

A report commissioned by the Japan Australia Business Co-operation Committee

**Strengthening the Strategic Partnership through
a Japan-Australia EPA**

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1 Introduction

The governments of Australia and Japan entered formal intergovernmental negotiations in April 2007, with the aim of concluding an Economic Partnership Agreement (EPA) between the two countries. A Japan-Australia EPA could become an indispensable tool with which to improve the international trade policy environment of the entire Asia-Pacific region. At the same time, it is expected that outcomes of the negotiations will affect Japan's position geopolitically and Japan's economic diplomacy, greatly.

This paper focuses on the economic dimensions of a possible EPA and argues that a Japan-Australia EPA is necessary. Firstly, in Chapter Two, we examine the current status of the network of free trade agreements (FTAs) that has developed rapidly in the past few years in the Asia-Pacific region. In Chapter Three, we reaffirm Australia's importance as a reliable supplier of natural resources and food to Japan. In Chapter Four, we examine rules in FTAs that Australia has concluded with other countries in recent years, and argue that Japan is becoming competitively disadvantaged in the Australian market, because of the high level of liberalisation realised in Australia's FTAs. In Chapter Five and Chapter Six, we use the Computable General Equilibrium (CGE) model and simulate the possible effects on the Japanese economy of a hypothetical situation whereby Japan ceased importation from Australia, and we also simulate the effect of a Japan-Australia EPA on the Japanese economy. In Chapter Seven, we review existing research outcomes and methodology regarding the effect of an EPA on Japanese agriculture, the greatest issue of concern in negotiations over a Japan-Australia EPA, and after reviewing protectionist policies related to agricultural items, we consider a solution that could enable a balance to be reached between maximizing benefits for consumers, while minimizing the negative impact on Japanese farmers.

2 The Status of the FTA Network in the Asia-Pacific Region

It has been argued that in the past, *de facto* economic integration in the East Asia region made progress, but that *de jure* economic integration was slow in coming, compared with integration in Europe and the Americas. In recent years, however, that situation has changed. A network comprising bilateral or multilateral FTAs is developing rapidly in East Asia, in particular among ASEAN countries (**Table 1**). The table clearly shows that although FTAs between any combination of Japan, China, and South Korea are slow in coming, it would not be an exaggeration to say that the network of FTAs between ASEAN+3 in particular, is almost complete.¹

¹ Kimura, Fukunari, Arata Kuno, Hyun-Hoon Lee, and Hyeon-seung Huh (2006) "Economic Integration in East Asia

TABLE 1: Status of FTA Network in East Asia (As of August 2007)

	Japan	Korea	China	ASEAN	India	Australia	NZ
Japan		○	△	◎/○	○	○	
South Korea	○		△	◎*	○		△
China	△	△		◎	△	○	○
ASEAN	◎/○	◎*	◎	◎	◎	◎/○	◎/○
India	○	○	△	◎			
Australia	○	△	○	◎/○			◎
NZ		△	○	◎/○		◎	

◎:Signed/In Force; ○: Under Negotiation/Agreed to Start Negotiations

△: Joint Research/Under Consideration

* Not signed between South Korea and Thailand

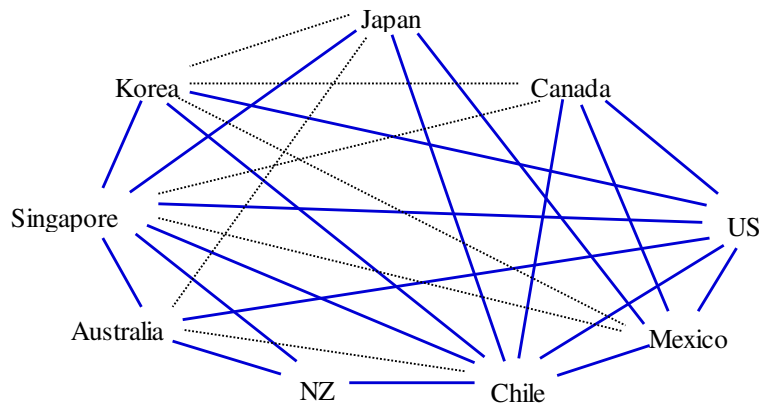
Source: Authors' compilation from various sources

A characteristic of the FTA network in East Asia is that FTAs are also being concluded with countries outside the geographic concept of the traditional “region”. In other words, while there are concerns that a “regional block”, such as that of Europe, could be created as a result of FTAs being concluded world wide, countries of East Asia are actively concluding agreements with countries “outside” of East Asia. And in doing so, an environment that matches the spirit of open regionalism as aimed for under APEC is being realised. **Figure 1** shows the FTA network linking nine developed countries (OECD member countries as well as Singapore and Chile) in the Pacific Rim region. Among the 36 bilateral combinations, FTAs have already been concluded in 19 bilateral combinations, and there are a further 7 combinations between which negotiations on FTAs have commenced, or there has been agreement that negotiations will commence.

We can see from this information that a network comprising bilateral FTAs is being created in the Asia-Pacific region. As for the feasibility of an APEC-wide FTA linking these countries together, some pessimistic views exist; however, it is anticipated that proposals on a plurilateral FTA in the Pacific Rim region, which is certainly feasible from a political and economic standpoint, will be forthcoming in an environment of competition between those making such proposals.

and Asia-Pacific and International Commercial Policies in Japan and Korea.” (in Japanese) *Mita Journal of Economics*, 99:2, pp. 5-29.

FIGURE 1: FTAs among Developed Countries in the Asia-Pacific Region (As of August 2007)



Note: bold blue line=Signed/In Force; dotted line= Under Negotiation or Agreed to Start Negotiations.

Source: Author’s compilation

There are many motivating factors for countries to conclude FTAs. In addition to the most common motivation, which has traditionally been to secure benefits through trade by gaining greater access to markets through tariff reduction, there are other motivations, such as to achieve deeper economic integration, and high standards in rules, for issues not currently dealt with in WTO Agreements (such as liberalization for investment in goods, competition policy, trade and labour, and energy issues); to obtain first-mover’s advantages through preferential liberalization for trade in services or investment; to reap gains from trade in product areas that are not internationally competitive; and to provide a means of securing foreign direct investment.²

Against this backdrop, the Japanese Government acknowledged the importance of FTAs/EPAs. Japan clarified its basic policy on FTAs at the Council of Ministers on the Promotion of Economic Partnership in 2004.³ According to the Basic Policy, “EPAs, against the background of growing economic globalization, contribute to the development of Japan’s foreign economic relations as well as the attainment of its economic interests, as a mechanism to complement the multilateral free trade system, centring on the WTO”, and not only “facilitate promotion of structural reform of Japan and its partners”, but also “contribute to the creation of an international environment further beneficial to our country from the politically and diplomatically strategic views through, among other things, fostering the establishment of an East Asia Community”. It confirms the existence of political benefits in addition to economical ones, and also clearly states “The government shall do its utmost

² Crawford, Jo-Ann and Roberto V. Fiorentino (2005) “The Changing Landscape of Regional Trade Agreements”, Discussion Paper No. 8, World Trade Organization.

³ Council of Ministers on the Promotion of Economic Partnership. “Basic Policy towards further promotion of Economic Partnership Agreements” (21 Dec 2004) at <http://kantei.go.jp/jp/singi/keizairenkei/kettei/041221kettei.html>

to conclude these EPAs as soon as possible”.

The attachment to the Basic Policy contains “Criteria on Identifying Countries /Regions to negotiate with on the FTAs/EPAs”. For example, criteria include not only the extent to which an EPA/FTA would contribute to the expansion and facilitation of trade and investment in real terms, but also criteria such as whether or not an EPA/FTA would contribute to the improvement of the business environment in the partner country in which Japanese-affiliated companies overseas operate; whether or not it would contribute to stabilizing the supply to Japan of natural resources and safe food and to the diversification of sources of supply; whether or not it would promote structural reform in Japan; whether or not it would facilitate efforts towards community building in East Asia; and whether or not it would contribute to Japan’s efforts in tackling political and diplomatic challenges it faces.

Australia is an ideal partner with which to conclude an EPA, as Australia meets the criteria detailed in the government’s Basic Policy. As demonstrated in this paper, Japan and Australia have a mutually complementary relationship in terms of economics, and both countries can expect to gain significant benefits from trade liberalisation. It would not be an exaggeration to claim that Australia, with abundant land and resources, is an important strategic partner for Japan with regard to energy and food security.

3 A Necessity to Secure Stable Supplies of Resources and Food through an EPA with Australia

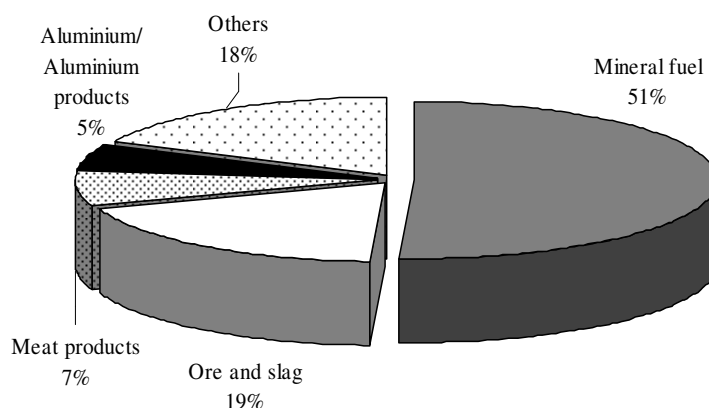
In this chapter, we reaffirm the importance of Australia as a supplier of natural resources and food. Looking closely at the breakdown of items that Japan imported from Australia in 2006, we see that four product areas: mineral fuel (HS27); ore and slag (HS26); meat products (HS02); and aluminium/aluminium products (HS76), accounted for over 80% of Japan’s imports from Australia. Therefore, we can reaffirm that the percentage of energy and food-related items in total imports from Australia is considerably large. **(Figure 2)**

At the same time, we can confirm the importance of Australia as a supplier of natural resources and food, when we consider Japan’s dependency on Australia regarding the abovementioned four product areas. Australia has the largest share of Japan’s imported ore and slag (26.8% dependency on Australia) and beef (30.5%). Regarding aluminium and aluminium products, Australia has the second largest share (4.8%) after Russia, and the fourth largest share of mineral fuels (8.7%), with the greatest share being held by Saudi Arabia. Next, we spotlight natural resources and review the

trade status for items at a more detailed level.

Firstly, among mineral fuels, which account for over half of Japan’s total imports from Australia, coal, briquettes, ovoids etc (HS2701) accounts for the largest share (60.2%), followed by oil gas (HS2711), which accounts for 32.8%. Combined, these two items account for 93% of Japan’s total import of mineral fuels from Australia. Japan also depends greatly on Australia for other items; Australia has the largest share (61.2%) of Japan’s coal imports, and the second largest share of oil gas imports (14.9%) after Indonesia.

FIGURE 2: Breakdown of Imports from Australia (2006)



Source: World trade Atlas

Next, on examination of the product breakdown of ore and slag, we see that iron ore (HS2601) accounts for over seventy percent (71.2%) followed by copper steel (HS2603, 16.8%). Combined, these two items account for 88% of Australian ore. Australia has the largest share (71.2%) of Japan’s iron ore imports, and it has the second largest share of copper steel (16.8%) after Chile. Finally, Japan imports aluminium from Australia, which accounts for 5% of Japan’s imports from Australia; however, almost all of it (98.8%) is aluminium ore ((HS7601). Australia is Japan’s second largest supplier of aluminium ore (19.4%) after Russia. Furthermore, Japan is not only dependent on Australia for natural resources in the abovementioned product areas. Australia is Japan’s largest supplier of uranium, essential for nuclear power generation, zinc, bauxite/alumina, lead, silica, titanium minerals, and zircon.⁴

As mentioned above, while Japan is already highly dependent on Australia for coal and iron ore, Japan has become even more dependent on Australia for these items in recent years (**FIGURE 3**).

⁴ Joint Study for Enhancing Economic Relations between Japan and Australia, including the Feasibility or Pros and Cons of a Free Trade Agreement (provisional translation) (Dec 2006) at, <http://www.mofa.go.jp/mofaj/gaiko/fta/pdfs/houkoku.ja.pdf>.

However, at the same time, Australia's total exports to China have been increasing in recent years. Furthermore, for the first time in 2004, Australia's exports of iron ore to China rose above iron ore exports to Japan (FIGURE 4), in response to buoyant demand for iron ore in China.

FIGURE 3: Japan's Import Dependency on Australia for Coal and Iron ore (2006)

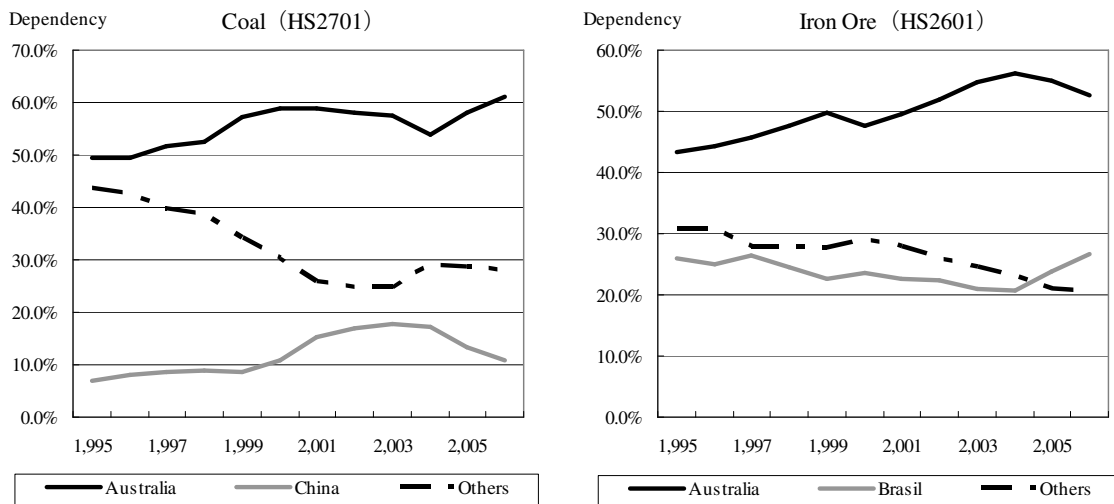
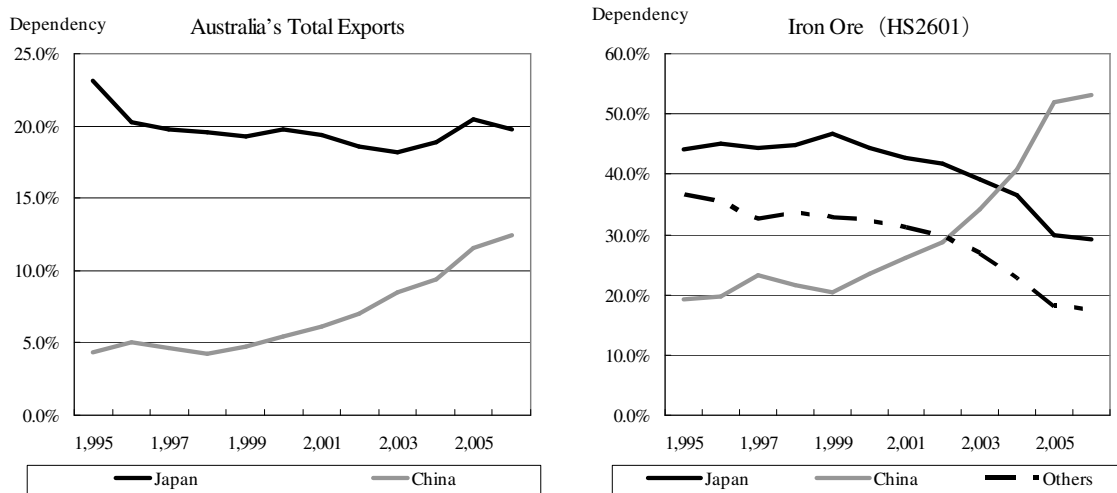


FIGURE 4: Australia's Export Dependency on Japan and China (2006)



Source: World trade Atlas

As is clear from the statistics, Japan relies heavily on Australia for various natural resources that are vital to the economic activities of Japan's corporations. In terms of benefits of an FTA/EPA, there is a tendency to focus on benefits that are derived from removing trade barriers on the side of the importing country; however, in recent years, countries have been trying to pursue policy objectives related to energy security through FTAs. An example of this is the North America Free Trade

Agreement (NAFTA). Article 605 of NAFTA: (Other Export Measures), provides rules for the Parties who wish to impose restrictions on the exports of energy and petrochemical goods. Under the GATT/WTO regime, as a general rule, the provisions prohibit quantitative restrictions on imports or exports; however, under Article XI:2 and XX (g) of the GATT, the application of restrictions on exports of limited natural resources is treated as an exceptional case. However, in NAFTA Article 605, in the case whereby Parties restrict exports of energy and petrochemical goods, Parties must ensure that: the restriction does not reduce the proportion of the total export shipments of the specific energy or basic petrochemical good made available to that other Party relative to the total supply of that good of the Party maintaining the restriction as compared to the proportion prevailing in the most recent 36-month period; the Party does not impose a higher price for exports of an energy or basic petrochemical good to that other Party than the price charged for such good when consumed domestically; and the restriction does not require the disruption of normal channels of supply to that other Party or normal proportions among specific energy or basic petrochemical goods supplied to that other Party.⁵

In the sense that this rule puts restrictions on the exceptional case rule under the GATT, it could be regarded as a WTO-plus rule. In the process of negotiating an EPA with Australia, a natural resources major, Japan should be creative in its approach, by introducing, for example, a similar rule to the one abovementioned for not only the energy sector, but also for food security. Furthermore, Japan should not simply adopt the same rule from the NAFTA, but it should also consider, for example, a system that would promote direct investment or technological licensing in Australia, in the area of agriculture, and enable Japanese proactive agricultural management entities to utilize Australian farm land. This could further contribute to stably supply Japan with a safe food from Australia and to create an additional business chance for Japanese business sector to promote Japan's high-value added foods (e.g., fruits) in the Australian market.⁶

4 Overview of Australia's FTAs

In the past, Australia, like Japan, developed a trade policy centring on the WTO. Australia was in fact rather cold to the idea of negotiating and concluding bilateral FTAs; with one exception, the FTA it concluded with its neighbour New Zealand. However, in recent years, Australia has changed its policy, and has already concluded FTAs with Singapore (in force in January 2001), the United States (in force in January 2005), and Thailand (in force in April 2005). Also, it is currently

⁵ However, this rule only applies between the US and Canada. The North American Free Trade Agreement, Chapter Six: Energy and Basic Petrochemicals, Annex 605.

⁶ In recent years, NZ kiwifruit producer Zespri outsourced its Zespri Gold kiwifruit production for the Japanese market to farmers in Aichi and Saga Prefectures, enabling farmers in both countries to reap benefits by using the opposite seasons to their advantage. Something similar, a new business model, could be realised between Australia and Japan.

negotiating FTAs with China (agreement to commence negotiations reached in April 2005), which is increasing its imports of natural resources from Australia; ASEAN (agreement to commence negotiation reached in November 2004); Malaysia (agreement to commence negotiations reached in April 2005); and Chile (agreement to commence negotiations reached in December 2006).⁷ A characteristic of Australia's FTAs is the high level of liberalisation. For example, in the Australia-United States FTA (AUSFTA), Australia committed to immediate tariff elimination for all of its agricultural products, and tariff elimination for all of its manufactured goods by 2015. The United States committed to eliminating tariffs from all of its manufactured goods by 2015, and from all of its agricultural products, with the exception of dairy products, sugar and sugar-products, by 2015.⁸

With regard to the investment sector, both sides give the other national treatment for investment purposes, which includes their respective manufacturing industries. Regarding government procurement, Australia, as a general rule, extends national treatment to US companies. (Currently, Australia is one of the developed countries that have not become a signatory to the WTO Government Procurement Agreement)

Under the ANZCERTA (Australia New Zealand Closer Economic Relations Trade Agreement), for example, Australia has already eliminated tariffs from 99% of its imports from New Zealand.⁹ In addition, it has achieved a high level of liberalisation, such as it does not apply anti-dumping duty or safeguards inside the region, and it extends national treatment to NZ for the purpose of government procurement. Under the Singapore-Australia FTA (SAFTA), both countries eliminated tariffs from all products immediately upon the FTA entering into force. Regarding export subsidies and safeguards, Australia committed to no application within the region. Regarding services trade, the highly predictable negative list approach has almost always been adopted.¹⁰ In its FTA with Thailand (TAFTA), Australia has committed to the elimination of tariffs from all products by 2015.

As presented, US and other foreign manufacturing firms, which are in competition with Japanese firms, already obtain preferential access to the Australian market with regard to trade in goods, investment and government procurement. Furthermore, if a Japan-Australia EPA is not concluded, or if the level of liberalisation under a Japan-Australia EPA is insufficient on both sides, Japanese-owned corporations will continue to face cost disadvantage following the conclusion of an EPA. In other words, Japan must inevitably achieve equal or greater liberalisation than that already

⁷ Department of Foreign Affairs and Trade (DFAT) "Australia's Trade Policy" at <http://www.dfat.gov.au/trade/> (as of April 16, 2007)

⁸ For a description of the AUSFTA, see DFAT "Australia-United States Free Trade Agreement: Guide to the Agreement" at http://www.dfat.gov.au/trade/negotiations/us_fta/guide/index.html

⁹ WTO (2007) *Trade Policy Review: Australia, Report by the Secretariat*, World Trade Organization.

¹⁰ The approach is such that sectors which have not been listed as ones for exemption from liberalisation are all liberalised.

achieved by third countries in their FTAs with Australia if it is to gain substantial benefits from an EPA with Australia.

5 Ceasing Importation from Australia and its Effect on the Japanese Economy

In this chapter and the following chapter, we will examine the scenario whereby Japan ceases importation from Australia, and the scenario whereby Japan and Australia achieve bilateral trade liberalisation, and we examine the effects of these scenarios on the Japanese economy. Before we look at our simulation results, we review the importance of the two-way trading partnership between Japan and Australia.¹¹

Japan is the Australia's largest export market. Australia's exports to Japan in 2005 were worth two trillion seven hundred billion yen. Meanwhile, Australia is Japan's twelfth largest export market. Japan's exports to Australia in 2005 were worth one trillion four hundred billion yen. In particular, Australia is Japan's second largest export market for vehicles and vehicle parts. With regard to imports, Australia is Japan's fifth largest source of imports. Natural resources from Australia play an important role in powering the Japanese economy. Japan and Australia have complimentary trade structures; Japan exports manufacturing goods to Australia, and Australia exports natural resources and food to Japan. Therefore, if Japan were to cease importation from Australia, an important trading partner, what would the affect be on the Japanese economy?

To compute the impact on macroeconomic indicators and the impact on production in various industries, we used the Computable General Equilibrium (CGE) model. The advantages of using the CGE model are that it is possible to analyse primary factors of production (such as labour and capital); analyse, through intermediate goods, the level of interdependency between industries; and analyse income and expenditure, price change and substitutability. The CGE model and database used for this paper were developed under the Global Trade Analysis Project (GTAP), by a global network of researches and policy makers, coordinated by the Center for Global Trade Analysis, Purdue University. Details about this multi-region, multi-sector GTAP model¹² and the GTAP 6 Data Base¹³, covering 87 regions (countries) and 57 industries based on the base period, 2001, have been made widely available on the Internet. The Center for Global Trade Analysis also provides the software necessary to conduct simulations.¹⁴

¹¹ Joint Study for Enhancing Economic Relations between Japan and Australia, including the Feasibility or Pros and Cons of a Free Trade Agreement. Final Report.

¹² Hertel, T.W., editor (1997). *Global Trade Analysis: Modelling and Applications*. Cambridge University press, New York

¹³ Dimaranan, B.V. and McDougall, R.A., editors (2006). *Global trade, Assistance, and production: The GTAP 6 Data Base*. Center for Global Trade Analysis, West Lafayette, Purdue University.

¹⁴ Visit the GTAP homepage (www.gtap.agecon.purdue.edu) for more information

We next examine the outcomes of the simulation, based on the scenario whereby Japan ceases importation from Australia. From **TABLE 2**, which shows the effects on Japan's macroeconomic indicators, whether it be in the short term or in the long term, there is a noticeable negative impact on GDP, investment, exports and imports. The difference in the impact over the short term and the long term lies with whether or not adjustments in capital stock due to Japan ceasing importation are considered. The outcome of Japan ceasing importation from Australia is a decline in GDP of Y668.6 billion over the long term, and a decline of Y451.6 billion over the short term. It should be noted here that the extent of the decline in GDP is also dependent upon whether or not substitution of imported goods with domestically produced goods is possible.

TABLE 2: The Impact from Ceasing Importation from Australia (Y100 million)

	Short term	Long term
GDP	-4,516	-6,686
Investments	-1,916	-1,475
Exports	-799	-2,156
Imports	-2,031	-1,746

(Source: author's calculation using GTAP Data Base 6)

TABLE 3: The Impact on Production Value by Industry Sector (Y100 million)

	Varibale =			Variable=		
	Long term	- Short term		Long term	- Short term	
Rice	-12	351	363	-387	-566	-179
Wheat	-1	65	65	-361	169	530
Grains	0	16	16	-477	-578	-101
Other Agr.	-20	359	379	-614	-532	82
Beef	-11	927	938	-544	-453	91
Dairy	-8	274	282	-308	-13	295
Sugar	-5	333	338	-1,520	-3,948	-2,428
Other Foooc	-83	145	228	-219	-19	200
Mineral	-151	1,045	1,196			

(Source: author's calculation using GTAP Data Base 6)

For example, in the case whereby it is more difficult to substitute goods imported from Australia with goods produced domestically, the decline in GDP would increase. The negative effect on investments and imports would be greater over the short term, with each dropping by Y191.6 billion and Y203.1 billion respectively. Regarding exports, the negative impact would be great over the long

term, reflecting a decline in production due to a decrease in capital stock, with the drop reaching Y215.6 billion. **TABLE 3** shows the effect on production value by industry. It shows that in the case whereby Japan ceased importation from Australia, production by Japanese industries in competition with Australian imports would increase over the short term; however, it can be seen from the variable that the extent of the increase would decline over the long term. Production in Japan of natural resources such as minerals and metals, and agricultural goods such as beef, increases as a result of increased demand for Japanese goods, because Japan ceases importation from Australia; however, if Japan ceases importation from Australia for a long period, the extent of the increase in production, declines. The variables showed that in all industries, over the short term and over the long term, there was a negative effect on production in the various industries. In particular, the negative effect on services and manufacturing sector over the long term is conspicuous.

6 Impacts of Concluding a Japan-Australia EPA

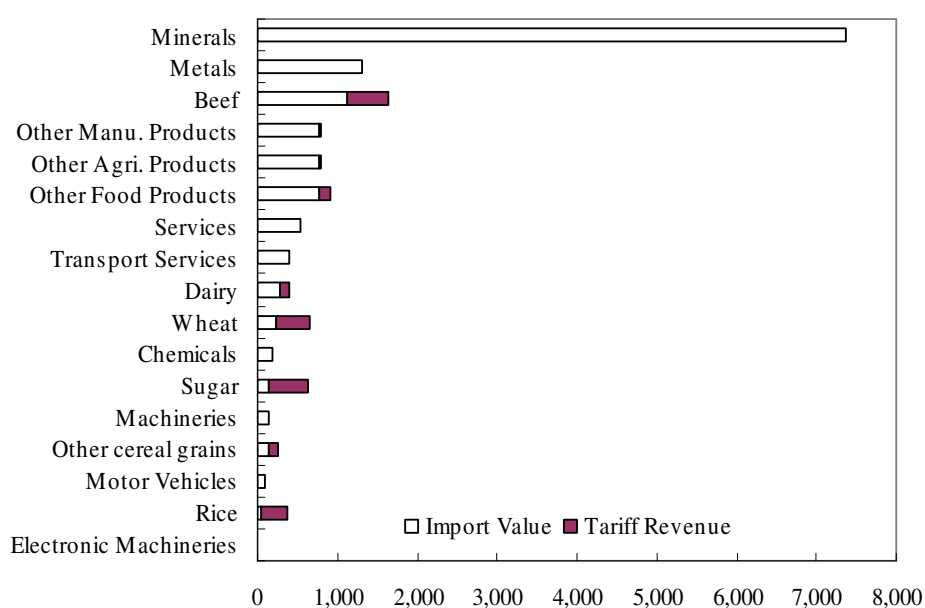
Using the GTAP Data Base and the model, we now simulate trade liberalisation based on the scenario whereby tariffs and export subsidies were completely eliminated between Japan and Australia. An EPA, in reality, would not stop at trade liberalisation; it would cover liberalisation and facilitation that extended to services, investment, government procurements, and others. Therefore, at this point it is important to note that our simulation results might be underestimates. **FIGURE 5** shows the level of the tariffs on products that would be within the scope of liberalisation, together with Japan's imports from Australia. The figure shows that Japan imports a lot of natural resources including minerals and metals from Australia, followed by beef and manufactured products. The tariff rates on imports of rice, sugar, wheat and beef are considerably high. Therefore, it is anticipated that the effect of eliminating tariffs would be greater, the higher the tariff is for a particular industry product.

From the simulation of trade liberalisation between Japan and Australia, we obtained positive effects on the GDP of the two countries, as shown in **TABLE 4**. Japan's GDP would increase by approximately two trillion yen as a result of trade liberalisation. It is expected that Australia would see an increase in its GDP of Y780.0 billion. This is an increase in GDP of \$16.2 billion for Japan and \$6.5 billion for Australia, using an exchange rate of \$1 = 120 yen. The increase in GDP in terms of % variable would correspond to 0.4% for Japan, and 1.8% for Australia. We anticipate a positive effect on trade and investment through trade liberalisation between Japan and Australia.¹⁵ The Japanese exports by individual industry which showed conspicuous increases were vehicles,

¹⁵ The affect on Japanese investment was miniscule.

machines and electronic equipment. Meanwhile, there was a large increase in imports of rice, sugar, beef, wheat and dairy products by Japan. The increase in imports of agricultural goods had a negative effect on Japanese domestic production; however, the effect of trade liberalisation on the economy as a whole was positive. In the following chapter, we discuss that it is important to give consideration to specific industries, and that it is important to take a whole-of-economy view, by, for example, examining those industries from the perspective of the impact on repercussions between industries and increases in consumption.

FIGURE 5: Imports from Australia by Industry and Tariffs (\$million)



(Source: author's calculation using GTAP Data Base 6)

TABLE 4: The Effect of Trade Liberalisation between Japan and Australia

	Japan	Australia
GDP	JPN 1.94 trillion	JPN 0.780 trillion
	\$16.2 billion	\$ 6.5 billion
	0.4%	1.8%
Exports	3.2%	3.1%
Imports	2.7%	9.4%
Investments	0.0%	4.7%

(Source: author's calculation)

7 The Effects of Japan-Australia EPA on Japan's Agricultural Sector

The Ministry of Agriculture, Forestry and Fisheries (MAFF), and the Hokkaido Government have released study reports in which they claim that a Japan-Australia EPA would have a considerable adverse effect on Japan's agricultural industry. In response, the mass media have widely reported concerns about, and activities in protest of, a Japan-Australia EPA. Firstly, we review the effect of a Japan-Australia EPA as analysed and announced by MAFF and the Hokkaido Government; we examine the protective measures currently in place for Japanese beef, wheat, dairy products, and sugar, which are seen to be the products that would be most affected by the conclusion of the EPA; and finally we examine the effect of eliminating tariffs from goods in the relevant four areas under a Japan-Australia EPA, and we propose some policy measures in response.

Review of Existing Research on a Japan-Australia EPA

Analysis by the Ministry of Agriculture, Forestry and Fisheries (MAFF)¹⁶

MAFF has released data, in which it claims that there would be a decline in production of Y790 billion in the case whereby tariffs were eliminated under a Japan-Australia EPA. The target region of the analysis was the whole of Japan. The target goods were: beef (production down by Y250 billion, excluding marbled beef); dairy products (production down by Y290 billion, excluding products for drinking); wheat (production down by Y120 billion); and sugar (production down by Y130 billion). The method of analysis employed was a simple aggregate of domestic production of the four products.

When reading these results, the following points should be considered. Firstly, the above is not an analysis of the impact of a reduction in import prices from the elimination of tariffs on the whole of the domestic Japanese economy. It is a simple aggregate of current domestic production of the products that are only partially in competition with key Australian agricultural products. In other words, the analysis assumes that there is perfect substitutability between imports and domestic products. It makes extreme assumptions, suggesting that if tariffs are eliminated, relevant domestic products would completely be destroyed. It implicitly assumes that after the importation of Australian beef and cheese becomes completely liberalised, Japanese consumers do not buy any Japanese produced beef or cheese whatsoever. Furthermore, it is important to note that MAFF's figures show the "sum of production", including production costs, not the value added or producers'

¹⁶ International Div., Ministry of Agriculture, Forestry and Fisheries (MAFF) 2007 "Japan-Australia EPA/FTA Negotiations" at http://www.maff.go.jp/sogo_shokuryo/fta_kanren/au_epa/fta.html

surplus in the context of partial equilibrium analysis.

Secondly, the analysis does not mention anywhere the increase in consumers' surplus due to the trade liberalisation. Consumers or user industries, such as the flour industry, which uses wheat as a raw ingredient; industries that produce breads, confectionaries and udon noodles; and the food-service industry can enjoy imported products with lower prices under the free trade. Currently, consumers pay enormous protection costs because of tariffs and other trade barriers. These additional costs are equivalent to the sum of increase in domestic producers' surplus; tariff revenue that will be used towards the society as a whole or for specific industries; and deadweight loss that goes into no one's pockets because of declines in efficiency. Liberalising trade means that while domestic producers would meet tougher competition with foreign imports; it would lead to a recovery in the efficiency in a country. As long as there are no severe market failures, the increase in consumers' surplus due to trade liberalisation will always exceed the loss in producers' surplus. The analysis conducted by MAFF focuses on only one aspect of the effect of trade liberalisation.

Analysis by the Hokkaido Government¹⁷

The Hokkaido Government also published the results of its analysis on the effect of a Japan-Australia EPA. It claimed that the decline in production in Hokkaido as a result of the elimination of tariffs from the conclusion of a Japan-Australia EPA would be minus Y1 trillion 371.6 billion (Y825.6 billion on an added value basis, equivalent to 4.2% of Hokkaido's GDP). The target region was Hokkaido. However, by adopting a different assumption/methodology, the Hokkaido Government claimed that the effect would be greater than the adverse effect, at the country level, claimed by MAFF in its analysis. The additional assumption adopted by Hokkaido Government includes that Japan will eliminate tariffs not only against Australia, but also against the US and Canada. They assume that Japan will be forced to liberalise its market through Japan-US and Japan-Canada EPA due to political pressures from these two countries after the conclusion of Japan-Australia EPA. The products it claimed would be affected were the same four products identified by MAFF, which were Hokkaido beef (Y42.2 billion, excluding marbled beef), dairy (Y236.9 billion excluding products for drinking), wheat (loss of Y85.2 billion yen), and sugar (Y81.3 billion). In addition, it claimed that agriculture-related manufacturing industries would also suffer losses: livestock farms (Y3.4 billion), dairy farms (Y317.6 billion), flour mills (Y17.9 billion), and sugar beet factories (Y102.5 billion). Furthermore, it added these figures to the amount of production decline figure ("A Y484.6 billion impact on the whole regional economy"), which is calculated by using input-output table.

¹⁷ Agricultural Div., Hokkaido Government (2006) "The Affects on Japan of a Japan-Australia EPA" at <http://www.pref.hokkaido.lg.jp/nsi/nouseihp/EPA%E4%BA%A4%E6%B8%89>.

With regard to the analysis undertaken by the Hokkaido Government, there are a number of points that should be noted when interpreting the results. Firstly, with regard to “A Y484.6 billion impact on the whole regional economy regarding the four products that will be directly affected”, the same points that were mentioned in this paper with regard to the analysis conducted by MAFF should be noted. Secondly, with regard to the adverse impact (Y441.4 billion) on manufacturing industries related to the four agricultural products (livestock farms, dairy farms, flour mills, and sugar beet factories), the analysis does not consider, at all, the possibility of flour millers using cheaply priced Australian wheat in making their flour, or bakers making their bread with cheaply priced Australian flour. In other words, the analysis assumes that flour could be made from Hokkaido wheat, but that there would be a huge impact on the flour mills because they could not use imported wheat as an alternative, meaning it assumes elasticity of substitution is zero between domestic wheat and imported wheat. It therefore can be concluded that there is no consistency with the first half of the analysis. Finally, it showed the effect on the entire regional economy using input-output analysis; however, because of the above mentioned reason, the exogenous shock (impact) on the related industries was overstated. Furthermore, it is worth noting that in standard input-output analysis, there are situations where it is not appropriate to analyse the effect of trade liberalisation on the whole of the economy, because the input coefficients (percentage for each intermediate good, which is required for the production of a particular final goods), are only dependant on technology and are fixed.

Current Status of Protectionist Measures for Beef, Dairy Products, Wheat and Sugar

As noted in the previous paragraphs, MAFF and the Hokkaido Government have reached conclusions that four products will be destroyed because of tariff elimination. However, the four products are currently protected by numerous measures in addition to tariffs. There are many measures in place that would limit the effect of an EPA on producers, even if tariffs were eliminated. The following is a close-up of the protectionist measures currently in place for the four products.

Beef

The current tariff on beef is 38.5%. In response to liberalisation of beef imports in 1991, and subsequent reductions in tariffs, beef tariff revenue is used annually for the action plan for veal, based on the “The Law for Special Measures Concerning the Stabilization of Veal Calf Production”.¹⁸ The costs for the action plan for veal are budgeted on the revenue from beef imports

¹⁸ MAFF “Action Plan for Veal Meat” at <http://www.maff.go.jp/lin/pdf/calfmeat.pdf>. Activities and budget can be seen on the Agriculture and Livestock Industries Corporation homepage.

anticipated for a particular year. The money is spent, through the government and the Agriculture and Livestock Industries Corporation, on various subsidies and projects. The costs for measures in 2005 were Y109.3 billion (tariff revenue actual were Y84.7 billion), and in 2006 the costs for measures were Y87.0 billion (tariff revenue budget was Y98.0 billion). Because of such measures, producers are receiving subsidies and income compensation, and there is price intervention occurring, such as buying up products and intervention in the selling price, so that the wholesale price remains between a certain price range, and the wholesale price of beef can be kept stable. Compared with the production amount Y250.0 billion (the amount of damage) of domestic beef, excluding superior quality beef, which MAFF showed in its analysis, it is easy to see just how large the Y100.0 billion budget is.

Needless to say, 38.5% tariff on beef is imposed to import price. What declines when the 38.5% tariff levy would be eliminated is also the import price, and it does not mean that the “retail price” of Australian beef would drop by 38.5%. If we assume that perfect competition is achieved, then hypothetically even if the importers, wholesalers and retailers returned all of the profit from reduced tariffs to the consumers, the portion of reduced tariff in the retail price would be less than 38.5%. And if hypothetically complete competition could not be achieved, the effect on the retail price would be even more limited.

Dairy Products

As prescribed in the Provisional Measures Law for Processed Raw Milk Producer Subsidies, certain dairy products are subject to State Trading. As an international commitment resulting from the Uruguay Round, Japan is required to allow minimum access regarding the importation of some dairy products including butter and powdered skim milk. In order for Japan to fulfil its commitment, the Agriculture and Livestock Industries Corporation, in its capacity as a state trade enterprise, became the unified current access importer of specified dairy products. Every year, the Corporation decides how much of a certain dairy product will be imported and when, while taking into account factors such as the domestic demand for a specific dairy product and the price trends.¹⁹ Regarding the out-of-quota tariff rate, the Corporation first buys up the relevant dairy product from the importer, and then re-sells it with a mark-up, the amount of which is decided by the Minister for Agriculture, Forestry and Fisheries.

For example, let us look at the case of low-fat butter (HS040510110-129) with tariff quota. The in-quota tariff rate applied to the current access import portion is 35%. As for the out-of-quota tariff rate, it is applied at 29.8%+179 yen/kg, with a maximum mark-up of 806 yen/kg. In addition, dairy

¹⁹ Agriculture and Livestock Industries Corporation “Importation of Designated Dairy Products” at <http://alic.lin.go.jp/dairy/import.htm>

products are in the scope of the special safeguard under the WTO Agriculture Agreement. So in the case that the import volume and import price exceed a certain threshold, it is possible to automatically increase the tariff on that particular item. Moreover, as long as the premise that state trading product and the mark-up system remains, the effect on the domestic price of dairy products would be limited if only the tariffs were eliminated.

Wheat

The system of tariff quotas exists also in the case of wheat. Wheat is subject to state trading as prescribed in laws regarding demand for staple foods and price stability. The low in-quota tariff rate is duty free; however, the government centrally manages the import of wheat and like in the case of dairy products, the government adds a mark-up to the cheaply purchased wheat it buys up, and sells it to flour mills. (The Nippon Keidanren has pointed out that as a result, domestic wheat products are at a competitive disadvantage).²⁰ The high out-of-quota tariff rate is low at 9.8 yen. However, importers must pay 45.2 yen/kg in addition to the tariff. Furthermore, wheat and sugar beet (a raw material for making sugar) are in the scope of the Sector-Wide Farm Income Stabilization Program in Japan, so farmers with “motivation and ability” who meet specified criteria are compensated for the sales revenue and production cost difference, which arises because of a difference in production conditions compared with the products produced overseas (Countermeasure to Compensate for Production Conditions which are Disadvantaging). And they are eligible to receive compensation of up to 90% of lost income if income for a particular year drops beneath average income (Countermeasure to Ease the Effect of Reduced Income). In addition, farmers may also be eligible for preferential treatment regarding loan conditions and tax (they are planned to come into force in 2007). The 2007 budget for the Sector-Wide Farm Income Stabilization Program in Japan is Y170.0 billion (including for rice, soybean and potatoes).²¹ Therefore, as long as the premise of maintaining the state trading, the payment system, and the various subsidies remains, the effect on the domestic price of wheat would be limited with only the elimination of tariffs.

Sugar

Some types of sugars are subject to *de facto* state trading as prescribed in laws regarding price adjustments for sugars and starches. The Agriculture and Livestock Industries Corporation buys up sugar at the price set by the Minister for Agriculture, Forestry and Fisheries, and then re-sells it with

²⁰ Nippon Keidanren “2006 Nippon Keidanren Regulatory Reform Wish list –Towards a Competitive and Vital Economy and Society—Wish List for Each Area” at <http://www.keidanren.or.jp/japanese/policy/2006/038/14.pdf>

²¹ MAFF “Outline of the 2007 MAFF Budget” at <http://www.maff.go.jp/soshiki/kambou/kessan/h19/kettei/3-1.pdf>

a mark-up.²² For example, with regard to sugar beet, the tariff is 21.5 yen/kg, depending on the type, and then it is marked-up, so that together with the producer subsidies, the effect is such that the domestic price of sugar and the import price of sugar become level. It has been pointed out that because of this practice, the confectionary industry is forced to purchase raw ingredients at high prices.²³

7.3 Dealing with an Increase in Australian Agricultural Products

As shown, wheat, sugar and dairy products are state trading products, so, there are price intervention systems and other subsidy systems for producers to ensure that prices do not drop because of imports, in the case that only tariffs were eliminated. Even if tariffs were to be eliminated from Agricultural products imported from Australia, it is difficult to assert that producers would be dealt a “destructive” blow, as MAFF and the Hokkaido Government fear. From the perspective of protecting consumer interests, or from the perspective of heightening social welfare in Japan as a whole, there would naturally be calls for the protectionist measures, in addition to tariffs, to be reviewed. It should also be noted here that the GATT Article XXIV, 8 (b) states that upon conclusion of an FTA, not only should tariffs be eliminated from “substantially all the trade”, but also “tariffs and other restrictive regulations”.²⁴ However, the extent to which these issues will be addressed in Japan-Australia EPA negotiations is not currently known.

Certainly, as for some raw materials such as sugar beet that are relatively difficult for domestic farmers to differentiate their products from imported products, it can be anticipated that there will be cases whereby domestic farmers are hit hard because of increase in imports after the conclusion of the EPA. Therefore, it might be necessary to find a way to minimize adjustment costs while exploring the possibility of creating a system to enable inter-sectoral adjustment. For example, in the United States, beef, sugar and dairy products are extremely politically sensitive items. Under the AUSFTA, sugar and dairy products were removed from the scope of products for tariff elimination. The two sides decided to eliminate the low in-quota tariff for dairy products, and increase the quota for Australia. However, for other dairy products, it was agreed that tariffs would be eliminated for all of the products over a maximum transition period of 18 years. Regarding beef, it was agreed that for the transition period only, a special safeguard, for which the necessary conditions to invoke it are less strict, could be invoked. Ultimately, however, beef will be liberalised in the United States.

²² Agriculture and Livestock Industries Corporation “Sugar-related businesses” at <http://alic.lin.go.jp/about/sugar/html>

²³ Nippon Keidanren wish list (footnote 18)

²⁴ Kuno, Arata and Fukunari Kimura. 2007 “How Far do Japan’s Economic Partnership Agreements (EPAs) liberalize trade? - Measurement Issues and Evaluation by industry.” (in Japanese) KUMQRP DISCUSSION PAPER SERIES, DP2007-002, Keio University.

In the case of a Japan-Australia EPA also, there might be calls for a transition period to provide domestic industries with time for adjustment, and a change in policy from border measures to a direct payments to producers. Also, by including flexible rules such as applying tariffs to products only during the Japanese harvesting period, and outside that period effectively make use of the opposite seasons between Australia and Japan, it would be possible to gain benefits from trade liberalisation and at the same time give due consideration to the domestic farmers. However, it must be emphasised here that Japan and Australia are both developed countries, and that in the case whereby liberalisation on the Japan side appears insufficient, obtaining market access commitment from the other country in exchange for various types of economic cooperation from Japan would not be successful. Therefore, there would be calls for a high level of trade liberalisation in a Japan-Australia EPA that exceeds the level of liberalisation in EPAs which Japan has so far concluded.²⁵ This means that Japan must accelerate domestic agricultural reform to be at the same pace as international trade policy.

As we reviewed in this paper, there is no doubt that Australia's rank as a strategic partner for Japan will rise in the foreseeable future. In particular, in the area of natural resources and food, it is desirable that through an EPA, Japan actively promotes direct investment in Australia in these areas and implements rules related to the restriction of exports, also from the perspective of security, so that it can be prepared for foreseeable increases in Chinese and Indian demand for natural resources and food in particular.

²⁵ Refer to Kuno and Kimura (2007)

Table 5: Aggregation of Countries/Regions in GTAP Data Base

	Country (Region)	GTAP Data (87 countries, regions)
1	Japan	Japan
2	Australia	Australia
3	China	China, Hong Kong
4	Korea	Korea
5	ASEAN	Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam
6	NAFTA	Canada, United States, Mexico
7	EU	Austria, Belgium, Denmark, Finland, France, Germany, United Kingdom, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden
8	ROW	New Zealand, Rest of Oceania, Taiwan, Rest of East Asia, Rest of Southeast Asia, Bangladesh, India, Sri Lanka, Rest of South Asia, Rest of North America, Colombia, Peru, Venezuela, Rest of Andean Pact, Argentina, Brazil, Chile, Uruguay, Rest of South America, Central America, Rest of FTAA, Rest of the Caribbean, Switzerland, Rest of EFTA, Rest of Europe, Albania, Bulgaria, Croatia, Cyprus, Czech Republic, Hungary, Malta, Poland, Romania, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Russian Federation, Rest of Former Soviet Union, Turkey, Rest of Middle East, Morocco, Tunisia, Rest of North Africa, Botswana, South Africa, Rest of South African CU, Malawi, Mozambique, Tanzania, Zambia, Zimbabwe, Rest of SADC, Madagascar, Uganda, Rest of Sub-Saharan Africa

(Source: GTAP Data Base ver.6)

Table 6: Aggregation of Sectors in GTAP Data Base

Sectors		GTAP Data (57 Sectors)
1	Rice	Paddy rice, processed rice
2	Wheat	Wheat
3	Other grains	Cereal grains nec
4	Other agricultural	Vegetables, fruit, nuts, oil seeds, plant-based fibers, crops nec, Wool, silk-worm cocoons, forestry, fishing
5	Beef	Cattle, sheep, goats, horses, meat: cattle, sheep, goats, horse
6	Dairy	Raw milk, dairy products
7	Sugar	Sugar cane, sugar beet, sugar
8	Other foods	Animal products nec, meat products nec, vegetable oils and fats, Food products nec, beverages and tobacco products
9	Minerals	Coal, oil, gas, minerals nec, petroleum, coal products, mineral products
10	Chemicals	Chemical, rubber, plastic prods
11	Metals	Ferrous metals, metals nec, metal products
12	Motor vehicles	Motor vehicles and parts, Transport equipment nec
13	Electronic machineries	Electronic equipment
14	Machineries	Machinery and equipment nec
15	Other products	manu.Textiles, wearing apparel, leather products, wood products, paper products, publishing, manufactures nec
16	Services	Electricity, gas manufacture, distribution, water, construction, Trade, communication, financial services nec, insurance, Business services nec, recreation and other services, Public administration, defence, education, health
17	Transport serv.	Transport nec, sea transport, air transport

(Source: GTAP Data Base ver.6)