

Summary: Australia-Japan Research Centre and Japan Research Institute Public Forum, Tokyo, 25 April 2024

Searching for productivity growth in Australia & Japan

On 25 April 2024, the Australia-Japan Research Centre and the Japan Research Institute co-hosted a public forum in Tokyo titled 'Searching for Productivity Growth in Australia & Japan'. The discussions covered a broad spectrum of topics, including enhancing productivity growth in both countries, managing the energy transition and dealing with the strategic competition between the United States and China.

The economic development of Japan and Australia has been dependent on 'Open Regionalism' since the Second World War. Open Regionalism promotes non-discriminatory trade practices and has been a cornerstone of the regional economic framework, contributing significantly to the Asia-Pacific's economic stability and growth.

The Australia-Japan bilateral relationship has its foundations in the Australia-Japan Commerce Agreement of 1957 where Australia granted Japan most favoured nation status in exchange for Japan removing protections on key industries. The relationship has since expanded, and during the 1973 Oil Shock, Japan was able to depend on Australia as a trusted trading partner for energy imports.

The 1957 agreement was a pivotal moment for both countries, fostering non-discriminatory trade practices in line with the General Agreement on Tariffs and Trade (GATT). This agreement was crucial for Japan's rapid industrialisation and Australia's prosperity, particularly in the mining sector which supplied the raw materials essential for Japan's economic development. Australia has since become the largest supplier of energy to Japan.

But the Australia-Japan relationship, primarily built on the trade of coal and gas, will require significant transformation to meet net-zero targets, as the contribution of coal and gas diminishes. In fact, even without the threat of climate change, the world would still need to transition away from fossil fuels as global energy demands increase and prices rise with the development of the rest of the world.

Thanks to their complementary economic endowments, however, Japan and Australia are still well-positioned to maintain a strong relationship under a changed energy mix. Japan can continue to excel in areas where it has a comparative advantage, such as advanced manufacturing, while Australia can supply the necessary inputs for these economic activities through the production of green steel and other resources.

An external environment favourable to cooperation is a critical priority for both Australia and Japan. But the global consensus on openness and trade is under threat by zero-sum strategic competition between China and the United States, which threatens to spillover to other nations. Sanctions and export controls, aimed at preventing each other from reaching technological frontiers, effectively increase the difficulty and cost of developing and implementing the new technologies essential for meeting the net-zero targets that Australia and Japan have committed to.

These geopolitical tensions exacerbate a broader slowdown in global growth forecasts, largely attributed to a decrease in total factor productivity. The IMF identifies misallocation of labour and capital, particularly within the service sector, as a critical issue exacerbating this decline. In Australia, productivity growth is underwhelming, with the flow of labour and capital not as efficient as it could be. New migrants often join less productive firms, challenging the assumption that labour naturally moves towards more productive enterprises.

While the export of commodities like iron ore and LNG significantly impacts Australian household income levels, the increasing dominance of service sectors and their associated challenges are becoming more crucial to understanding and enhancing productivity in Australia.

In Japan, a declining and aging population is creating significant challenges for productivity. The country's working-age population peaked in 1994 and has since declined by 15.2 per cent— a demographic decline that no country, save those affected by war or disease, has experienced. This decline is the most significant cause of the so-called 'lost decades' rather than the commonly blamed deflation. In fact, although Japan's overall GDP growth has been stagnant since the end of the Bubble era, its GDP growth rate per working-age population is the highest among G7 countries. This has been partially driven by increased participation in the workforce from women and the elderly.

The declining population in Japan not only affects productivity growth by reducing the pool of innovators, but also complicates the delivery of infrastructure and services to regional areas, which are most heavily impacted by population decline. Aging further hampers productivity growth as aging societies are slower to adopt new technologies and have different policy priorities. Politicians must cater to the interests of the elderly, who tend to focus more on pension and social security issues. And as the domestic market shrinks, Japanese firms increasingly invest overseas in pursuit of growing markets.

To improve productivity in Japan, it is necessary to not only target productivity itself, but to look more broadly at improving social welfare through both traditional economic measures and social policies. Japan can address some of its labour demands through increased automation, greater female participation in the workforce and improved labour allocation. Although Japan has higher levels of female workforce participation than the United States, few women hold managerial positions, and the majority are employed in part-time roles. Efforts are needed to better utilise this labour pool and to attract skilled migrants with pathways to residency to meet Japan's future labour needs.

Australia and Japan face substantial challenges that demand comprehensive solutions, involving policy, economic and social components. Addressing these challenges will be necessary to not only weather the impacts of climate change but to improve productivity and social welfare between the two nations. With their shared interests and significant influence, Australia and Japan are uniquely positioned to lead by example and use the rules-based international system to effectively overcome these challenges.