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FUTURE AUSTRALIA-JAPAN TRADE RELATIONS

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The leitmotif of this paper is the strong, rising and alarming trend of deficits in Australia's balance of payments current account, which makes it overwhelmingly important to increase exports. Market promotion, substantially the existing method, will not do the job in a world with politically set up trade barriers. Multilateral political negotiations about the removal of the trade barriers within the G.A.T.T. system are unlikely to help for Australia's range of exports. Therefore Australia must enter into bilateral negotiations with any likely important customer, the most obvious one being Japan, to lower trade barriers on a bilateral basis, and this under the existing international agreements can be done only under the guise of a partial free trade area.

1. General

It would be worse than futile to consider the trade relations between any two countries in isolation. How the trade between the two countries will develop, what bargains the two countries will be willing to make in the way of trade concessions will depend on:

- (a) the general economic circumstances of both countries; and
- (b) their wider international connections.

It has to be stressed that the general export performance of the Australian economy leaves much to be desired. As Table 1 and Table 2 show, in the post-war period the growth of Australia's exports has lagged behind that of many countries though it has not been so poor as the growth of British exports.

TABLE 1
Index of the Value of Exports^a

	1958	1961	1964	1967
Japan	100	148	246	376
Italy	100	176	239	360
France	100	148	174	214
Germany	100	135	170	224
Australia	100	118	167	180
U.K.	100	111	123	132

^a Source: *Barclays Bank Review*, August 1968. Australian figures added by the author. Australian figures are calculated on a fiscal year basis.

This relative decline of Australia's importance as an exporting country could be viewed as a sign of Australia having become economically more independent or self-sufficient. However, any closer examination would not bear this out. This relative decline of Australian goods in world trade has been accompanied by persistent and rapidly growing deficits in Australia's current account of the balance of payments. These deficits have been covered by foreign capital inflow

TABLE 2

Australian Exports as Percentage of World Exports^{a b}

Year	Percentage	Year	Percentage
1938	2.47	1961	1.99
1948	3.11	1964	2.01
1953	2.67	1967	1.79
1958	1.74		

^a Based on data in the *Year Book of International Trade Statistics* U.N.O. 1964, and *Direction of Trade*, IMF, May 1968.

^b The world totals throughout exclude the exports of the present communist countries.

TABLE 3

Balance of the Current Account of Australia's Balance of Payments^a

Year ended June	\$ million	Year ended June	\$ million
1950	-99	1960	-444
1951	+188	1961	-742
1952	-1,045	1962	+2
1953	+383	1963	-466
1954	-34	1964	-25
1955	-318	1965	-778
1956	-476	1966	-888
1957	+180	1967	-657
1958	-337	1968	-1,058
1959	-369		

^a Sources: The Australian Balance of Payments 1928/9 to 1951/2, *Commonwealth Yearbooks*, Reserve Bank of Australia Statistical Bulletin.

which makes the country more dependent, not less dependent, on policies and trends in foreign countries.

From Table 3 it can be seen that, in the course of the last 19 years, Australia has had a cumulative deficit of \$7,193 million on current account, which has been covered by foreign capital. The Vernon Report contains an estimate that Australia will have an annual deficit in her current account of \$1.2 billion to \$1.7 billion by 1975.¹ The actual growth of the deficit seems to be faster than the prediction. The deficit predicted for 1975 was almost reached in 1968. It is true that, in the seventies, the exports of minerals, and the balance-of-payments savings on oil, will be of some assistance. However, by then, foreign investors will be transferring home especially large profits so there will be some offsets. In any case, the most likely market for the minerals will be Japan. Japan will certainly take substantial imports from Australia, but whether she will take as much as Australia needs to sell will depend on the policies of the two countries.

¹ Report of the Committee of Economic Enquiry (Vernon Report) Government Printer, Canberra, May 1965, Table 15.5.

2. *Post-War Changes in Australia's Geographical Pattern of Trade*

As can be seen from Table 4, in the post-war period Australia's trade connections with the United Kingdom have been dramatically reduced in the relative sense and, it should be added, in the last few years also in the absolute sense. The United Kingdom has fallen from the position of Australia's best export market to the second, and any time now will fall to the third place after Japan and the U.S.A. The U.K. has already been displaced from the position of the dominant supplier of imports to Australia by the U.S.A. These changes have taken place despite continued tariff preferences between Australia and the U.K. The conclusion that the U.K. economic connection has become grossly inadequate for Australia is hence unavoidable. Further, this connection has also developed some features unfavourable to Australia. H. Johnson, viewing Commonwealth preferences as custom duty foregone, estimated that at about 1961 and 1962 Australia annually lost on balance over £stg.9 million per year to the U.K. (more exactly to particular producers in the U.K.)² This loss is probably mainly due to the fact that British preferences for Australian products, having been fixed in 'specific' terms, have been eroded by inflation, whereas Australian preferences for U.K. products, having been fixed in *ad valorem* terms, have been untouched by inflation. In addition, there is the fact that the much-spoken-of duty-free entry for Australian foodstuffs to the U.K. was deprived of its significance when the U.K. granted subsidies to domestic farmers. Subsidies are an alternative to tariffs (indeed one can express the one in terms of the other). The existence of those subsidies is a breach of the spirit, though not of the letter, of the agreements.³

TABLE 4
Australia's Geographical Pattern of Trade Trends^a

	Exports		Imports	
	Average 1931/2-1935/6	Year ended June 1968	Average 1931/2-1935/6	Year ended June 1968
	%	%	%	%
U.K.	50.0	14.0	42.3	21.0
Japan	12.9	21.7	6.2	10.4
E.E.C.	18.0	12.7	7.4	12.5
China Mainland	3.1	4.3	0.6	0.7
New Zealand	3.0	5.0	1.7	1.8
Indonesia	1.2	0.4	6.2	1.7
U.S.A.	2.6	13.9	15.4	28.4
Malaysia (incl. Singapore)	1.0	3.4	0.6	1.1
Canada	1.2	1.8	5.0	4.1
India and Pakistan	0.7	2.4	5.0	1.5
Hong Kong	0.6	1.5	—	—
Papua and New Guinea	0.1	2.6	0.3	0.06

^a Source: Basic data, *Commonwealth Yearbook*, figures for 1968 on the basis of *The Reserve Bank Bulletins*.

² Johnson, Harry, 'The Commonwealth Preferences: A System in Need of Analysis', *The Round Table*, Oct. 1966.

³ At the time this article went to press the U.K. decided to impose tariffs and variable levies on Australian produce.

It is true that, prior to the Ottawa Agreement of 1931, Australia gave tariff preference to the U.K. although the U.K. did not reciprocate. In those days, however, the U.K. provided credible defence arrangements in the Pacific and the Indian Oceans for which Australia did not pay. This clearly is not the case today. The full 'imperial preference' system was built up in the Great Depression of the thirties when it almost certainly increased Australia's and Britain's exports and employment in conditions where correct full employment theory and policy were not in existence. Today conditions are completely different and Commonwealth preferences hinder Australia's expansion of her exports in so far as they limit Australia's negotiating power with the third countries, and also generate ill will in those countries. Johnson noted that the estimated figures of net losses of revenue on account of preferences (in the case of Australia, £stg. 9 million in 1961) are relatively small. He also queries the value of such estimates: 'Suggestive as they may be, such calculations rest on the self-evidently false assumption that trade volumes would be unchanged by the elimination of preferences.'

These statements are occasionally misconstrued to mean that Johnson thought the national cost of preferences to be small. But it should be clear that what he considers important is the distortion of the pattern of trade (and therefore of production in both countries) caused by the preferences. Johnson regrets that no one has made estimates of *these* losses.

Further, the generally unfavourable 'trade diversion' effect of customs unions has at least some attenuating features in that prices fall to consumers and there is a favourable 'consumption effect' and 'consumer's surplus' effect. In the case of 'imperial preferences' these favourable effects do not arise because these preferences were established by *increasing* tariffs and therefore consumer prices.

Some people would argue that the allocation-of-resources distortion caused by preferences might tend to bring about the 'second best' and the most politically feasible solution. But is that so? Firstly, no one can assert that the protective effect accorded to *some* Australian primary producers by the Commonwealth preferences would produce the 'second best' situation. The result might just as well be the fifth best or the hundredth best. For the creation of the 'second best' situation it would be necessary that protection be given in an equal degree to all economic activities, and this would be difficult even in theory. Secondly, *approving* any new protective measure on the grounds that it is a step towards the 'second best' allocation of resources is naïve, though common. In fact, all *direct* measures of government intervention in trade are always deliberately 'selective' as to the economic activity and the level of protection. That the 'second best' solution is politically less feasible than the 'first best' (i.e. free trade) is proved by the fact that free trade has existed in the world, but history has not recorded any case of uniform protection.

In general, an examination of Table 4 shows that in the post-war period the U.K. has become an inadequate trade partner for Australia, and that the countries that have been gaining significance as buyers of Australian goods are all in the Pacific area. Similarly, most of the countries that have gained importance as suppliers to Australia are also

in the Pacific area. This suggests that the future of Australia's trade, in the next decade at least, is in the Pacific area.

These conclusions will no doubt produce some sentimental pangs of regret. However, the facts are that the strong links between Australia and the U.K. are being destroyed often by the very people who used to speak about the partnership or about promoting the Commonwealth connection. On the Australian side, those who have insisted that Australia should have every conceivable manufacturing industry (irrespective of cost), and on the U.K. side, those who decided to protect domestic farming have been destroying trade connections between these two countries. In addition, there are the facts that the U.K.:

- (a) has a relatively low rate of population growth;
- (b) has a low rate of economic growth; and
- (c) is already saturated with the type of products that Australia can offer.

As a result, the British market has little growth potential, whereas Australia with her very fast growth of population must keep expanding her export markets. When one looks at Table 4 and when one considers the economic position of Australia's potential customers, it becomes quite clear that, while no market, even a small one, can be ignored in the next decade, the real and substantial prospects for Australia are confined to Japan and the U.S.A.

Since it happens to be the case that, for Japan also, the U.S.A. has become of overwhelming economic importance, it follows that any future Australian trade policies should be directed as far as possible to include both those countries in some kind of agreement and co-operation. At the moment, however, the prospects of increasing trade with the U.S.A. do not look very good, because of the strong protectionist reaction in the U.S.A. and because of the U.S.A. balance of payments deficits. Japan, however, is in the mood for expanding trade, and Australia could expand her trade with Japan. The question arises here: should we do it and, if so, how?

3. *Trade Dependence on Japan*

It has been established that Australia badly needs, and will continue to need, both to expand exports, and to improve her balance of payments. It happens, however, that Japan also wants to improve substantially her balance of payments.⁴ At first sight it might appear that the desires of the two countries are in conflict and cannot be reconciled through mutual concessions. However, if Australia made a bargain with Japan, such as offering her similar tariff treatment as Britain receives, and if Japan gave Australia equivalent concession in her protective system, which might leave the bilateral balance of trade between the two countries largely unaltered, the *over-all* balance of trade of both countries would be improved, at the expense of third countries. Of course, at the same time, some distortions in the allocation of resources would be removed by this act.

The new trade alignment would produce some 'trade creation' which would have very favourable production and consumption effects, and a

⁴ Economic Planning Agency, *The Social and Economic Development Plan 1967-71*. Government of Japan, Tokyo, p. 123-4.

good deal of what inappropriately has to be called 'trade diversion'. Diversion of trade from the high-cost British suppliers, now favoured by exclusive preferences, to lower cost Japanese suppliers would in fact be the opposite to what the technical term 'trade diversion' means and, for Australia, would be completely advantageous, as it would give all the gains of 'trade creation' without its disadvantages. 'Diversion of trade' from other countries to Japan would, however, be exactly what the term normally means.

The basic factors in favour of a new trade alignment are that in 1967/8 Australia had a visible trade deficit with the U.K. of \$A297 million and a deficit with the U.S.A. of \$A438 million. Moreover, there is *no scope at all* for Australia to increase her exports to the U.K. and, for different reasons, little scope for increase in exports to the U.S.A. By contrast, Australia could have an enormous market in Japan, if the latter were induced to open this market to Australian exports.

Some people who stress the relatively small value of preferences in terms of duty foregone—Johnson estimated that in 1961 this 'cash value' of the preferences given by Australia to the U.K. was £stg.20 million—might conclude that giving Japan similar preference would not produce a significant response. Quite apart from the fact that Australia's *imports* from the U.K. are now significantly larger than they were in 1961, so that the present value of preferences given might be in the region of \$A50 million annually, what is important is the value of trade that this preference *diverts* to the U.K., and that it would divert (or re-divert) to Japan, if Japan were given similar preference. If one realizes that, at present, Japan is highly competitive in price and quality with respect to almost any British export, and that the elasticity of substitution of Japanese goods for the goods of any industrialized country must be very high, it becomes clear that the proposed bargain should be very attractive to Japan. (Of course, the idea would have to be 'sold' both in Australia and in Japan.) Australia's imports in 1967/8 from the U.K. amounted to \$A723 million and from the U.S.A. they were \$A841 million. Japan, if offered preference, could attract a great deal of trade now going to Britain, and even some trade going to America and other industrial countries. Australia's total imports in 1967/8 amounted to 3.2 billion dollars, much of it in producer's equipment and semi-processed materials, much of which could come from Japan.

However, there are many people, both in Australia *and* in Japan who are afraid of great trade dependence of the one country on the other. In Australia the fears are of various kinds. Some Australian manufacturers panic at the mere mention of greater Japanese entry to the Australian market (but under this proposal they would be hardly affected). This fear is mixed with another fear; a widespread one, of economic dependence on such a great and dynamic power as Japan. It is probable that in this case 'trade dependence' is confused in its effects with political or defence dependence. The two kinds of dependence are, however, quite different.

This writer fears greatly the present Australian dependence on 'our great allies' (even though the dependence is inevitable) because, in defence alliances, the big ally is liable to 'use' the small one when its own interests are involved, but when the contingency where the small ally's interests are threatened arrives, i.e., when the *quid pro quo* is to

be given, the assistance is forthcoming only in the form, time and strength, if any, as would be dictated by cold calculation of the big ally's own interests at that future time.⁵ A defence alliance at any moment *always* looks uneven, and because of this its operation is uncertain as the contingencies change. However, a trade agreement of the normal tariff-reducing type differs in so far as, at any time, it is always a bargain where both sides gain. An increased exchange of Australian goods for Japanese goods (which follows from mutual trade barrier reductions) is equally attractive to the Australian party to the deal as to the Japanese party. If it were not, the terms of the particular deal would be altered. This means that, as long as Australia offers Japan a reasonable bargain, it is in Japan's self-interest to accept it.

It is true that on occasions, governments have started 'trade wars'. These are nationalistic aberrations, or miscalculations. When they do occur both countries can play the same game and both are hurt in any case. But there is no good reason for our restricting trade *now* because we fear that in ten or fifteen years' time the other party *might* restrict trade. If in that future period circumstances change, because of a foreign country's change of policy, or because of basic changes in supply and demand conditions, we can *then* make an adjustment in our trade.

It is significant that fear of excessive dependence occurs both in Australia and Japan. On the basis of history, however, it is the Japanese who have a better reason to be afraid. In 1936 it was Australia who started a policy of 'trade diversion' directed against Japan. It should be noted here that, as the Great Depression developed, Japan became a very important trade partner of Australia.⁶ In 1931,⁷ for example, Australia was the fourth most important supplier to, and twelfth buyer from Japan, a ranking similar to that of the present decade.

It was in these circumstances that Australia unilaterally decided to divert her trade from Japan⁸ under pressure from the U.K., some other countries, and from domestic textile manufacturers.⁹ The arguments on which Australia acted at the time were, that traditional and good customers of Australia were hurt by Japanese inroads into Australia and that those countries were unable to compete with Japanese prices. This was in spite of the fact that Japan was also a very good and important customer.

It is possible that it was felt at the time that Japan was a captive customer, buying essential raw materials and foodstuffs from Australia, and therefore not requiring any consideration. There is a tendency to think in the same way today. However, when the Australian Govern-

⁵ Bismarck said: 'In an alliance the big ally is always the rider and the small ally the horse'.

⁶ Mainly because Japan maintained employment and economic growth better than most countries.

⁷ Melbourne, A.C.V., *Report on Australian Intercourse with Japan and China*. Brisbane 1932, p. 63.

⁸ Nicholson, G. D., *Australia's Trade Relations*, F. W. Cheshire, Melbourne 1955, pp. 8-10.

⁹ At the same time Australia imposed similar discrimination against the American goods. In this case the *announced* main purpose of the policy was to establish motor car production in Australia, but the policy did not produce this effect. In fact, since the discrimination was general, various UK manufacturers made gains temporarily while the policy continued.

ment drastically cut the imports of Japanese goods, the Japanese Government promptly retaliated, Japanese wool-buyers withdrew from Australia and other imports from Australia were embargoed. Seven months later the two governments agreed to remove some of the restrictions but the exports of both to each other never reached the level of 1935 until the post-war period. In addition, prior to the outbreak of the war with Japan, the U.S.A. and some other countries restricted their supplies of oil and other materials to Japan.

Thus the Japanese have more reason than anyone else to fear a high degree of trade dependence on any one country. Indeed, even in the post-war period, various countries have actively singled out Japan for a special degree of trade discrimination. As a result Japan is so concerned about her dependence on foreign raw materials, and on particular supplier countries, that she is trying to diversify her sources of supply and to assure her supply of minerals by investing in exploration and mining in alternative countries. The two futile and costly Australian attempts of 1936 to apply trade diversion, for some domestic or foreign political ends, show that trade diversion is an ineffective instrument of policy. In the end both parties regret it. In addition, there are many lessons of history that trade wars, waged by one country against another country, are unsuccessful and hurt both countries. Further, even *world-wide* and *complete* trade boycotts have been found to be ineffective both in the case of the 'sanctions' against Italy during the Abyssinian War, and the present trade boycott of Rhodesia.

When one considers the above points it becomes clear that the fears of trade dependence in both Australia and Japan are unwarranted if one has in mind some sort of economic domination or sudden trade blackmail. However, it is true that in negotiations about the particular trade barriers or about the particular conditions of sale of a particular product, other things being equal, it is always better to deal with many customers than a few large ones, because the greater ease of making marginal shifts gives one stronger bargaining power to obtain a *better price*.

If we keep it in mind that it is a better price that we are after, it at once becomes clear that, if high trade dependence of one country on another gives them both better prices than they could get elsewhere, then trade dependence is good. In other words trade diversification is good only if it gives us better or at least not worse, prices. If, at any stage, a higher 'trade dependence' were to give us lower prices for our exports or higher cost of our imports, we would simply look then for a new, better customer. If we fear that Japan might suddenly cut imports from Australia in future we must realize that this would hurt Japan at least as much as it would hurt us. If Japan were to put very stiff terms on her exports, she would be hurting herself, because what she sells can be purchased elsewhere. Above all, Australia can always retaliate in such a situation.

One way of making a trade blackmail by Japan less likely is to increase now the potential penalties in future by *increasing* now our imports from Japan. A partial diversion of our import trade to Japan would make Japan so much more dependent on us in the sense that if we decided to retaliate we would wield a much bigger stick. This puts the conventional argument on trade dependence upside down!

All the preceding is not to deny that some countries will become dependent on Japan economically, as recipients of aid and technological know-how, and that they, or others, may become dependent on Japan politically or militarily. This will not be because of trade, but because Japan is already one of the three economic super-powers and could become a military super-power any time she wished.

The argument for further development of trade with Japan becomes even stronger when we consider that the U.K. is now more likely than ever to be admitted into the E.E.C. This is not because de Gaulle is gone, but mainly because the economic circumstances and interests of the community have altered. At the time of the earlier British attempts at entry, the Community did not have any significant food surpluses, as it does now. While Britain is as anxious as ever to be admitted, for the Community the admission of Britain would provide the easiest quick relief for the Community's agricultural problem by pre-emption of the whole, large British food imports market. Britain would also help to finance the present enormous cost of general assistance to the Community's agriculture.

Since in the previous attempts to join the E.E.C., Britain was prepared to sign terms giving no exceptions from the Community's rules for Australian exports, and since the Community has now large food surpluses, it must be assumed that any special concessions are quite unlikely.

In 1967/68 the total Australian exports of goods to the U.K. amounted to \$A418 million.¹⁰ An item by item examination of these exports allows them to be divided into three categories, according to the degree to which they would have been affected had the U.K. been a member of the E.E.C.

- (1) About \$194 million of Australian exports would have unquestionably lost the market, owing to the prohibitive 'variable levies'.
- (2) About \$126 million of tariff-sensitive Australian exports would be seriously threatened, as the Australian products would have to jump a tariff whereas the competitive Community suppliers would not meet any tariff.
- (3) About \$95 million of Australian exports (wool and ores) would be unhindered.

The most important commodities by value in the long list of those unquestionably losing the British market are wheat, sugar, meat, and butter. The world markets are choked with those commodities. The Community has surpluses in them all and has so much butter that in 1968 it could not all be stored. In 1967/68 Australia sold 126 million lb. of butter to the U.K. (for \$31 million). Where would those Australian exports go if Britain joined the E.E.C.? Would Australia dump into the oceans 126 million lb. of butter every year? And who would provide the purchase money to the farmers? How would the balance of payments effect of the lost market be met? Japan could help solve these problems.

¹⁰ *Australian Exports, 1967/68*, Commonwealth Bureau of Census & Statistics.

4. *The Legal Problems About Expansion of Trade*

How can Australia expand her trade with Japan, U.S.A. and other countries?

Under a system of private importing the level of exports of any country is determined by the price and quality attractiveness of goods to would-be importers. However, the final price of traded goods depends on:

- (a) the exchange rate of the currency of the exporting country, which the exporting country can change, virtually at will; and
- (b) the level of trade barriers in the importing country, which the exporting country can influence by negotiations.

Countries in trade difficulties usually devalue. However, devaluation would not be likely to increase the value of Australia's exports very much because many important trading countries, such as Japan, the E.E.C., the U.S.A., and others maintain rigid quantitative controls on many of the goods that happen to be main Australian exports. Devaluation could not affect those controls in Australia's favour.

What remains therefore is negotiation to reduce trade barriers. There are two methods of reducing trade barriers: one is by negotiations under the G.A.T.T. system, the other is through the formation of a 'free trade area'. Unfortunately for Australia, G.A.T.T. has done very little for countries whose main exports are agricultural because its most important members have quantitative controls on imports of foodstuffs and are unwilling to negotiate about them.

Hitherto, in 1957 and in 1963, Australia could easily negotiate bilaterally with Japan, because she had concessions up her sleeve which she could offer to Japan. In 1957 it was a qualified Most-Favoured-Nation treatment for Japan's goods and in 1963 an unqualified, full M.F.N. treatment under G.A.T.T.¹¹ But, even in 1963, Australia (but not Japan) was running short of bargaining material, so much so that the Treaty stipulated that Australia would give Japan '... full opportunities of fair competition for sale of capital goods to the Australian government ... and its statutory authorities.' And indeed very shortly after that the Australian Postmaster-General's Department accepted a Japanese tender for micro-wave equipment of substantial value. This rather odd provision of the 1963 Agreement would either suggest that the Australian Government prior to that date was not accepting tenders on their economic merits, or alternatively, that Japan was to obtain preferred treatment after that date.

The difficulty for Australia in making any concessions is that one strong principle on which G.A.T.T. rests is that of non-discrimination among members. This means that Australia and Japan, as members of G.A.T.T., must not give each other concessions that would be withheld from others. At any rate, they must not do it in an obvious way.

Australia could, of course, pick an important item in Australia-Japan trade for tariff reduction and ask Japan for an equivalent concession. If a bargain were reached, however, both the Australian concession and the Japanese one, would have to be generalized for all the members of the G.A.T.T., under the Most-Favoured-Nation rule, although the other countries would be getting a 'free ride'. Where such a 'free ride' is

¹¹ Bieda, K., 'Australia Looks to Japan', *The Banker* (U.K.) Nov. 1963.

slight (because the third beneficiaries do not export much of either of the two commodities involved) this should be acceptable to Australia and Japan as being in the spirit of the G.A.T.T. system. In the case of Australia-Japan concessions, however, the 'free rides' for the third parties, e.g. the U.S.A., the E.E.C., Canada, and the others would be substantial, (because for example the U.S.A. competes substantially in Japan with Australian produce and in Australia with Japanese manufactures) and this naturally inhibits granting of such concessions.

Of course, Japan, which has some import controls, is in a position to give concessions to Australia without appearing to do so, but Australia does not have import controls and cannot reciprocate in this way. From the preceding analysis it follows therefore that, at the present stage, Australia and Japan could expand their trade by new concessions only within the framework of formation of a so-called 'free trade area', to which other countries willing to make similar concessions could also belong.

Discriminating concessions which are the essence of a 'free trade area' are permissible under G.A.T.T., provided however that 'substantially all the trade' is freed of tariff barriers. This quaint and deliberately vague ruling has been vaguely interpreted as being complied with when approximately 60 per cent of trade of the member countries is included in the trade liberalization programme.

Australia and Japan could form such a 'free trade area'. However, public opinion is not yet ready in Australia for a full 'free trade area'. But Australian politics might allow a *partial* 'free trade' if the seriousness of the situation were recognized. Australia would then extend to Japan the same tariff treatment that is given to the U.K., in exchange for Japanese reduction of trade barriers against Australian goods.

5. *The Problems Involved in Abolition of British Preferential Margins*

If the U.K. joined the E.E.C. Australia would simply have to cancel the preferences she gives Britain, because Britain would start *discriminating* against Australia. How could Australia abolish the preferences and what could be the wider effects of this step? There are two ways open:

- (1) Australia could increase the British preferential rates up to the M.F.N. rates; or
- (2) lower the M.F.N. rates to the British preferential rates.

In the first case the landed cost of very many importables (Australia still buys more than one fifth of her imports from the U.K.) would go up (by a great deal more than the amount of the mere preference margin because of 'pyramiding' of sales tax and profit margins over the amount of the increased tariff). In addition this step would:

- (a) give some added protection to those Australian manufacturers who compete with the British suppliers; and
- (b) make it easier for third countries to sell in Australia.

From the Australian national point of view there is no reason why either of those effects should be dispensed freely.

Alternatively the M.F.N. rates could be lowered to the level of the British preferential rates. This would lower very substantially both the

cost of living and the cost of various inputs for virtually all Australian producers, but, on the other hand, some Australian producers, who compete mainly with the M.F.N. countries, would lose so much of their present protection that many of them would be unable to continue operating unless, of course, this tariff change were accompanied by a devaluation. Here again, by lowering the M.F.N. rate to the British rate, the third countries would obtain a large trade concession for nothing.

It now becomes quite clear that when the day comes that Australia will have to, or will want to, abolish the British preference margins she would be giving the third countries, especially those that sell a similar range of goods as Britain, something valuable for nothing.

The next important fact to be noted is that the preferences mutually accorded by the U.K. and Australia cannot be used as bargaining counters by both these countries. Only the country that is first to offer its preference system as a trade concession can obtain any *quid pro quo*. Should Australia take a step like that?

It is a historical fact that the U.K. twice offered the Commonwealth Preferences, as part of a package deal, to enter the E.E.C. in 1962-3 and 1967. If and when the U.K. joins the E.E.C., she will cancel the preferences and start to discriminate against Australia. Then Australia's trading partners would presume that Australia will have to cancel preferences that she gives whatever they may do, and then the threat in negotiations to continue preferences would not be credible. It is therefore proper now for Australia in her day of need to approach Japan, the U.S.A., the E.E.C. and any other interested country with the offer to abolish the preferences she gives to the U.K. if those third countries would make equivalent concessions in their tariff structure through the device of a *partial* 'free trade area'.

There is some uncertainty as to how the G.A.T.T. would regard such a free trade area which merely *reduced* tariffs on 60 per cent of trade, but did not propose to *eliminate* them. However, the logic of the whole situation and the spirit of the G.A.T.T. rules should be in favour of it. James Meade has put an argument that a partial free trade area is more likely to bring a favourable result than a full free trade area. G.A.T.T. could not completely ignore that argument.¹² Alternatively, the two countries could propose a partial free trade area now and a complete one in 50 years' time. The E.E.C., Greece and Turkey have set up a 20 years timetable for complete customs union and this has not been challenged by G.A.T.T. In such case why not 50 years? And in 50 years' time the world will be so different that the provision would bring no problem.

6. *What is the Nature of Trade Barriers Inhibiting Trade Between Australia and Japan?*

A Japanese executive of one of the Mitsui group of enterprises listed to this writer the following trade obstacles to the sale of Japanese goods in Australia (in diminishing order of importance).

(a) The British preferential tariff rate.

¹² Meade, J. E., *The Theory of Customs Unions*, North Holland Co., Amsterdam 1955.

- (b) The Special Advisory Authority.¹³
- (c) The high expense of hedging against the danger of a devaluation of the Australian dollar for Japanese firms which have sold goods to Australia. Because Japanese payments to Australia are more often than not in U.S. dollars, or other foreign currencies, hedging tends to be one way only, i.e. against the danger of Australian devaluation. As a result, the exchange brokers cannot 'marry' opposed would-be hedgers because the demand is one-sided and therefore the cost of hedging is high. This cost will continue to be higher than normal, as long as Australian sales to Japan are not more or less equal to purchases from Japan (at present they are about twice as high).
- (d) Lack of written guarantee by the Reserve Bank of Australia as to free convertibility of the Australian dollars earned by say, a Japanese sale of electronic equipment to Australia under long-term payment arrangements. Without such a guarantee the Japanese trading bank is unwilling to lend to the Japanese exporter. The Japanese source estimated that this would push up the price of the Japanese product by about 5 per cent. The Reserve Bank of Australia should consider the feasibility of giving such guarantees in the case of genuine long-term credit sales to Australia.

It is significant that the Japanese source put the British preferential tariff rate as by far the biggest obstacle to their trade with Australia. This is evidence that granting Japan the same degree of access to the Australian market as the U.K. has would be valued highly by Japan and might produce a very substantial reduction of Japanese trade barriers against Australian goods.

7. *What is the Nature of Trade Barriers in Japan?*

Japan, like any other country, has its customs tariff system, which in this case is of the three column type: general, G.A.T.T., and temporary rates. For the majority of tariff items the G.A.T.T. rate is the same as the General Rate.

It is difficult to pass judgment on the Japanese tariff rates. Their temporary rates sometimes resemble the Australian by-law system under which components for some local manufacture enter free of duty if there is no local supply, and sometimes resemble the Australian temporary tariff, imposed by the Special Advisory Authority to give quick protection when some industry appears to be in distress. It is impossible to pass judgement on the general height of the Japanese tariffs because weighting problems involved in finding the average tariff rate for a country make it impossible to compare the height of tariffs in one country with another.¹⁴

A perusal of the tariff books of the two countries suggests, however, that the Japanese tariff rates are somewhat lower than the Australian rates, though the Japanese tariffs are on c.i.f. values, while the Australian

¹³ The S.A.A. is a one-man institution in Australia which gives quickly, almost on request, a rather high degree of temporary protection pending a full enquiry and report by the Tariff Board when an industry claims to be severely hurt.

¹⁴ Bieda, K., 'Trade Restraints in Western Community', *American Economic Review*, March 1963.

lian tariffs are on f.o.b. values. In the case of Japan, the vast majority of items are in the 10 to 20 per cent tariff rate group and, if one excludes tobacco (200 to 355 per cent), some alcoholic beverages (50 per cent), bananas (60 to 70 per cent, temporary) and a few metal articles plated with precious metals (50 per cent), the remaining tariff items are well below 40 per cent.

However, the comparison is made difficult by several facts. Both countries have some 'specific' tariff rates, where the *ad valorem* rate varies with change in the import price but is usually very high. Australia employs 'support prices' for chemicals to boost protection and Japan employs 'designated values' for some *processed* metals in both of which the *ad valorem* equivalents are very high.

In any case, although the Japanese tariffs may be on the whole somewhat lower than the Australian ones, not much meaning can be attached to that. First, how big an obstacle to trade a particular tariff rate in any country is, depends not only on the height of the tariff, but also on the elasticity of supply of the competing product in the importing country. If in one country the elasticities of *supply* of the import-competing products are higher than in the other, then the first will enjoy a larger *protective* effect, even though both might have the same tariff rates. Second, if the elasticity of *demand* in the importing country is high then, again, even a low tariff will have a large *obstructive* effect.

Above all, however, tariffs are only one of many protective devices. Indeed, as far as Australia's exports to Japan are concerned, the main obstacle is not tariffs but import licensing and to some extent dietary habits. In fact, in the case of such important products as wool, hides, skins, coking coal, and minerals in general, Japan does not charge any customs duty, and the tariff on other items is relatively low, for example, on mutton, lamb and pork, 10 per cent, on poultry, 20 per cent, and on beef 25 per cent.

8. *The Prospects for Various Australian Products in Japan*

With respect to Australian mutton and lamb, the Japanese producers of whatever might be the competing products enjoy a special form of natural protection in that the taste for mutton has not developed in Japan. For this reason, no doubt, imports of mutton are free of control. The Japanese find mutton and lamb repugnant in smell. Their cooking methods and appliances make this matter of odour even more acute. At present almost all Australian mutton is mixed with whale, Korean rabbit, and Brazilian horse meat, minced, bleached and put into a very inferior variety of 'continental sausages'. Australian mutton sales to Japan rose in the present decade to 27,000 tons¹⁵ in 1967 (out of the total Australian exports of 80,000 tons), but recently they have been levelling off, and the mutton-mix 'sausage' will have little future in a prosperous Japan.

Australian lamb sales have been quite negligible because of the same prejudice, and the fact that its price makes lamb unsuitable for the sausages. Poultry, goat, kangaroo and horse meat are free of import controls but Australian poultry is not competitive (with 20 per cent tariff and freight) and the other meats are not attractive. Beef, veal and pork are attractive meats, but they are subject to drastic import controls.

¹⁵ See: Australian Meat Board, *Thirty-Second Annual Report*, 1967, p. 10.

The potential scope for expansion of Australian beef exports to Japan is tremendous. Because of the very high degree of restriction of beef imports, beef prices are extraordinarily high in Japan. Indeed, beef is such luxury that it is quoted and sold in 100 gram (less than a quarter of a pound) lots.

Australian exports of beef to Japan have been restricted by Japan to about 7,000 tons a year for the last few years,¹⁶ (1965, 1966, 1967), out of total Australian exports of beef that fluctuated between 250,000 and 300,000 tons. Further, Australian beef sold in Japan is mainly of the lower grade, mostly 'briskets' and has the reputation of being 'hard', or 'tough'.

The reasons for this preponderance of lower grade beef may be several. One is historical, in that the first import quotas were expressed in value terms and the importers tried to get as much cheap beef within the quota as possible. Apparently, once the habit started, it has continued even though the quotas are now in weight terms. Then, until recently, Australian beef has been frozen, which reduces the quality. It was only in January 1968 that the first chilled beef was exported to Japan on trial. Another possible reason is that some Japanese dealers may buy very cheap and low grade Australian beef and pass it on as a higher grade. Above all, however, the facts are that while Australian beef is undoubtedly the cheapest in the world (and the Japanese government experts know it), it is not the best beef and certainly, being from grass-fed cattle, cannot compare with the Japanese beef from cattle which are grown in stables, grain-fed and even beer fed and massaged daily.

Japanese *per capita* consumption of beef and of dairy products is extremely low, partly because of cultural factors and partly because of price, artificially pushed up by protection of domestic beef producers. As for the cultural factors, it is necessary to remember that 100 years ago, i.e. before the Meiji Restoration, it was illegal and immoral to eat beef. The intensely religious (Buddhist) shoguns forbade killing cows. If the meat of the cow cannot be eaten, the dairy industry also becomes an uneconomic proposition. In addition, for a poor country, animals are uneconomic converters of plant proteins. For these reasons, consumption of dairy products has always been negligible.

The levels of nutrition of the average Japanese are still extremely low by Australian standards. The average Japanese consumed 77·6 grams of protein from all food per day in 1965 and, of this, less than one-third was of animal origin.¹⁷ The culturally induced frugality in food consumption has been, and still is, so strong that even in calorie intake the Japanese level of nutrition is low. In 1965 the daily calorie intake of the average Japanese was only 2353.¹⁸ By contrast, in that year Australian calorie intake was 3251 and total protein intake 91·3 grams, of which two-thirds was of animal origin.¹⁹

The average Japanese allocates his income in a way substantially different to that of the average Australian. The Japanese consumption of

¹⁶ *Ibid.*

¹⁷ Ministry of Foreign Affairs, Japan, *Japan's Agriculture Today*, Tokyo, 1967, p. 15.

¹⁸ *Ibid.*

¹⁹ *The Official Yearbook of the Commonwealth of Australia*, 1967, p. 1217.

modern electronic gadgets is fully comparable to the Australian one. In cars, clothing etc. the Japanese is rapidly approaching Australian standards, but in food and housing he is way behind.

The present population of Japan is 100 million and it is estimated that it will be about 115 million by 1985. In view of this and having regard to the present very low level of animal protein consumption, it is evident that Australia, as one of the most economical animal protein producers, has a very large potential market in Japan. However, this market has to be opened up by:

- (a) promotion in the market;
- (b) negotiation with the Japanese Government for favourable treatment for Australia as long as import controls are operated;
- (c) negotiations about complete abolition of these import controls in exchange for some Australian concessions.

Wheat exports to Japan are in similar position to beef and dairy products. Japan protects strongly its own wheat growers and to a lesser extent rice growers by import controls imposed on wheat. Wheat is used in Japan mainly in noodles (where it appears as a big competitor of rice) and in bread (which is available mainly in big cities and is consumed mainly by the younger westernized people).

Wheat is purchased in Japan by the Food Agency, subject to a world quota. In fact, however, importers are invited to tender for the supply of a fixed quantity of particular defined type and quality of wheat each week. The Food Agency is supposed to select the cheapest tender. However, this is not a simple matter because the various tenderers offer wheat which differs in quality in various ways. In selecting the successful tenderer, as well as in the prior choice of the type of wheat to be purchased, the Food Agency can discriminate between countries (within the total annual quota).

Australian wheat sold in Japan has been traditionally mainly of the lower grade, low-protein f.a.q. soft wheat in Japan called 'Feed Wheat'. This Australian wheat is milled on the basis of 40 per cent flour (for noodles) and 60 per cent bran for animal feed. The better types of hard wheat for bread have been traditionally supplied by the U.S.A. and Canada, yet some parts of Australia can grow hard wheat. In 1967, according to the Food Agency figures, Japan took 55.8 per cent of its wheat imports from the U.S.A., 30.4 per cent from Canada, and 13.8 per cent from Australia. At the end of 1968, however, Japan greatly reduced purchases of wheat from the U.S.A., and Australia became the largest supplier (perhaps temporarily). This switch was partly a result of shipments of some rain-damaged wheat by the U.S.A. and partly perhaps a result of Japanese dissatisfaction with U.S. trade policies. At the end of 1968, Argentinian and French wheat came onto the Japanese market for the first time.

Japan is the biggest commercial importer of wheat in the world. In the Japanese fiscal year ended 31 March, 1968 Japan imported 4.2 million tons of wheat, while its domestic production is about 0.6 million tons annually.

In recent years Japan has also been the biggest buyer of Australian sugar, in terms of quantity, but not in terms of value, because she bought at the low free-market price. The new International Sugar Agree-

ment, and a higher price, should make Japan the best customer in another product, although this could also give Japan the opportunity to switch some of the purchases to other suppliers, as a bargaining device.

In the case of wool, Japan has been Australia's best customer since 1959, and, in this period, she has not collected any tariff on wool imports (the U.S.A. collects 25 cents per lb. of wool). This position, however, should not be taken for granted. In the 1963 Australia-Japan Trade Agreement, Japan gave a temporary assurance of having '... at this time no intention of imposing a duty on raw wool . . .', but added, '... this did not in any way bind the Japanese Government legally or morally'.

Some people in the Australian Government seem to believe that wool and all raw-materials being 'essential' raw-materials will have to be bought by Japan whatever the Australian policy might be. This is, however, not quite so.

With respect to fine merino wool, for which Australia has a world 'monopoly', there are substitutes in the form of other fibres, natural and man-made. Even in the thirties when substitutes were fewer and inferior, Japan cut wool purchases in retaliation to the Australian 'trade diversion'. Today, she could more easily switch into synthetics of which her chemical industry produces a large and increasing amount. Wool usage in Japanese textile industry has always been rather small. Its share, expressed as percentage of square metres of finished material, was 3.4 per cent in 1955, and 5.1 per cent in 1960 and 1965.²⁰ There has been in Japan an almost twenty-fold increase in the usage of chemical fibres between 1955 and 1966 but that has been at the expense of cotton, rayon, and other fibres, not wool.

Australia managed to sell some surplus cotton to Japan in 1968, almost certainly at an uneconomic price. Apart from the normal price being too high, Australian cotton fibre is not of the right type. Japan uses mostly long fibre and a small quantity of short fibre, while the Australian cotton is of medium length. Australian cotton fibre, at the normal price, is simply unattractive to the Japanese manufacturers. This is not because of any protectionist policy because Japan stopped growing cotton in the 19th century.

When it comes to minerals, Japan not only does not impose any trade barriers, but actively encourages foreign supply by investment in mining and exploration abroad. In this field, Japan has been for several years Australia's best customer in: coal, copper, lead, pig iron, iron ore, manganese ore, aluminium ore, and opals. But Japan is so concerned about stability and continuity of supplies that she is trying to diversify her sources of supply by long-term contracts and investment in mining ventures including transport from the mine in many countries (including the Soviet Union through the development of Siberia).

When one considers manufactures, however, the prospects of Australian sales in Japan are not great under the present rate of exchange, and under the present organization of manufacturing in Australia where, in contrast to Japan, most manufacturing plants are far below the optimum size, with short runs of production and large numbers of small producers who organize themselves in cartel-type organizations to assure high mark-ups.

²⁰ See: Keidanren, *Economic Picture of Japan*, 1967. Keidanren, Tokyo, p. 36.

It is not because Japanese wages are so much lower that the Japanese are so competitive. For skilled workers Japanese wages, together with large fringe benefits, are almost as high as in Australia. Some services, such as haircutting or laundry, are much dearer than in Australia. The wages of the unskilled (there are not many of these in Japan) are *picking up* very rapidly towards the Australian level. Even in the Cinderella of the economy, agriculture, 'it has become hard (in 1968) to hire a labourer to work in the rice fields for less than U.S.\$10 per day . . .'²¹ Indeed, it will not be long, perhaps 10 or 15 years from now, that some *weak* Japanese producers may start complaining that they cannot be expected to compete with the cheap Australian labour!

If one takes the 1965 *per capita* G.N.P. in Australia, U.S.\$1,724 and allows it to grow at 3 per cent annual compound rate (which is not understating the growth rate for Australia in the last 10 years or so) and the Japanese *per capita* G.N.P. of U.S.\$853 in the same year, and allows it to grow at 7.4 per cent annual compound rate (which is fairly conservative for Japan), the *per capita* G.N.P. in both countries will become equal by 1982.

Saburo Okita and Fumiro Murobuse of the Japan Economic Research Centre estimated that by 1985 (and since 1965) Japan will have overtaken 20 countries in income *per capita*, to be the fourth richest country in the world, after the U.S.A., West Germany and the Soviet Union. Some non-Japanese writers estimate that in 31 years from now Japan will be the second richest country in the world after the U.S.A.

This rapid growth of income in Japan has a double meaning. First, the Japanese competitiveness does not lie so much in low wages as in the large size of production units, and if the producers in Australia are worried about Australian high wages, relatively to Japan, their worries will soon be solved. The second meaning of this growth of income is that it will speed up westernization of consumption in Japan, in addition to the probable tremendous growth of consumption. Both the total growth of consumption, and the westernization of the Japanese diet, will aid Australia's exports, particularly as the labour force in Japanese agriculture is declining rapidly so that food deficits will grow.

9. *The Lack of Success of Australian Trade Promotion in Japan and the Alternative Approach*

There is a tendency in Australian official circles to believe that the Japanese buy only those Australian products that they *have to*, i.e., the essential raw-materials. The fact that very few more highly processed Australian products have been sold to Japan, in spite of strenuous and expensive promotion by the Australian Department of Trade, is held against Japan. Starting from this premise comes an attitude which justifies the premise, *viz.* that it is unnecessary to bargain for mutual trade barrier reductions, because in any case the Japanese will buy only what they have to.

In trying to increase Australian sales in Japan it is usually assumed that the basic raw-materials do not need promotion because the big users are usually well informed. It is, however, assumed that manu-

²¹ *The Economist*, October 19, 1968.

factured or processed Australian goods should be saleable in quantity in Japan with good commercial promotion. The success of market promotion, however, is dependent on two conditions:

- (a) the produce must not be restricted by quantitative import controls; and
- (b) the product must have merit in that market in terms of price (including quality considerations) which is initially unknown, but which can be established by market promotion techniques.

If either of these conditions is not satisfied, commercial promotion is wasted money. Yet apparently the Australian Department of Trade has tried commercial promotion in Japan when those conditions did not exist. Mr Peter Robinson wrote:

Since the Australia-Japan Trade Agreement was signed in 1957, the Department of Trade has spent millions of dollars in trying to establish Japanese markets, for what might be termed 'promotable' goods as distinct from essential raw-material or basic foodstuffs. Hundreds of exhibitions of Australian products ranging from cars and industrial machinery to canned goods and knitwear have been held throughout Japan without much success . . .²²

Then Mr Robinson pointed out that if one divided Australian exports to Japan into the 'essential' to Japan, and 'promotable', the latter amounted in 1966/67 to only \$2.6 million out of a total export figure of \$586.5 million. Then he concluded that as the Department of Trade spent in that year about \$0.5 million on its trade activities and a trade fair in Japan, every \$4 earned from 'promotable' exports cost \$1 spent on promotion.

No one has, however, pointed out that the above listed 'promotable' goods are not very promotable. It is unrealistic to treat Australian cars in Japan as promotable goods because Japan has import control on cars and, because if one gave the Australian and the Japanese cars equal customs treatment the Japanese car would undoubtedly give a better value per dollar spent. That this is so is proved by the relative sales of Japanese and Australian cars in the third markets.

Similar criticism applies to practically every other supposedly 'promotable' good. Indeed, in Australia's case, if one takes a longer-run look, the truly promotable goods are those that are supposed not to need any promotion, i.e., the essential raw-materials. Japanese manufacturers are almost neurotic about the uncertainty of supply of those essential products. They take great pains to assure themselves of steady supplies by long-term contracts, part-ownership of the supplying firm, and spreading their sources of supply all over the world. The Japanese have convinced themselves that Australian industry is particularly strike-prone. Although this is not quite true,²³ this belief makes Japanese businessmen distrustful of security of supply from Australia and induces them to develop supplies from, for example, Siberia (where apparently strikes are extremely unpopular). Market promotion in this situation would mean persuading the Japanese businessman that the true facts about strikes in Australia are not so bad. Market promotion would also mean

²² *The Australian Financial Review*, 10 April 1968.

²³ The incidence of strikes in the last ten years or more, as measured by hours of work lost, has been higher in Japan than in Australia. See: U.K. *Ministry of Labour Gazette*, 1967, p. 880.

assuring the Japanese that, foreign matter in, or poor grading of, some products, e.g., wool, will be rapidly eliminated.

Above all, it is futile to promote a product that is subject to import control, and it is futile to try to beat the politicians' decision about import control through *market* promotion, in the hope that the consumers will somehow persuade or coerce politicians to relax their policy. Where the obstacle to trade is not the market's judgement of products but politically set up trade barriers, one has to direct one's persuasive powers at the politician who can lift that barrier.

In such a case it is again quite futile for any government department or minister to wax indignant and moralistic, and to rant against the other country's protectionist practices. Politically set-up trade barriers in foreign countries are reduced by quiet political negotiations where a favour is offered each time a favour is asked.

It is here, however, that frustration sets in for the Australian Government. In any potential negotiations with Japan, the Australian Government, for which 'imperial preferences' and any free trade agreement with Japan are taboo, does not now see any more privileges or concessions that it could offer because, since 1963, Japan has been accorded the fullest M.F.N. treatment by Australia. It is possibly this frustration that leads to market promotion. The Government, for doctrinaire reasons, as well as a matter of domestic political expediency, is not prepared to make even a small reduction of tariffs on the products of even the most uneconomic industry, and does not seem to be aware of any alternative.

Finally, it should be added that if Australia came to an agreement with Japan, on the lines suggested in this paper, this might, as a by-product, open up fruitful prospects of trade negotiations with the U.S.A. and perhaps even the E.E.C. countries. In recent years Sir John Crawford has repeatedly stressed the desirability of a trade agreement with the U.S.A. and so did the Vernon Report. But the U.S.A. has at present no motivation to enter into negotiations. The prospect of being discriminated against in Australia in favour of Japan, and in Japan in favour of Australia, would give the U.S.A. such motivation. It would also have a similar effect on the E.E.C.'s attitude to Australian trade interests.