

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

Final Report

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Section 1: Background

1. The relationship between Japan and Australia is now stronger than ever. It is based on shared democratic values, mutual respect, deep friendship and shared strategic views. It is characterised as a comprehensive strategic relationship encompassing political/security, economic and people-to-people relations.

2. The two countries have been cooperating closely to enhance such economic relationship. Based on the Trade and Economic Framework signed by Prime Minister John Howard of Australia and Prime Minister Junichiro Koizumi of Japan in July 2003, various works have been conducted centring on the Joint Consultative Committee (JCC) led by senior officials. These works include the Joint Study to examine the costs and benefits of the liberalization of trade in goods and services and investment between Australia and Japan. The report of this Joint Study was completed in April 2005.

3. In April 2005, Prime Minister Howard and Prime Minister Koizumi agreed to commence a joint study on various policy options to enhance economic relations between Japan and Australia, including the feasibility or pros and cons of a free trade agreement, building on the above mentioned work and taking into consideration both sides' sensitivities as recognised by the leaders.

4. The Study Group established has been undertaking the Study under the supervision of the JCC and is to report its conclusions to the JCC which will in turn report the findings of the Study to Prime Ministers. The Study's Terms of Reference and membership are attached. Consistent with the Terms of Reference, representatives from the private sector were invited to present their views to the Study Group.

5. The JCC and the Study Group meetings have been held as follows.

JCC meeting	15 September 2005	Canberra
Joint Study Meeting 1	2 November 2005	Tokyo
Joint Study Meeting 2	9-10 February 2006	Canberra
Joint Study Meeting 3	28-30 March 2006	Tokyo
JCC meeting	30 March 2006	Tokyo
Joint Study Meeting 4	18-21 July 2006	Canberra
Joint Study Meeting 5	20-22 September 2006	Tokyo
JCC meeting	6-7 November 2006	Canberra

Section 2: Summary of Discussions

A Highly Complementary Relationship

6. The Study Group noted the high degree of complementarity between the Australian and Japanese economies. Both countries benefit enormously from the trade and economic relationship which is an important part of the comprehensive strategic relationship between Australia and Japan. The study group noted the profound contribution each country had made to the other's economic development.

7. Japan is Australia's largest trading partner and it has long been, by far, Australia's largest export market. In 2005, Australia's exports to Japan were \$A31.6 billion (around ¥2.7 trillion) - an increase of 24 per cent and larger than Australian exports to China and the United States combined.

8. Australia is Japan's twelfth largest export market and seventh largest trading partner, taking over ¥1.4 trillion (around \$A16.6 billion) of Japan's exports in 2005. Australia is Japan's second largest export market for automobiles and their parts (\$A8.5 billion / ¥713 billion in 2005), and is a key market for many other industrial goods.

9. Australia is Japan's fifth largest source of imports – imports which play a key role in the Japanese economy. Australia is Japan's third largest supplier of minerals and energy and the largest contributor to Japan's energy supply. Australia's stable supply of minerals and energy to Japan is essential for powering the Japanese economy. Japan continues to rely on Australia for well over half its iron ore and coal needs, one sixth of its natural gas needs and one third of its uranium needs. Australia is Japan's largest supplier of a further six key minerals: zinc, bauxite/alumina, lead, silica, titanium minerals and zircon. Australia is one of the world's largest suppliers of resources with the world's largest known reserves of numerous minerals and energy and one of the few net energy exporters in the developed world. At the same time, Japan as a big purchaser of minerals and energy provides an important market for Australia.

10. Australia's high quality, safe food exports are also important to Japan, including as valuable inputs to the food processing and stock-breeding industries. Japan's self sufficiency ratio is as low as 40 per cent on a calorie basis and raising this ratio, ensuring stable and reliable food imports and maintaining multi-functionality of

agriculture are important policy objectives of Japan. Japan aims to ensure stable and reliable food imports through diversifying food supply sources and maintaining relations with major food exporting countries. Japan relies on the United States for 31 per cent of its food imports, the EU-15 for 14 per cent and China for 12 per cent. Under the existing trading arrangements, Australia is Japan's fourth largest supplier of agriculture and food imports supplying 10 per cent of Japan's needs. Japan relies on Australia for half of its beef needs, one third of its cheese requirements and about one fifth of its wheat and sugar consumption. Japanese farmers purchase from Australia more than half of their feed barley.

11. Australia, for its part, relies on Japan for important industrial products. 58 per cent of imported passenger vehicles, 37 per cent of imported commercial vehicles and 27 per cent of imported construction equipment comes from Japan. These contribute to robust economic activity in Australia, including in the mineral and energy fields.

12. Services trade is an important component of bilateral trade. For Australia, Japan is its third largest export market for services and its fifth largest source of services imports. For Japan, Australia was its thirteenth largest export market for services and its ninth largest source of services imports as at end 2005. Tourism and travel receipts are particularly important, and account for the largest proportion of services trade in both directions. As Australia and Japan are both developed economies, with advanced and competitive service sectors, and have a mature economic relationship, there is great potential to expand trade in this sector. Growth in Japan's services exports to Australia in recent years, much in non-travel sectors, is indicative of the potential.

13. Japan is Australia's third largest foreign investor, with an investment stock of \$A53 billion (¥4.5 trillion) as at end 2005. Around 45 per cent of this was direct investment, 44 per cent was portfolio investment and 10 per cent was categorised as other investment. Japanese investment has been vital in developing many of the export industries that drive Australia's strong export performance. In a virtuous circle, Japanese investment to meet Japanese demand has been vital in the expansion of the Australian resource industry, particularly iron ore and coal. Exports of such resources have in turn fuelled Japan's exports worldwide – including to Australia. Japanese investment has also been important for the development of a competitive, export-oriented manufacturing sector in Australia. In tourism Japanese investment has contributed to the growth of the Australian industry, with Japanese-funded infrastructure underpinning a significant proportion of Australia's export earnings in

this sector. Japan has made substantial investments in the Australian food sector to serve demand in Japan and Australia.

14. Australia is Japan's 15th largest source of foreign investment. Australia's stock of investment in Japan was \$A32 billion (¥2.7 trillion) as at end 2005. Direct investments account for less than 1 per cent of the stock. That said, in recent years Australian investors have responded to opportunities provided by Japan's economic reforms and deregulation to make notable investments in Japan. This responsiveness to opportunity can do much to realise the potential for the economic integration of two advanced economies. Australia has a large pool of managed funds, the fourth largest in the world. Australia also has an excellent profile as an investor in other advanced economies. For example, Australia is the ninth largest source of foreign direct investment in the United States. There is scope for growth in the pool of Australian investment in Japan.

15. The study group noted that Australia and Japan were developed, open market economies with strong, transparent regulatory systems that foster competition and provide robust protection for intellectual property and investment. Australia and Japan have similar regimes in such areas and a history of cooperation. This brings certainty and stability, makes an important contribution to the success of a highly complementary economic relationship, and provides an excellent basis for its future growth.

Contributing to Economic Growth

16. The study group noted that econometric modelling undertaken jointly by the two governments, concluded that both countries would derive significant economic benefits from an EPA/FTA.¹ GDP, trade and investment would increase in both countries as a result of an EPA/FTA. These gains were larger than the gains that could be expected from EPAs/FTAs with most others. The estimated magnitude of the macroeconomic gains varied between the two econometric studies undertaken, ranging from 0.66 per cent to 1.79 per cent for Australia's GDP in 2020, and between 0.03 per cent and 0.13 per cent for Japan's GDP in 2020. In net present value terms over 20 years, the lower end of the range of Australia's GDP gains would equate to \$A39 billion (around ¥3.3 trillion), while Japan's would be \$A27 billion (around ¥2.3 trillion). Australian consumers would be \$A19 billion (¥1.6 trillion) better off over

¹ The modelling, which was conducted using the APG-cubed and GTAP/FTAP models, was based on the assumption of full and immediate liberalisation across all sectors. While a useful forecasting tool, all economic models, by definition, are a simplification of reality and rely on numerous assumptions.

20 years, while Japanese consumers would gain \$A68 billion (¥5.7 trillion) over the same period. The study group also noted the modelling indicated a reduction in production and employment in some sectors including those of some agriculture sectors in Japan from trade liberalisation.

Building a Comprehensive Strategic Relationship

17. Referring to the March 2006 joint ministerial statement between the Australian and Japanese Foreign Ministers, “Building a Comprehensive Strategic Relationship”, the study group noted their governments’ commitment to the highest level of ambition in the future development of the relationship. Australia and Japan have a proud record of achievement in working together to improve regional and international security in areas including in East Timor, Afghanistan, and Iraq and on such issues as non-proliferation, the fight against terrorism, and natural disasters. The study group also noted their governments’ commitment to develop and deepen the bilateral economic partnership between Australia and Japan as part of the strategic relationship. The study group assessed that an FTA/EPA would be the most appropriate next step to achieve this. By further integrating our two economies, an EPA/FTA would tie our two democratic, developed countries more closely together and strengthen the comprehensive strategic relationship.

Realising the Relationship’s Potential

18. The study group noted both countries have pursued a policy of negotiating EPAs/FTAs with others. Australia has FTAs with New Zealand, Singapore, the United States and Thailand. It is negotiating FTAs with China, ASEAN and Malaysia. Japan has EPAs with Singapore, Mexico and Malaysia and its EPA with the Philippines was recently signed. Negotiations are at various stages with Thailand, Indonesia, Brunei, Vietnam, ASEAN, ROK, Chile, India and the GCC.

19. Against that background, and noting that 2007 would mark the 50th anniversary of the landmark Australia-Japan Agreement on Commerce, the study group agreed there was merit in an EPA/FTA to establish the platform for economic and trade relationship for the next 50 years. This would ensure that our bilateral ties keep pace with others and that the Australia-Japan relationship continues to grow and achieve its full potential, contributing to the economic well being of both countries.

Building an East Asian Community

20. The study group noted Australia and Japan's shared commitment to building an East Asian community and their governments' resolve to work together to strengthen regional institutions. The study group assessed that a high quality, comprehensive EPA/FTA between Australia and Japan would make a positive contribution to the development of an East Asian community and help to foster stability and prosperity in the Asian region.

Trade in Goods

21. The study group noted that customs duties are levied on over 70 per cent of the goods imported from Japan to Australia, and around 20 per cent of goods imported from Australia to Japan. The study group also noted that the simple average applied tariff of Australia is 3.5 per cent and that of Japan is 7.1 per cent in 2006.

22. The study group assessed that there would be substantial benefits to both countries from an EPA/FTA that liberalised trade in goods. An EPA/FTA would increase export opportunities for Australia and Japan, including by redressing discrimination as a result of FTAs with third countries. An EPA/FTA that liberalised trade in goods would increase economic growth, trade, investment and employment in both countries. It would also foster structural reform and improve productivity. Consumers, including businesses that use the products as inputs to their production, would benefit.

23. The Japanese side explained in detail its sensitivities, particularly in the agriculture, forestry and fishery sector, its concern at the potential impact of tariff elimination, and its handling of sensitive products in its EPAs. It also pointed out that if there were to be an EPA/FTA, negotiators should be mindful to avoid any adverse effects on agriculture, forestry and fishery products of Japan as agriculture reform is now being implemented. It explained the situation surrounding domestic production, demand and supply of a number of sensitive agriculture, forestry and fishery products and the serious impact on local economies by tariff elimination of those products. The Australian side indicated it had a better understanding of Japan's sensitivities and its handling of sensitive products in its EPAs. The study group, having reviewed the track record of each country's EPAs/FTAs with others, agreed the best way to handle these sensitivities was through negotiations, where a flexible, constructive approach would be required.

24. The study group agreed that all options for flexibility, including not only “phasing” but “exclusion” and/or “deferral for later negotiation”, should be available to negotiators. The study group also agreed that considerable flexibility was required while maintaining WTO consistency if a negotiation were to be concluded successfully.

25. Noting Japan’s interest in increasing its agriculture, forestry and fishery exports, the study group agreed that an EPA/FTA should create mutual benefits including by providing increased agriculture, forestry and fishery export opportunities for both countries.

26. The study group agreed there was merit in including chapters on customs procedures and rules of origin in an EPA/FTA. Such chapters would help ensure that the full benefits of trade liberalisation resulting from an EPA/FTA were realised. Customs procedures play an important role to facilitate legitimate trade flows, while also ensuring effective enforcement at the border. There should be appropriate rules of origin to prevent circumvention by goods from third countries, although they should not be an impediment to liberalised trade. The study group noted Australia and Japan had generally adopted compatible approaches to customs procedures and rules of origin in their existing bilateral agreements.

27. The study group agreed that provisions addressing non-tariff measures (NTM) and technical barriers to trade (TBT) would have merit in an EPA/FTA by complementing and giving effect to commitments relating to liberalisation of trade in goods between the parties. These provisions could facilitate trade by committing both governments to regimes that are transparent, provide certainty and minimise transaction costs, and to arrangements that contribute to closer cooperation in the regulatory field, building on existing levels of cooperation.

28. The study group noted that Australia and Japan’s EPAs/FTAs with other countries had addressed NTM and TBT in a similar way. These agreements had included provisions reaffirming the WTO Technical Barriers to Trade agreement, encouraged cooperation in regional bodies, established contact points, and provided for the establishment of a sub-committee on TBT issues.

29. The study group agreed on the importance of SPS, noted that Australia and Japan had a good history of cooperation on SPS issues, and emphasised the necessity for a science-based approach consistent with the WTO SPS Agreement. The study

group agreed that strengthening cooperation and exchange of information on SPS issues was desirable and discussed appropriate ways for this purpose. The study group agreed to identify the most appropriate approach, including within the framework of an EPA/FTA, to work together to find solutions for issues of mutual interest between Japan and Australia.

30. The study group agreed that new technologies could contribute greatly to the speed and efficiency of business transactions, and that measures to promote e-commerce could play an important role in further facilitating bilateral trade. The study group noted that the two governments had included provisions on e-commerce in their existing EPAs/FTAs and that their approaches were compatible. The study group concluded that there would be merit in addressing electronic commerce in an EPA/FTA.

31. They agreed that a range of other trade facilitation measures, including those aimed at improving the business environment, facilitating cooperation between private sector organisations, and promoting research and development cooperation, could also be examined in the context of an EPA/FTA negotiation.

Security of Supply (Food)

32. The study group noted that food is a key part of the economic and strategic relationship and that the good and stable relationship between the two countries had provided benefits for both countries, namely, the reliable supply of safe and high quality food to Japan and export opportunities for Australia. The study group also noted that Japan's policy for securing its food supply was to maintain and enhance domestic production, combined with ensuring stable and reliable imports and stockpiling. An EPA/FTA could assist to strengthen food trade relations and help Japan realise its food security objectives, including in such cases as world supply shortages. Australia would benefit from enhanced export opportunities to its most valuable customer and from closer integration with Japanese food supply chains.

33. The study group concluded that it would benefit both countries to consider measures to strengthen and provide improved stability and reliability in the food supply relationship between Japan and Australia, as part of a comprehensive bilateral EPA/FTA. These could include:

- i) prohibiting the use of measures that prohibit or restrict agricultural exports to Japan and also prohibiting export duties;

- ii) provisions to liberalise and facilitate two-way investment in the food sector;
- iii) measures to help ensure the high levels of safety and quality of food exports;
- iv) provisions to promote transparency and consultation; and
- v) provisions allowing for review of an FTA/EPA with respect to the food sector.

Security of Supply (Minerals and energy)

34. The study group agreed that two-way trade and investment in minerals and energy is a critical element of the bilateral strategic relationship and that both sides derive enormous benefits from it. The study group noted increasing global demand for minerals and energy.

35. The study group noted that Japan is critically dependent on imports of minerals and energy, and that Australia is one of Japan's most important, reliable and stable suppliers of such resources. An EPA/FTA that enhanced the security of supply of minerals and energy would have considerable merit for Japan. At the same time, Australia would benefit from assured and continued access to its largest, most reliable export market, while increased Japanese investment in the Australian minerals and energy sector would contribute to its further development and benefit the Australian economy.

36. The study group noted that neither Australia nor Japan had included a dedicated chapter on minerals and energy in an EPA/FTA before, but that this issue merited particular attention in any EPA/FTA between them.

37. The study group concluded that, as part of a comprehensive bilateral EPA/FTA, it would be feasible to consider provisions to enhance the security of supply of minerals and energy to Japan. Noting the importance both governments attached to trade and investment in the resources sector being based on market principles and the effectiveness of the existing consultation arrangements, the study group concluded that Australia and Japan could consider a chapter on minerals and energy that included commitments such as:

- i) provisions that reinforce the role of the market (for example, by preventing the use of export and import restrictions),
- ii) investment liberalisation and protection provisions that improve the investment environment,
- iii) measures that promote transparency of policy and regulation with respect to the minerals and energy sector,

- iv) provisions for a consultation mechanism involving business with respect to issues in the minerals and energy sector, and
- v) provisions allowing for the review of an EPA/FTA as it applies to the minerals and energy sector.

38. The study group agreed that measures such as these would bring about benefits for both countries, namely contributing to security of supply of important resources to Japan and to economic growth of Australia.

Investment

39. The study group noted the close investment relationship between Australia and Japan and the levels of investment by both in third countries. The evidence indicated that current levels of investment were lower than they could be in both directions, but particularly FDI from Australia to Japan. An EPA/FTA which liberalised and facilitated investment would attract more investment in both directions and be consistent with Japan's objective of promoting inward FDI and contribute further to Australia's economic growth.

40. The study group noted both countries had derived significant gains from bilateral investment and would benefit from its further growth. Japanese investment in the Australian minerals, energy, food, and tourism sectors has contributed significantly to the development of these sectors. Recently Australian investors have taken advantage of new investment opportunities in Japan. These investments have increased tourism to Japan, contributed to economic development in Japan's regional areas, and helped build a closer relationship between the two countries.

41. The study group concluded that in the context of a comprehensive EPA/FTA there was merit in Australia and Japan considering measures that would liberalise, facilitate and protect bilateral investment. Such measures would serve to ensure that both sides reaped the full economic benefits of any EPA/FTA, which would include economic growth, structural reform, and expanded trade and investment opportunities. The study group noted state-investor dispute resolution provisions have been included in some of each side's existing EPAs/FTAs on a case by case basis.

Services

42. The study group concluded that, as Australia and Japan were developed countries with services sectors accounting for more than 70 per cent of each country's

GDP, there was merit for both sides in addressing services, business mobility and recognition of qualifications in any EPA/FTA.

43. The study group assessed that liberalisation and facilitation of trade in services, measures to improve business mobility and addressing recognition of qualifications would create new opportunities for Australian and Japanese services exporters. These measures would increase trade in services and economic growth in Australia and Japan and foster structural reform in both countries.

44. The study group noted that enhanced business mobility, recognition of professional qualifications and increased services trade would increase two-way investment and people-to-people links. Investment liberalisation would also promote growth in services trade and greater exchange among people.

45. The study group noted that Australia and Japan were actively engaged in services negotiations in the WTO and had made ambitious services commitments in EPAs/FTAs with others. The study group concluded it would be important that an EPA/FTA be “GATS-plus”. An ambitious, GATS-plus outcome on services would send a strong message to the region and be a model for future trade and economic agreements in the region.

Intellectual Property

46. The study group agreed the protection of intellectual property was an issue of high priority for Australian and Japanese business. The study group noted the high standards of protection given to intellectual property rights in each country. The study group also noted existing cooperation between Australia and Japan on intellectual property, such as ongoing discussions on streamlining and harmonising the patent system to expedite patent applications and on anti-counterfeiting measures.

47. The study group concluded there would be significant benefits for both countries in including intellectual property commitments in an EPA/FTA. The study group agreed negotiators should explore commitments beyond our existing TRIPS obligations, including measures to enhance cooperation on intellectual property. Such a chapter would have the added benefit of promoting high standards in the region.

Competition Policy

48. The study group noted existing cooperation on competition policy and the importance Australia and Japan attached to competition principles in underpinning the market economy. Both governments have developed compatible approaches to competition policy.

49. The study group noted the important contribution that further bilateral cooperation could make to more effective enforcement of the competition law of each country. The study group concluded that there was merit in including a chapter on competition policy in an EPA/FTA to ensure that the gains from an EPA/FTA could be fully realised. It would also set a standard for others in the region.

Transparency

50. The study group noted that ensuring transparency of relevant laws and regulations was a basic requirement to facilitate trade and investment and provide predictability in business activities. The study group noted that the two governments' approaches to transparency in their respective EPAs/FTAs with third parties were compatible.

51. The study group concluded both countries would benefit from an EPA/FTA that included measures that improved the transparency of their legal and regulatory frameworks.

Dispute Settlement

52. The study group noted a chapter on dispute settlement would provide clear, certain procedures in the event of a dispute between the parties. The study group agreed a dispute settlement chapter should ensure that the parties realised the benefits of an EPA/FTA and encourage the parties to resolve disputes through consultation.

53. The study group concluded that there would be merit in including a dispute settlement chapter in an EPA/FTA.

Government Procurement

54. The study group noted government procurement accounted for a significant portion of the Australian and Japanese economies. Australia estimated that government procurement accounted for around 11 per cent of Australia's GDP. Japan estimated that government procurement accounted for around 5.7 per cent of Japan's GDP. The study group noted that both parties had included chapters on government procurement in their existing FTAs/EPAs with third countries and that Australia was not a party to the WTO Agreement on Government Procurement and that it had no intention of becoming one. The study group noted that with respect to government procurement, an FTA/EPA could include provisions on national treatment and non-discrimination.

55. The study group concluded that there was merit in addressing government procurement in an EPA/FTA and considering measures such as those provided for in EPAs/FTAs which Japan and Australia respectively have concluded with third countries.

Section 3: Analysis and conclusions

56. The study group concluded that a comprehensive and WTO-consistent EPA/FTA would bring about considerable benefits to both countries. The study group also concluded that there were sensitivities on both sides and that for the EPA/FTA to be feasible, such sensitivities needed to be handled in an appropriate manner while balanced and mutual benefits needed to be realised.

57. The study group concluded that a comprehensive and WTO-consistent EPA/FTA would bring about significant benefits to Australia and Japan:

- Consistent with the commitment of the Australian and Japanese governments to the highest level of ambition in the future development of the relationship, an EPA/FTA would develop and deepen the strategic partnership between Australia and Japan as two democratic, market-based, developed countries sharing many common values and interests.
- Noting that 2007 will mark the 50th anniversary of the landmark Australia-Japan Agreement on Commerce, an EPA/FTA between Australia and Japan would greatly enhance the economic and trade relationship for the next 50 years. Such a foundation would ensure that the economic relationship achieves its full potential and continues to make a major contribution to the well being of both countries.
- At a time when Australia and Japan are both actively pursuing preferential arrangements with other trading partners, an EPA/FTA would address discrimination resulting from each country's EPAs/FTAs with others.
- An EPA/FTA would foster economic integration in the region based on market principles and be an important step in the two countries' shared aspiration to build an East Asia community.
- By facilitating closer integration of the Australian and Japanese economies, an EPA/FTA would deliver major economic gains for both countries. These gains would include increased economic growth, production, national wealth and consumer welfare, through increased opportunities for trade in goods and services as well as investment. Against the backdrop of our ageing populations, an EPA/FTA would promote ongoing economic reform and increase productivity in both countries.

- An EPA/FTA would create new opportunities in the services sector which makes up around three quarters of both our economies and employs the bulk of our people, including by improving business mobility.
- An EPA/FTA would tie Japan more closely to the largest contributor to Japan's energy supply and its third largest supplier of minerals and resources overall, reinforce the role of the market, and ensure reliable supplies of key minerals and energy into the future. An EPA/FTA would also help Japan realise its food security objectives.
- An EPA/FTA would provide Australia with enhanced export opportunities to the world's second largest economy and its largest market for minerals, energy and food. An EPA/FTA would promote greater Japanese investment in Australia which would integrate Australia more closely with the Japanese market.

58. Notwithstanding the significant benefits of an EPA/FTA, the study group concluded that, as with all bilateral EPA/FTA negotiations, there are sensitivities on both sides. In particular, it was recognised that agriculture is an especially sensitive area for Japan and the study group noted how sensitivities had been handled in each country's respective EPAs/FTAs. The best way to handle these sensitivities was through negotiations, with both sides taking a flexible, constructive approach, with a view to achieving a mutually beneficial package of benefits. Thorough and adequate consultations during the course of negotiations would be necessary without setting a rigid deadline.

59. The study group concluded it would be feasible to negotiate an EPA/FTA, bearing in mind the sensitivities of both sides. Should the negotiations begin on the EPA/FTA between Australia and Japan, this should be guided by the following:

- Negotiations should begin with all products and issues, as well as all options for flexibility, including not only "phasing" but "exclusion" and/or "deferral for later negotiation", on the table.
- An EPA/FTA should be comprehensive. The negotiations should cover trade in goods and services, investment, security of supply of resources and food, customs procedures, rules of origin, non-tariff measures and technical barriers to trade, cooperation on sanitary and phytosanitary issues, trade facilitation, government

procurement, intellectual property, competition policy, transparency and dispute settlement.

- An EPA/FTA must be WTO-consistent and wherever possible should seek to be WTO-plus.
- An EPA/FTA should be concluded through a single undertaking to achieve a balanced outcome.

Annex

Private sector views

(NB: Sessions with private sector representatives were held in accordance with “Chatham House Rule”.)

Points made at one session

(1) Points were made as follows:

- The contents of a Japan-Australia FTA must be different from that of the FTAs/EPAs Japan has concluded with ASEAN countries. In order to ensure a stable supply of mineral/energy resources, food security, and to establish a model EPA in the region, Japan should promote an FTA/EPA with Australia.
- Regarding the ideas for securing supply of mineral/energy resources and food on a long-term basis, those ideas could include at least provisions for consultation in cases of emergency and for commitment of a ban on export restrictions.
- Protective measures on domestic industry have a negative impact on the public, at the cost of consumers. Some items would need special treatment under FTA/EPA, but FTA/EPA would not have a strong impact on Japanese agriculture. Australian beef cannot replace Japanese “wagyu” beef.
- The importance of FTA/EPA between Japan and Australia lies more in a bilateral context, such as securing stable supply of mineral/energy resources and food, than in a context of division of labour in the region.

(2) Points were also made as follows:

- Japan depends for 60 per cent of its food on import from foreign countries. In particular, more than half the agricultural products imported from Australia are sensitive items such as rice, wheat, barley, sugar, dairy products and beef. Farming in Japan is extremely small-scale compared to Australia and tariff elimination of these sensitive items would have a serious effect.
- Japan, therefore, has been applying exceptional measures for these sensitive items in other EPA negotiations. We cannot conclude an FTA with Australia, if

it includes tariff elimination of these sensitive products. The Australian side refers to an analysis that an FTA between the two countries would bring only a 5 per cent increase in Australian exports of agricultural products to Japan, but this is an impact on agriculture in Japan as a whole. Impact of tariff elimination on specific product, such as that on grains and dairy products, would be very large.

- If tariffs are eliminated for these agricultural imports from Australia to Japan and other countries request the same treatment, Japan's agriculture and its reform would not be able to endure. Therefore, tariff elimination in sensitive products cannot be accepted.

(3) Points were also made as follows:

- The relationship between the Japanese and Australian business sector has been strong and stable, but has been taken for granted. Considering recent developments in the international arena, further enhancement of the relationship is required.
- Trade in goods and services, investment, access to government procurement markets, financial transactions, communication, tourism and other activities can further promoted and the FTA will be an important step for this. The FTA will be a good opportunity to help Australian business to reaffirm the significance of economic relationship between the two countries. It is also effective for the movement of people and investment and the securing of reliable sources of energy and resources.
- Regarding agriculture, the scale of Australia's agriculture sector is much smaller than that of Japan, and Australia's agriculture sector will never be able to overwhelm Japan's. Joint econometric modelling indicated that Japan's agricultural exports would increase as a result of an FTA. An FTA would be beneficial for both countries.

(4) Points were also made as follows:

- The Joint Study should be completed by the end of this year and EPA/FTA negotiations should be started in 2007.
- Japan is dependant on imports for its energy supply and Australia is a major and reliable supplier of energy. Australia and Japan have built a bilateral partnership that could only be described as "indivisible". In recent years, however, the

environment surrounding natural resources has changed. Demand in other countries has increased rapidly, but this must not work to the detriment of Japanese businesses that has long been making investments.

- Japanese businesses are looking for new investment opportunities, and strongly request that the Japan-Australia FTA remove the restrictive measures on investment and the movement of people and take steps to improve the investment environment. This will also contribute to economic integration in the region. Delay in the conclusion of the FTA will result in competitive disadvantage for Japan. The AUSFTA had put Japanese companies at a disadvantage, compared to US companies.
- The two countries should aim for a comprehensive FTA but show flexibility on certain agricultural products whose liberalization is difficult for Japan.

(5) Points were also made as follows:

- Though there are some sensitive issues in agricultural products, it is necessary to carry out negotiation for an FTA between the two countries as early as possible, in view of the trends in the global community. Sensitive issues can be overcome.
- An FTA would provide high-quality and safe food at reasonable prices and would enhance the standards of living for consumers. Food security and food safety is very important for Japan and Australia has an excellent reputation in this regard. It is important for Japan and Australia to swiftly conclude an FTA/EPA from the viewpoint of securing stable supply of food.
- Structural reforms in the agriculture sector should be carried forward, while flexible measures should be taken for some sensitive products, such as suspension of liberalization for a certain period and a gradual reduction in tariffs.
- The structural reforms may cause pain, and technical innovation, expansion in farming scale and policies to facilitate these are necessary. Farmers and cooperatives are already making efforts, such as direct supply of quality food to retail companies. The concerned parties' willingness to innovate and sense of crisis against competition can be a springboard to differentiate Japanese agricultural products from foreign products and provide high added value in order to realise structural reform in Japan's agriculture, forestry and fisheries sectors.

(6) Points were also made as follows:

- Australia is the second largest export destination of automobiles from Japan. Australia has already entered into FTAs with the US and Thailand, which resulted in competitive disadvantage for Japan compared to these countries. Australia is one of the world's most fiercely competitive auto markets. The elimination of a 5 per cent tariff is a significant advantage, as seen in the FTA between Chile and Korea where elimination of 6 per cent of tariff resulted in significant increase in Korean automobile exports.
- An FTA between Japan and Australia would reduce the cost of auto parts, which is important for automakers there, as two-thirds of the automobiles manufactured in Australia are exported and the export of automobiles from Australia is important. Japanese auto companies in Australia have contributed to its economy through their production and exports.
- A network of production-sales-procurement operations among Japan, ASEAN and Australia would create the best combination of manufacturing bases and R&D bases, with important R&D bases in Australia having competent engineers.
- We look forward to positive progress in the Japan-Australia FTA.

(7) A paper on the sensitivity in fishing industry was submitted.

Points made at another session

- The bilateral economic relationship was highly complementary. Both sides derive extraordinary benefits from it. It was strategically important.
- Joint statements by the Australia-Japan Business Cooperation Committee and the Japan- Australia Business Cooperation Committee as well as deliberations at the 2006 Australia Japan Conference and a symposium sponsored by Nippon Keidanren and the Japan and Tokyo Chambers of Commerce and Industry demonstrated that the Australian and Japanese business communities strongly supported an FTA.
- An FTA should be WTO-consistent and comprehensive addressing goods, services, investment and other issues such as business mobility, intellectual property, competition policy and government procurement. It should create a common economic space between the two most developed countries in the region – one in which goods, money, people and ideas could move more easily.
- An FTA would deliver economic growth for both countries and improve living standards in Australia and Japan, particularly in the context of our ageing populations. It would do this by increasing trade and foreign direct investment and by contributing to productivity increases in both countries.
- An EPA/FTA would address the discrimination resulting from existing FTAs.
- The projected rise in regional urbanisation and living standards in East Asia predicts strong competition for both resources and food.
- An EPA/FTA is an opportunity for Japan, in a world of “resources deficit”, to gain security of supply of minerals and energy. An EPA/FTA would formalise the best of what we already have with respect to this aspect of our relationship and what we hope to achieve. Reflecting the importance of the strategic relationship, the minerals and energy sector is one that cannot stand still. Tariffs on resources are low, but an EPA/FTA could encourage further Japanese investment into this sector as a means of guaranteeing access and security of supply as well as encouraging resources exploration and the benefits of long term contracts.
- Bilateral FTAs are also a vehicle for ensuring food supply through both increased trade and heightened equity participation. Food security is increasingly important as demand for food in East Asia continues to rise.

China's overall diet, for example, is heavily weighted on cereals and vegetables but urban diets are better balanced with dairy, meat and fruit accounting for a greater proportion of what people eat. This predicts increasing demand for food as incomes in China increase and greater demand for dairy, meat and fruit in particular.

- An EPA/FTA would help Japan realise its food security objectives including by improving the terms for direct investment by Japanese firms in Australia and providing an incentive for ensuring that Australian agriculture exports were appropriately tailored for the Japanese market.
- An EPA/FTA would increase Japan's agricultural exports, improving the competitiveness and sustainability of Japan's agricultural sector and helping to achieve the Japanese government's goal of doubling Japan's agricultural exports by 2009.
- While Australia would continue to be a reliable supplier of high quality, safe agricultural produce to Japan, an EPA/FTA would not have a significant negative impact on Japan's agricultural sector. Japan's agricultural production was three times Australia's, Japan's agricultural imports from Australia were only 6 per cent of Japan's agricultural production, and there were limits to Australia's production capacity due to the lack of suitable land and water.
- There were sensitivities in both countries. Dealing with these issues in an EPA/FTA would require flexibility and creativity. They should not be the cause for delaying negotiations.
- In relation to Japanese agriculture, its sensitivity is well understood. It is necessary to have a flexible approach to address concerns regarding sensitive products. On the other hand, exclusion of agriculture from an EPA/FTA could not be accepted, but Australian producers and exporters have no wish to harm Japanese agriculture. An EPA/FTA would not do so, but could open the way for productive cooperation in the agrifood sector.
- An EPA/FTA would create new opportunities in sectors such as financial services, telecommunications, professional services, education, tourism, health and aged care, and tourism. The services sectors accounted for more than 70 per cent of each of the Australian and Japanese economies and employed the bulk of our people.

- Increasing the mobility of capital is a particularly important priority for an FTA/EPA. It is key to unlocking the potential economic growth from which both countries would benefit.
- An EPA/FTA would have an important head-turning effect. It would signal to Australian business that Japan was “open for business” and refocus their attention on Japan.
- An Australia-Japan EPA/FTA, which would be a high quality agreement between two developed economies, and would show leadership in the process of regional integration.
- Ensuring a stable and predictable business environment is essential for foreign companies to do business. An EPA/FTA would help secure such an environment for the future, including in the area of mineral and energy resources. An EPA/FTA would also contribute to securing a stable flow of trade in energy, resources and food.
- Australia and Japan should conclude an FTA as a matter of priority.

Attachment 1

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

Terms of reference

1. Purpose of the Study

In order to further develop and deepen the bilateral economic partnership between Australia and Japan, both countries will study various policy options to enhance the economic relationship, including the feasibility or pros and cons of a bilateral Free Trade Agreement (FTA), as decided by Prime Ministers Koizumi and Howard in April 2005.

2. Status of the Study

The work of the Study will be overseen by the JCC (Joint Consultative Committee). The Study Group will report its conclusions to the JCC. The JCC will report the findings of the Study to Prime Ministers.

3. Duration of the Study

The Study will be completed within two years from April 2005, unless otherwise directed by the JCC.

4. Scope of the Study

Without prejudice to the position of either country, and taking into consideration both sides' sensitivities as recognised by leaders, the study will assess all aspects of trade and economic relations, including the following areas, building upon the work undertaken under the Trade and Economic Framework.

(1) Feasibility or pros and cons of (i) a comprehensive bilateral Economic Partnership Agreement (EPA) or Free Trade Agreement (FTA)

- Trade in goods, including tariffs, non-tariff measures, customs procedures and related matters, and rules of origin
- Trade in services, movement of business people, and recognition of qualifications
- Investment
- Energy and mineral resources
- Government procurement

- Intellectual property
- Competition policy
- Technical regulations and standards
- Other trade facilitation and regulatory measures, including but not limited to e-commerce and paperless trading
- Dispute avoidance and resolution
- Transparency
- Security of supply
- Other matters such as sanitary and phytosanitary measures (SPS)

and (ii) other possible policy options to enhance the economic partnership, covering those aspects above.

(2) Other aspects

The Study Group will also explore other possible ways to enhance economic relations including tourism, other people to people exchanges of economic interest, training of entrepreneurs, R&D cooperation and other trade facilitation and regulatory measures. It will also exchange information on possible new areas of cooperation, such as biotechnology, renewable energy, etc.

5. Membership

Membership of the Study Group will comprise government officials only. The Study Group meetings will be co-chaired by both countries. On the Japanese side, representatives from 4 ministries will formulate a co-chair group and the representative from the Ministry of Foreign Affairs will act as co-ordinator. On the Australian side, the Department of Foreign Affairs and Trade will act as co-chair and co-ordinator. Representatives from the business and academic sectors may be invited to present their perspectives.

6. Schedule

In principle, meetings of the Study Group will be held alternately in both countries with a three to four month interval, or more often if agreed.

Attachment 2

The study was overseen by the Joint Consultative Committee, co-chaired by Dr Geoff Raby, Deputy Secretary, Department of Foreign Affairs and Trade, and Mr Mitoji Yabunaka, Deputy Minister, Ministry of Foreign Affairs.

Study group participants

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Department of Foreign Affairs and Trade

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Australian Embassy, Tokyo

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