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# PAFTA: An Australian Assessment

by Prof Dr H. W. Arndt, Canberra

The past decade has witnessed a remarkable expansion of trade between Australia and Japan. Japan has replaced Britain as Australia's main export market. Australia has risen to second place among suppliers of Japanese imports and to third place as a market for Japanese exports. Australia welcomes participation of Japanese capital in the development of its vast new mineral discoveries and in some of its manufacturing industries. There is willing, if as yet modest, co-operation between the two countries in aid and technical assistance to the developing countries of South-East Asia. But Australian reaction to Japanese ideas about a Pacific-Asian Free Trade Area is cool, to put it mildly. Most official and unofficial opinion dismisses such plans as, for any foreseeable future, quite unrealistic.

## Australian-Japanese Trade Partnership

Between 1954 and 1966, Japan's share in Australian exports rose from 7 to 19 per cent, while Britain's share declined from 36 to 14 per cent. During the same period, Japan's share in Australian imports rose from 1 to 10 per cent, while Britain's share fell from 49 to 26 per cent.

To a large extent the change reflects the increasing complementarity of the Japanese and Australian economies and the much faster rate of economic growth in Japan, than in Britain. Japan and Australia, it has been said, are natural trade partners [3]. Australia specialises in export of the primary products — foodstuffs, such as meat and dairy products, and raw materials, such as wool and minerals — which Japan needs in ever increasing volume. Conversely, Australia's imports consist largely of capital equipment and other products of heavy industries which increasingly predominate among Japan's exports. More than two-thirds of the shift in the direction of Australian exports from Britain to Japan are accounted for by the fact that Japanese import demand for Australia's main export products has grown so much faster than British import demand for the same products [2].

Trade policy, however, has contributed to the development of the trade partnership [1]. During the 1930s Japanese-Australian trade had been deliberately curtailed in the interest of the British and Australian textile industries; and of course it ceased altogether during World War II. For some years after the war, Australia continued to discriminate against Japan.

The new era began with the trade agreement of 1957. Under this, Australia accorded Japan most-favoured-nation treatment, with consequent reduction in tariffs on textiles and other consumer goods, and non-discriminatory treatment in import licensing. In return, Japan granted freer access to its market to several of Australia's most important agricultural products and undertook not to impose a duty on wool. In 1963, the agreement was further extended. Australia agreed to relinquish the right to impose emergency restrictions on imports from Japan under article 35 of GATT, while Japan made further concessions in its import policy towards Australian wool, foodstuffs and motor vehicles. In the last few years, Japanese interests have taken an active part in projects for the development of the huge iron ore deposits of Western Australia and other mineral developments. There has also been some Japanese investment in the Australian motor car and one or two other manufacturing industries, partly under deliberate Australian prodding through tariff policy.

Under the aegis of the trade agreement, much effort on both sides has gone into promoting trade and fostering closer relations. A Japanese-Australian Business Co-operation Committee has held regular meetings, alternately in Australia and Japan, to discuss outstanding problems in trade between the two countries. Ministers, parliamentarians, businessmen, academics, journalists have exchanged visits. Exhibitions, trade journals, special newspaper supplements have displayed each country's products in the other. The initiative has generally come from the Japanese side. But Australian response has been active and warm.

Co-operation between the two countries in aid and technical assistance to South-East Asia is much talked about, though as yet with few concrete results. Both countries have been major partners in the establishment of the Asian Development Bank; both have joined the Development Assistance Committee of the OECD in Paris; both are active in ECAFE, and there is some Australian-Japanese co-operation in efforts, both at the government and the private business level, to assist in the restoration of the Indonesian economy.

But in Australian eyes trade and co-operation with Japan are one thing, a Pacific-Asian Free Trade Area quite another.

### PAFTA Plans

Talk about a Pacific Common Market was first heard, in Australia and Japan, during the 1961-3 attempts of Britain to join the European Common Market. At that time, it did not go much beyond geo-political speculation among journalists prone to see the world splitting up into economic and power "blocs".

In much more sophisticated and professional terms, the idea was revived in 1965 by the Japanese economist, Kiyoshi Kojima, Professor of International Economics at Hitotsubashi University, Tokyo, and well-known in Australia through his visits there and his acute and frank observations on Australian economic and commercial policy [5, 6, 7, 8]. Professor Kojima's plan, first outlined in two papers in 1965, attracted much wider attention and achieved semi-official status when Mr Takeo Miki, former Japanese Minister for Trade and Industry, became Minister for Foreign Affairs in the Sato Government in 1966. In speech after speech, Mr Miki has throughout this year advocated closer co-operation in trade and aid among the advanced countries of the Pacific [10, 11, 12]. While not officially sponsoring a Pacific Free Trade Area at this stage, Mr Miki early this year sent Professor Kojima on a world tour to sound out official and unofficial opinion in the Pacific and South-East Asian countries as well as in Europe [4].

Professor Kojima's plan has two parts. One envisages the formation of a Free Trade Area among the five advanced countries of the Pacific: Japan, the United States, Canada, Australia and New Zealand. The other is a scheme whereby these five are to assist the developing countries of South-East Asia through trade and aid.

The Free Trade Area proposal is simple enough. It consists in "the abolition of inter-area tariffs" (and presumably all other trade restrictions) among the five member countries, no doubt in gradual stages [6, p. 81]. The "trade and aid" scheme would, in the first instance, require the five advanced countries to transfer from one another to South Asian developing countries their imports of competitive agricultural products, such as maize, sugar, tea or cotton, and perhaps of minerals. The advanced countries are also enjoined, though less specifically, to "cast away

their protective policy on light manufacturing industries and to open their doors to the products of developing countries" [5, p. 30].

Professor Kojima has emphasised that his plan is "extremely hypothetical", "a concept requiring and worth sufficient study" [6, p. 78]. He has candidly explained the rationale of the scheme from Japan's point of view. In view of what he regards as the virtual certainty of either a Greater European Common Market or a North Atlantic Free Trade Area, he sees PAFTA as "the second best choice for Japan":

"These several still nebulous plans for regional unification among advanced nations are all plans centering on West Europe, or American plans for a new free trade area looking towards the Atlantic, to counter West Europe; Japan, Australia and New Zealand are treated lightly, merely to the extent that they can participate, if they wish, as fringe countries of a big free trade area, so to speak. We feel deep frustration over this point. Should not Japan prepare and propose a counter-plan, which is closely linked with Japan's interests and in which Japan will play one of the main roles?" [6, p. 79].

Mr Takeo Miki has set the scheme in a wider politico-economic context:

"The Pacific Ocean in the past separated Asia from the American Continents and Oceania, but now it serves as a link between Asian nations and other Pacific nations. Politically and economically, the nations in Asia and nations around the Pacific affect each other. The conflicts in Asia are attributable to poverty and Asia is an easy prey to communism. Therefore, Asia must be developed economically in order to establish peace in the region... Japan, located between the Asian Continent and other Pacific nations, must create a climate of cooperation with Asia among the people in Australia, Canada, the US and New Zealand who are interested in the problems of Asia and do whatever we can to realise a system of co-operation between these nations and Asian countries."

"Japan is planning shortly to initiate intergovernmental consultations with Australia and New Zealand. It is my hope that, provided the other parties agree, the consultations will be elevated to regular foreign minister level talks in the future" [12].



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Ministerial talks were in fact held in Tokyo in April, first with the Australian Minister for External Affairs and later with the New Zealand Minister of Agriculture. Towards the end of the month, at the fifth joint meeting of the Japan-Australia Business Co-operation Committee, observers from the United States, Canada and New Zealand were present for the first time. But the Japanese delegation hastened to reassure the Australians that "it is not our immediate intention to . . . plan to establish a free trade area" [13] and the Australian delegation, for its part, emphasised that "at this stage there should be no moves whatsoever toward establishing any 'free trade' concept between our nations" [13]. The only positive action was the formation among business representatives of the five countries of a "Pacific Economic Co-operation Committee" whose functions would be confined to acting as an information bureau and clearing house and stimulating research and exchange of ideas.

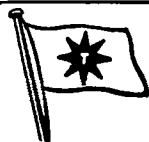
### Economic Effects

Even in Japan, the notion of an unqualified free trade area embracing the United States, as well as Canada, Australia and New Zealand, must seem pretty daring. With all its new industrial strength, Japan can have few industries which would contemplate with complete equanimity free access to the Japanese home market for all American manufactures. Few Japanese producers of meat and dairy products would survive free entry of New Zealand and Australian foodstuffs. On the other hand, as Professor Kojima points out, Japan would have much to gain from free access for its manufactures to the other four markets, and indirectly also from effective large-scale development aid by the Five to South-East Asia with which Japan now has such large export surpluses dependent on aid. While anything like free entry into Japan for the light industrial products of the industries of Korea, Taiwan, Hong Kong and other countries of South-East Asia would put severe pressure on the still substantial labour-intensive sector of the Japanese industrial economy, the proposed switch in competitive food and mineral imports from advanced towards South-East Asian developing countries would leave Japan quite unscathed. (If preference for the agricultural products of South-East Asia were to be carried further, even at the expense of domestic industries in the advanced

countries, Japanese rice and tea producers would be affected.)

For Australia, the effects of the scheme would be much more drastic and far-reaching. Tariff-free access to the manufactures of the United States, Japan and Canada at the present exchange rate would wipe out considerable sections of Australian manufacturing industry. If Australia were expected also to give substantially free entry to light industrial products of South-East Asia, some of the industries able to survive Japanese and American competition would disappear. If the proposal for preferences to South-East Asian competitive rural and mining products were implemented, the Australian sugar industry (for which Japan is now a major market) would be severely hit, and Australian prospects for export of iron ore and other minerals would be dampened. Allowance would also have to be made for the effects on Australia's present export industries of possible retaliatory measures by countries (especially the EEC and EFTA countries) against whom Australia would discriminate under the PAFTA arrangement. Against all these disasters could be set only the prospects for expansion of exports of rural and mining products that would come with free access to the large Japanese and North American markets, and perhaps similar prospects for a few specialised manufacturing industries that could take advantage of the economies of scale offered by the PAFTA market.

This of course is an unrealistic picture in one important respect. Since it seems unlikely that Australian exports would expand as rapidly as Australian imports in response to the abolition of inter-area tariffs, the exchange rate could probably not remain constant: and if balance of payments equilibrium were maintained by appropriate changes in the exchange rate, the resultant devaluation of the currency would restore a measure of protection to domestic import-competing industries. How much protection would depend on the responsiveness of export industries to the double stimulus of devaluation and free access to the markets of the free trade area. The greater the expansion of exports, the less the protection given to, and the greater the contraction of, import-competing manufacturing industries. (For this reason, rather paradoxically, the free trade area proposal, with its promise



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of greater opportunities for export expansion, presents more of a threat to Australia's protected manufacturing industries than a proposal for unilateral abolition of tariffs by Australia.)

It is impossible even to guess what the net effect of all these changes would be. Certainly, all the higher-cost Australian manufacturing industries, those now enjoying more than average effective rates of tariff protection, would disappear as the free trade area gradually took effect. Australian rural and mining industries would receive a great stimulus to which most of them would undoubtedly respond by expanding production, absorbing a great deal of capital but little labour. This would not necessarily mean mass unemployment, as Australian protectionists tend to assume. The labour rendered redundant in manufacturing could no doubt, given time and adequate policies for the maintenance of total effective demand, be absorbed in service industries. There would be a considerable shift in the distribution of income in favour of primary producers. There would probably also be a still further shift in the control of Australian manufacturing industries towards foreign parent companies, since it is their Australian subsidiaries that are most likely to withstand import competition (if only because of the greater scope for the regulation of competition enjoyed by international corporations). There would also be a drastic change in the directions, if not the volume, of inflow of overseas capital, from manufacturing to primary industries. Since there is no reason why full employment should not be maintained even with a contracting manufacturing sector, Australia's capacity to attract immigrants need not be adversely affected, though the average Australian might be hard to convince of this.

This picture is less dismal than the first. But nothing even like this is acceptable in Australia, now or in any foreseeable circumstances. The structural changes involved would be too formidable, even if the transition were spread over a decade or two; and the end product, insofar as its outlines are discernible, would be an economy and society which most Australians, rightly or wrongly, would probably regard as a change for the worse.

The structural changes required would be generally expected to exceed those which the carrot and whip of market forces can accomplish even in conditions of quite rapid and sustained overall economic growth

and with government forethought and help. Whole industries, manufacturing and rural, many of them localised in cities or regions, would disappear, and with them the usefulness of much infrastructure capital. At present one-quarter of Australia's workforce is employed in manufacturing industries; a considerable proportion of this labour—how large a proportion no one can guess—would need to find employment in primary or tertiary industries. No government in a democratic society can adopt a policy which is generally believed (and not necessarily wrongly) to demand change on this scale.

And for what end? Since the creation of so large a free trade area would presumably bring a better international division of labour and more efficient use of resources, the Australia that would ultimately emerge as a partner in an accomplished PAFTA might well enjoy a higher average income per head. But it would be a much less industrialised society, heavily dependent on its rural and mining export industries, and on imports for most of its manufactures, its relatively few major manufacturing industries largely owned and controlled abroad, an economy altogether too reminiscent of Australia's colonial past. For all sorts of non-economic as much as economic reasons, it is not a prospect that is at all likely to appeal to the average Australian.

#### The European Analogy

Why, it may be asked, should Australia have so much more to fear from a Pacific free trade area than did France or the Netherlands in joining the EEC or Denmark or Sweden in joining EFTA?

As Professor Kojima has pointed out, the five countries he envisages as partners in PAFTA, Japan, the USA, Canada, Australia and New Zealand, are not significantly more unlike one another in size, per capita income, stage of economic development or industrial structure than Germany and Luxembourg, on the one hand, or Denmark and the United Kingdom, on the other. As much as one-third of the trade of the five countries is already mutual trade with one another [5].

Yet, there are several reasons why the European analogy does not hold, at least in Australia's case.

In the case of the six partners in EEC, physical contiguity and close economic relations throughout their



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history had ensured that, despite national frontiers and tariffs, their industrial structures had been to a considerable degree complementary and enmeshed even before the establishment of the Common Market. There was therefore in any case less need for major structural change. The risk of serious dislocation was further reduced by the fact that the change was made in a period of exceptionally rapid economic growth and by the intimate ties and arrangements for the regulation of competition between the major industrial concerns of the partner countries.

The Benelux countries, and Denmark and Sweden in EFTA, were all low-tariff countries whose manufacturing industries were for the most part specialised and export-oriented. They had relatively little to fear from intra-regional free trade. Australia's manufacturing industries, like those of the United States, Canada and New Zealand, began as home-market oriented, import-replacing industries under cover of tariff protection.

All these four have been high-tariff countries because of their very wealth in natural resources. The tariffs needed to give adequate protection to their import-replacing manufacturing industries were initially high largely because of high real wages reflecting the high incomes that could be earned in agriculture. Unlike the United States, Australia has only just begun to move out of this phase of industrial development.

Two other factors have probably played some part in holding back the development of specialised export-oriented manufacturing industries in Australia. One has been Australia's distance from the major markets and from the centres of technological advance of the western world. The other has been the relatively small size of Australia's domestic market. Sweden and Switzerland, among others, have shown that a small domestic market is not, in itself, an insurmountable obstacle to the development of efficient and competitive export-oriented manufacturing industries. But the combination of both factors in Australia's case has undoubtedly been a considerable handicap.

#### Conclusions

These various considerations go a long way towards explaining why Australia cannot be expected to take the plunge into PAFTA with the readiness with which

Denmark joined EFTA or the Netherlands the EEC. On the other hand, they should not be interpreted as excuses for Australia's present excessive protectionism or as arguments against gradual further moves towards freer trade between the Pacific countries and co-operation in assisting economic development in South-East Asia.

It is fair to say that most professional economists in Australia are unhappy about the protectionist policies of the present government, in relation both to high-cost manufacturing and to high-cost rural industries (such as a large part of dairy farming) and that this unhappiness is shared by considerable sections of public opinion.

Some, in their impatience for more liberal policies, may be tempted to plump for PAFTA on the argument that only a magnificent project of this sort that can capture the imagination of public and politicians, and enlist political and other emotions, will make any impact on entrenched vested interests. This, after all, they may argue, is what brought the European Common Market into being. Like many supporters of British entry into the EEC, they may believe that industry will never make the effort to maximise efficiency so long as it is molycoddled by tariffs; that only the fresh breeze of import competition will stir it up. Others may pin their faith in planning, a grand vista of controlled optimum allocation of the vast resources of the five countries through intelligent programmed co-operation between their governments and business leaders.

Some in Australia, as in the United States, may be attracted to the idea on purely political grounds—the need to find an economic basis for a political grouping that will keep Japan oriented towards the West and give Australia and New Zealand a greater feeling of security in their part of the world—and may think some economic sacrifice a price worth paying.

A case can be made on one or the other of these lines, but it is most unlikely to persuade the majority of economists, let alone the public and the politicians. Most Australian economists undoubtedly share Professor Kojima's broad objectives of freer trade among the advanced countries of the Pacific and more imaginative co-operation between them in development aid to South-East Asia. But they will prefer a more humdrum approach.



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They would like to see a much more selective policy of industrial protection, the gradual elimination of industries requiring very high effective rates of tariff protection, and the deliberate use of tariff and other policies to encourage a more competitive industrial structure. They welcome the lead given by Australia to other industrial countries in granting preferences to manufacturing exports of developing

countries but would like to see a considerable gradual extension of the present modest scheme. Most of them would support much more vigorous action by Australia, in co-operation with Japan and other advanced countries, to extend to South-East Asia the sort of imaginative development aid suggested by Professor Kojima. But PAFTA? No.

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## SOUTH AFRICAN INTEGRATION

# An Economic Unit of the Future

by Dr H. Cohn, Port Elizabeth

Once more the idea of a common market for Southern Africa is being discussed by economists and politicians throughout the Republic. This is timely because the governments of South Africa, Lesotho, Botswana and Swaziland will discuss revision of the existing customs agreement this year and these discussions may well determine the pattern of relations between the states of Southern Africa. It is not impossible that on account of the outcome of these negotiations further progress towards economic co-operation involving additional countries such as Rhodesia, Angola, Mozambique and Malawi may be made.

The customs agreement concerning the three former British protectorates Basutoland, Bechuanaland and Swaziland was concluded by Britain and South Africa as contracting parties in the year 1910, that means 57 years ago under different conditions to those prevailing today and therefore—of course—under different considerations as well. Yet the agreement has worked and if the question of revision has ever been raised, Britain and South Africa have been always prepared to give it low priority and dispose of it in amicable forms behind closed doors. Meanwhile new conditions have arisen, new personalities have taken over leadership in all countries concerned and—what is the most important change of all—Basutoland, Bechuanaland and Swaziland are not British pro-

tectorates any longer, but the autonomous states Lesotho, Botswana and Swaziland which are trying hard to develop their natural resources and to attract foreign capital. It goes without saying, that a customs agreement concluded in the era of colonialism cannot be applied to the new autonomous states.

#### Many Hurdles have to be Overcome

It is the general belief in Lesotho and Botswana, that the existing agreement inhibits development of these countries in two ways. Firstly, the non-existence of tariff barriers within the territories concerned prevents them from protecting their infant industries in the way it should be, and secondly, the slow growth of customs revenue under the conditions created by the customs agreement is absolutely inadequate. It was originally intended by the Prime Minister Lebua Jonathan of Lesotho, to persuade South Africa to allow his country to set up tariff protection for five or six industries of its own and—as a compensation—he was prepared to impose voluntary restraint on the number of "foreign Bantu" from Basutoland flooding the Republic's labour market at present. It seems that the idea of tariff protection meanwhile has been dropped by the parties concerned, as rail rates to and from Lesotho represent a far more potent influence for or against local industrialisation than the pres-