

Similarly, there is a need to be clear on investments with links to prices different from either world prices or existing levels of contract prices for the commodity. Of course, although they are becoming less common, the concept of long-term contracts with fixed or relatively fixed prices, implies prices different - and perhaps substantially different - at any point from world prices, whether or not investment funds are involved.

Where such funds are associated with price contracts, it may be difficult to separate the price for the resource from the price for capital. This need not have adverse effects provided that it is an arrangement decided in a reasonably balanced competitive situation. Yet to the extent that it implies a two price market system - over and above the normal contract price/market price differences - it raises important questions about the efficiency with which resources are being allocated.

Against this, the investment funds involved are very great and the risks and uncertainty of such investments substantial. The desire to protect this kind of investment is understandable. If such protective actions could possibly affect the profitability, from the community viewpoint, of existing or other potential resource developments, it is difficult for governments not to maintain a watching brief. Yet, economic principles do not necessarily provide unambiguous guidelines for governments in such circumstances.

In the fields of domestic policies, major questions will arise in Australia in the coming decades about the share of the gains from resource developments, and particularly the economic rents, that should go to the developers and the benefits which should be received by society. This will similarly take governments into the resource field within Australia, which will affect both production and trade in resources of interest, among others, to Japan. Some understanding of these issues will be important to avoid misunderstandings.

Finally, the Australian Government has a long standing commitment to a non-discriminatory, multilateral and liberal world trading system. Within this it has sought collaborative solutions to problems that arise in international trade. This applies particularly to the problems of international commodity trade which have tended to be generally severe for Australia for much of the period since 1951. Consequently, it is an established and substantial policy stance to participate actively in international commodity discussions and to expect to be members of such groups. It consequently finds actions aimed simply at setting rules for export controls, for example, that are concerned with the consumer interest and with little concern for the problems of producers, such as the discussions in the OECD, too unbalanced to be either helpful or constructive. At the same time, the emphasis in the commodity field has been to stress the need for producer/consumer participation in discussions and in the development of arrangements to deal with the resource and other trade problems, rather than to investment flows and the market strength of investors, and resource pricing.

(iv) There is not a better mutual understanding of the domestic and international ramifications of resource policies relevant to our two-way trade and economic relationship.

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