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Expectations of the empire connection and the Trade Diversion Policy, 1936–37

Hugh White, in what has become a familiar refrain in assessments of Australia's contemporary relations with China and the US, argues that today is the first time in the nation's history that 'our biggest trading partner—and our biggest potential trading partner—has not been a close ally'. This situation is complicated by the fact that China is a strategic rival of the US.¹ While White rejects the notion, many hold that Australia need not choose between China and the US and the trade and security interests they represent.² These assertions disregard the situation in the 1930s, when Japan was both a significant market for Australian goods—at one

1 Lowy Institute, 'In conversation: Hugh White on How to Defend Australia' (Lowy Institute, Sydney, 16 July 2019), available from: www.lowyinstitute.org/news-and-media/multimedia/audio/conversation-hugh-white-how-defend-australia. See also, Peter Grete, 'China Rising: The Challenges for Australia as China and the US Struggle for Supremacy in Asia', *Four Corners*, [ABC TV], 3 October 2016, available from: www.abc.net.au/4corners/four-corners-china-rising-promo/7890504.

2 For assertions and assessments of this view, see Alex Lavelle, 'Australia Doesn't Have to Choose US Over China or Vice Versa', *The Age*, [Melbourne], 1 March 2018, available from: www.theage.com.au/national/australia-doesn-t-have-to-choose-us-over-china-or-vice-versa-20180301-p4z2cd.html; Rod Lyon, 'What Happened to the "Canberra Consensus" on Australia–China Relations?', *The Strategist*, 3 July 2019 (Canberra: Australian Strategic Policy Institute), available from: www.aspistrategist.org.au/what-happened-to-the-canberra-consensus-on-australia-china-relations/. Remy Davidson judged the 2017 Foreign Policy White Paper to be a continuation of Australia's policy of hedging its bets. Remy Davidson, 'Australia is Hedging its Bets on China With the Latest Foreign Policy White Paper', *The Conversation*, 23 November 2017, available from: theconversation.com/australia-is-hedging-its-bets-on-china-with-the-latest-foreign-policy-white-paper-88009. Until recently, White was himself of the view that Australia need not choose between China and the US as the two nations could be convinced to share power.

point, Australia's second-best export market—and a challenger to British commercial interests and dominance in the Asia-Pacific region. The 1936 Trade Diversion Policy was a point at which Australia did, in fact, choose, highlighting the interplay between trade, diplomacy and defence and the nation's longstanding dilemma of constructing foreign policy within an asymmetrical relationship.

On 22 May 1936, Henry Gullett, who was responsible for the negotiation of trade treaties, announced a new protectionist policy targeting Japanese textile imports. This policy was known as trade diversion. Japan's immediate and predictable response was to boycott Australian exports, leading to a heated, albeit short-lived, trade war. Although the Australian government suggested the trade diversion measures were designed to eradicate its trade deficit, Japan was the nation's second-best trading partner with a balance of trade firmly in Australia's favour.³

There are two prevailing assessments of the Trade Diversion Policy. For many, the contradictory economic logic of trade diversion renders the episode a disaster that 'achieved a maximum of irritation with a minimum of benefit' as Joseph Lyons' government naively sacrificed trade relations with Japan for the sake of British textile producers.⁴ Kosmas Tsokhas and others reject this 'imperial fallacy' in which Australia was a 'passive victim' of British pressure.⁵ Instead, trade diversion was a calculated gamble influenced by domestic politics that was designed to better position Australian exports in the British market, and any benefits afforded to Britain were only of secondary importance.⁶

3 "Considerations which led to the Adoption of the Trade Diversion Policy", Department of Trade and Customs Memorandum, [n.d. (1937)], NAA: A1667, 430/B/52A.

4 Eggleston, *Reflections on Australian Foreign Policy*, 3. See also J.B. O'Brien, 'Empire v. National Interest in Australian-British Relations During the 1930s', *Historical Studies* 22, no. 89 (1987): 569-86; Stuart Ward, 'Sentiment and Self-Interest: The Imperial Ideal in Anglo-Australian Commercial Culture', *Australian Historical Studies* 32, no. 116 (2001): 91-108, at p. 93.

5 Kosmas Tsokhas, 'The Wool Industry and the 1936 Trade Diversion Dispute Between Australia and Japan', *Australian Historical Studies* 23, no. 93 (1989): 442-61, at p. 459.

6 *ibid.*, 442-61; Kosmas Tsokhas, *Markets, Money and Empire: The Political Economy of the Australian Wool Industry* (Melbourne: Melbourne University Press, 1990), 12-15, 98-118. See also Drummond, *Imperial Economic Policy, 1917-1939*, 375-6, 398-406; D.C.S. Sissons, 'Manchester v. Japan: The Imperial Background of the Australian Trade Diversion Dispute With Japan, 1936', *Australian Outlook* 30, no. 3 (1976): 480-502, at pp. 495-8; D.C.S. Sissons, 'Private Diplomacy in the 1936 Trade Dispute With Japan', *Australian Journal of Politics and History* 27, no. 2 (1981): 143-59.

Despite their differences, these two assessments similarly depict trade diversion within a vacuum, overlooking the range of pressures that contributed to the policy and had been building for several years. This chapter broadens the historical understanding of the trade diversion episode and its aftermath by bringing into focus the interplay between economics, security and the expectations of empire membership, in terms of both British pressure to act on behalf of its economic interests and what Australia sought to negotiate in return. What emerges from the Trade Diversion Policy case study is an important lesson, for the Australian policymakers of the 1930s and today.

The Trade Diversion Policy

In February 1935, in what appeared to be a very natural progression after years of increasing commercial relations, negotiations opened between Japan and Australia for the Treaty of Friendship, Commerce and Navigation. Early negotiations focused on a reciprocal most-favoured nation (MFN) status and greater liberty for cargo ships to port.

The negotiation process appeared outwardly smooth and it was generally assumed a mutually beneficial settlement would be reached.⁷ It therefore came as somewhat of a surprise when negotiations reached a stalemate in March 1936. The central issue was Gullett's advice to the Japanese Consul-General, Kuaramatsu Murai, that unless Japan agreed to a voluntary quota on rayon and cotton piece goods exported to Australia, negotiations could not continue. The proposed quota was 75 million square yards (62.7 million square metres) per annum, compared with the 152 million square yards (127 million sq m) purchased by Australia in the previous financial year. In return, Gullett offered an intermediate tariff rate. This rate established a median between the tariff rates foreign nations paid and those paid by empire nations as stipulated in the 1932 Ottawa Agreements.⁸ In the context of negotiating a trade treaty and Australia's significantly favourable trade balance, Japan expected reciprocal trade to be

7 'Revised Draft Treaty of Commerce and Navigation between Japan and the Commonwealth of Australia, 13 February 1935', NAA: A981, Trad 68 Part 2. MFN grants the best possible trade terms to a trading partner. Other MFNs would be treated equally, but not better. For Australia, this would be MFN status outside the benefits enjoyed by other members of the British Empire.

8 'Longfield Lloyd (Trade Commissioner in Japan), to Murphy (Secretary Department of Commerce), 12 March 1936' and 'Longfield Lloyd to Murphy, 16 March 1936', NAA: A601, 402/17/28.

expanded rather than restricted. Gullett's proposal was simply unacceptable and Japan's refusal to cooperate led to the breakdown of negotiations. On 22 May 1936, Gullett announced the Trade Diversion Policy.⁹

With a narrow range of primary exports and reliance on foreign markets for manufactured goods, Australia continued to struggle to maintain a balance-of-payments surplus. The Trade Diversion Policy was promoted as addressing this problem by increasing sales of primary exports, expanding the nation's developing secondary industries and, in turn, increasing employment. The Trade Diversion Policy amended the licensing system for foreign goods, prohibiting the importation of more than 90 classes of goods unless the Australian government granted special approval. Additionally, the customs duties on foreign rayon and cotton were increased to 40 per cent and between 68 and 85 per cent, respectively.¹⁰

These measures targeted so-called bad customers—those nations benefiting from unfair trade advantages or with whom Australia had a trade imbalance. It was hoped the threat of exclusion would force bad customer nations to pursue a more favourable position in Australia's market. Conversely, 'good customers' could easily apply for a licence, thereby exempting them from the new restrictions. Australia expected to benefit in kind with increased purchases from good customers.¹¹ In this way, Gullett informed the House of Representatives: '[W]e have resolved to give more room in this market to those who are our great buyers, and somewhat less room to those who are indifferent buyers.'¹²

The two countries most affected by trade diversion were the US and Japan. The US was a bad customer. In the face of a continuing trade imbalance, a series of embarrassing and ill-fated proposals for an Australian-US bilateral trade agreement and mounting pressure from commercial circles, the Australian government 'had no alternative but to seek an adjustment of the unsatisfactory trade position by unilateral action'.¹³ Trade diversion sought to protect Australia's primary and fledging secondary industries

9 CPD: *Representatives*, 22 May 1936, No. 21, 2211–20.

10 *ibid.*; 'Adoption of Trade Diversion Policy, [n.d. (1937)]', NAA: A1667, 430/B/52A.

11 "Government's Courageous Trade Policy", Press Release, Prime Minister's Department, 1 June 1936, in Prime Minister's Department: Records relating to the Imperial Conference, 1937, NAA: CP4/2, 33.

12 CPD: *Representatives*, 22 May 1936, No. 21, 2213.

13 'The Trade Diversion Policy, [n.d. (1937)]', NAA: A1667, 430/B/52A.

against the United States' developed and heavily subsidised industries.¹⁴ The Department of Trade and Customs estimated an annual gain of more than £580,000 in increased sales from Australia's secondary industries as a result of the new measures affecting the US.¹⁵

While the US was undeniably a bad customer, the same could not be said of Japan. That nation's response was swift and harsh. On 25 June 1936, the Japanese government announced a boycott of Australian wool purchases. A special import duty of 50 per cent was also introduced for other Australian goods. The Australian government retaliated by placing licensing restrictions on a further 38 classes of Japanese exports.¹⁶ The two nations were locked in a trade war.

The inconsistency of trade diversion in Australia's recent trade relations with Japan sparked a great deal of criticism among the Australian public. R.L. Curthoys, former editor of Melbourne's *The Argus* and an Australian correspondent for *The Times* of London, concluded that the policy was 'a complete repudiation' of the 1934 AEM and the appointment of a trade commissioner in Tokyo, 'the obvious implication' of which was 'that Australia intended to do more business with her Pacific neighbours'.¹⁷

Among the most vocal in their criticism of trade diversion were, unsurprisingly, Australian wool producers. Prior to May 1936, Australia had provided Japan with an estimated 85–95 per cent of its raw wool requirements—one-quarter of Australia's total annual wool clip.¹⁸ Joseph P. Abbott, Vice-Chairman of the Australian Woolgrowers' Council and President of the Graziers' Association of New South Wales, described Japan's wool purchases as having sustained the Australian wool industry during the Great Depression and being 'an outstanding factor' in the nation's ongoing economic recovery.¹⁹ The architects of trade diversion had initially assumed that Japan's dependence on Australian wool would force the nation to negotiate a quick settlement and accept a voluntary

14 *ibid.*

15 *CPD: Representatives*, 22 May 1936, No. 21, 2214. It was estimated that more than £1.7 million in trade would be diverted annually from the US. For a recent assessment of the impact of trade diversion on Australian–US commercial relations, see Shannon Tow, *Independent Ally: Australia in an Age of Power Transition* (Melbourne: Melbourne University Press, 2017), 84–113.

16 R.D. Westmore, 'Japan and the Trade Diversion Policy', *The Australian Quarterly* 9, no. 1 (1937): 93–6, at p. 95.

17 R.L. Curthoys, 'Australia in the Changing East', *Foreign Affairs* 15, no. 4 (1937): 750–6, at p. 752.

18 Cumpston, 'The Australian–Japanese Dispute of the Nineteen-Thirties', 50.

19 'Statement by Vice-Chairman of Australian Woolgrowers' Council, J.P. Abbott, at deputation to Prime Minister, J.A. Lyons, 17 July 1936', in Copland and Janes, *Australian Trade Policy*, 295.

textile quota. Although Australian wool was preferable, Japan was able to meet its needs by importing from South Africa.²⁰ With the boycott in place and an alternative wool supply sourced, the value of Japan's wool purchases from Australia fell by almost 50 per cent between 1935–36 and 1936–37.²¹ During the 1937 annual conference of the Graziers' Association of New South Wales, an irate Abbott restated the damages of trade diversion, remarking that wool was Australia's 'lifeblood' and 'those who would cut us off from our international markets would cut the carotid artery of the nation and bleed Australia to death'.²²

For Abbott and his contemporaries, it appeared that Australia's commercial interests had been sacrificed on the 'altar of Imperial sentiment'.²³ In addition to the higher import duties on foreign textiles introduced under trade diversion, the imperial preference tariff on British textiles was lowered.²⁴ In terms of fiscal returns, Britain was the largest benefactor of trade diversion. Of the estimated £2.3 million that would be diverted annually from bad customers, £1.3 million would benefit British producers. Australia expected to receive considerably less at £845,000. The remanding trade would be diverted to other good customers, predominantly within the Empire.²⁵ To critics of trade diversion, the government appeared to have disregarded Japan's competitive advantage in textile production, along with the benefits to Australian consumers of affordable manufactured goods, in an attempt to protect British trade interests.²⁶

Following Japan's retaliatory actions, Australian Prime Minister Joseph Lyons offered his government's justification for the trade diversion measures in a nationwide radio broadcast. Lyons lay 'the entire

20 'Longfield Lloyd to Murphy, 16 June 1936', NAA: A1667, 194/B/4/A/2 Part 1.

21 Japan's wool purchases from Australia for 1935–36 totalled £14.6 million; for 1936–37, wool purchases totalled only £7.5 million. *Official Year Book of the Commonwealth of Australia*, No. 30 (1937), 511, and No. 31 (1938), 515.

22 'Address of the President of the Graziers' Association of NSW, J.P. Abbott, at Twentieth Annual Conference, 1 March 1937', in Copland and Janes, *Australian Trade Policy*, 298.

23 Edward Masey, *Is It Necessary? An Examination of the Commonwealth Government's Trade Diversion Policy* (Sydney: Stafford Printing, 1936), 11.

24 *CPD: Representatives*, 22 May 1936, No. 21, 2215–17.

25 *ibid.*, 2214; Earl Page, *Truant Surgeon: The Inside Story of Forty Years of Australian Political Life*, ed. Ann Mozley (Sydney: Angus & Robertson, 1963), 246. These figures did not account for motor vehicle chassis—exports of which received a separate licensing system and duties to account for British Empire member Canada's proximity to the US—nor benefits to Lancashire, which were estimated at £10 million annually.

26 Masey, *Is It Necessary*, 3, 10, 14–18; 'Press Statement by the Premier of Queensland, William Forgan Smith, 28 December 1936', in Copland and Janes, *Australian Trade Policy*, 323.

responsibility’ for trade diversion at the foot of Japan and its textile exporters, who had ‘continuously and drastically’ reduced the prices of their goods beyond reasonable competition. The Australian textile market had traditionally been reserved for British exports. As Japan’s prices fell, the market in Australia for British textiles ‘was doomed to extinction’.²⁷ In 1932, Britain had sold 167 million square yards (140 million sq m) of cotton piece goods and 8 million square yards (6.7 million sq m) of rayon piece goods to Australia. By 1935, this had fallen to 90 million square yards (75.3 million sq m) and 7.25 million square yards (6 million sq m). In 1932, foreign producers—for the most part, Japanese—accounted for 40 million square yards (33.4 million sq m) of cotton piece goods and 13 million square yards (10.9 million sq m) of rayon piece goods. By 1935, this had increased to 90 million square yards and 68.5 million square yards (57.3 million sq m), respectively.²⁸ Trade diversion sought to arrest this.

Lyons argued that Australia refused to ‘weaken in its firm resolve to adhere to its Empire trade treaty obligations and—above and beyond all material considerations—to the Empire bond’. Britain’s textile market was closely linked to Australia’s overseas trade. Australia had a narrow range of primary exports and relied on British purchases.²⁹ In the past, textile purchases from Britain had partially offset Britain’s immense purchases from Australia. However, as Australia’s market for British textiles contracted—Japan having replaced Britain as Australia’s largest textile supplier in 1934—the nation could not expect Britain to continue purchasing large volumes of its exports. Lyons pointed out that if sales to Britain fell Australia would ‘sell very little indeed’ anywhere else, leaving the nation’s farmers and graziers to ‘face ruin’. Valuable as trade with Japan was, for every pound it spent in Australia, Britain spent four. Moreover, Japan’s purchases were centred on wool and wheat, while Britain purchased from across Australia’s primary and incipient secondary sectors.³⁰

27 “The Truth about the Japanese Trade Position”, Lyons broadcast, 25 June 1936’, NAA: A981, Trad 68 Part 2.

28 *CPD: Representatives*, 22 May 1936, No. 21, 2214–15.

29 Britain was Australia’s best overall customer, purchasing nearly 50 per cent of Australia’s total overseas trade. *Official Year Book of the Commonwealth of Australia*, No. 30 (1937), 506.

30 “The Truth about the Japanese Trade Position”, Lyons broadcast, 25 June 1936’, NAA: A981, Trad 68 Part 2.

The Trade Diversion Policy overlapped with attempts by the Australian government to increase its beef exports to Britain. Tsokhas argues that trade diversion pandered to imperial sentiment and the appearance of sacrifices in the Japanese market in the interest of British textile manufacturers in exchange for a privileged position for Australian meat and other primary produce in the British market.³¹ While government documents confirm that exports to Britain did shape the Australian government's approach to trade diversion, Tsokhas's assessment disregards the strategic object of the economic and diplomatic relations Australia had cultivated with Japan over the previous half-decade. These activities are rendered as little more than part of a broader political ploy designed to pressure the British government. This is a misrepresentation of the relationship between the domestic and international spheres in Australian decision-making. To understand what motivated the Australian government to adopt trade diversion and the protracted process of arriving at this decision, we must consider events unfolding prior to 22 May 1936.

Pressure, protectionism and Australia's reluctance to act against Japan

Some have diminished the significance of the Australian–Japanese trade treaty negotiations, suggesting Australia was only making a show in the hope this would placate Japan without having to make any definite commitment. Tsokhas only gives the negotiations passing mention and Sandra Tweedie writes that 'far from contemplating a treaty', Australian officials actively sought to resist Japan, and it was only after 'insistent Japanese demands' that the nation finally yielded.³² These assessments do not acknowledge the intersection of Australia's trade interests with diplomatic and broader strategic interests in the years preceding trade diversion, nor the nation's reluctance to act against Japan in the face of British pressure.

Japan's textile industry was highly organised, modern and, due to lower wages and longer working hours, competitively priced. The British textile industry was slow to adopt modern techniques like mass production

31 Tsokhas, *Markets, Money and Empire*, 12–15, 105–9; Tsokhas, 'The Wool Industry and the 1936 Trade Diversion Dispute Between Australia and Japan', 442–4.

32 Tsokhas, *Markets, Money and Empire*, 105; Tweedie, *Trading Partners*, 141–5.

and consisted of hundreds of small, independent units. This resulted in unnecessary administrative costs, a lack of cooperation and ineffective production.³³ Japan's competitive advantage saw the nation replace Britain as the world's largest cotton market in 1933.³⁴

The textile producers in Lancashire, who held significant political leverage, lobbied Whitehall to limit Japan's competitive advantage.³⁵ There was particular embitterment surrounding Australia's textile purchases from Japan. The Australian government's slow action on implementing the Ottawa Agreements further exacerbated this situation. Australia had failed to comprehensively reduce tariffs so as to treat British producers as domestic competitors, even increasing duties to protect its emerging cotton industry despite an adverse effect on Lancashire.³⁶ British textile producers directly contacted Lyons and Bruce, High Commissioner in London, calling on Australia to use anti-dumping duties against Japan and act on 'the *principles* for which it accepted responsibility at Ottawa'.³⁷ The British Foreign Office and Tariff Board also criticised Japan, accusing the nation's producers of extensive cost-cutting. The Tariff Board accordingly recommended that members of the Empire enforce anti-dumping duties against Japan to protect the British textile market.³⁸ Despite this pressure, the Australian government refused to adopt prohibitive measures on the grounds that Japanese textiles, dumped or otherwise, did not directly compete with Australian exports. In ignoring the recommendations of the Tariff Board, Australia had contravened the Ottawa Agreements.³⁹ It is worth recalling that the Tariff Board recommendations came soon

33 A. Trotter, *Britain and East Asia, 1933–1937* (London: Cambridge University Press, 1975), 27–9; Masey, *Is It Necessary*, 10–15.

34 Sissons, 'Manchester v. Japan', 490.

35 Antony Best, 'Economic Appeasement or Economic Nationalism? A Political Perspective on the British Empire, Japan and the Rise of Intra-Empire Trade, 1933–37', *The Journal of Imperial and Commonwealth History* 30, no. 2 (2002): 77–101, at pp. 81–4.

36 Bernard Attard, 'The Limits of Influence: The Political Economy of Australian Commercial Policy After the Ottawa Conference', *Australian Historical Studies* 29, no. 111 (1998): 325–43, at pp. 330–2; Felicity Barnes, 'Lancashire's "War" with Australia: Rethinking Anglo-Australian Trade and the Cultural Economy of Empire, 1934–36', *The Journal of Imperial and Commonwealth History* 46, no. 4 (2018): 707–30, at pp. 707, 713–18.

37 'Manchester Chamber of Commerce to Lyons, 17 August 1932', in Australian High Commission, United Kingdom [London]: Correspondence files, multiple number series (Class 400), 1913–60, NAA: A2910, 413/5/135 Part 1; 'W.H. Milsted and Sons to Bruce, 14 February 1933', NAA: A2910, 413/5/135 [emphasis in original].

38 "Japanese Competition", Memorandum by the Board of Trade, 11 December 1933', in Records created or inherited by the Foreign Office, Foreign Office and Foreign and Commonwealth Office: Embassy and Consulates, Egypt—General Correspondence, TNA: FO 141/755/7.

39 Cumpston, 'The Australian–Japanese Dispute of the Nineteen-Thirties', 51.

after the Manchurian Crisis and Australia's rejection of sanctions against Japan based on economic and security imperatives. Against this backdrop, Australia's response can be better understood.

As the British government and manufacturers encouraged greater protectionism, Australia continued to explore opportunities in Japan. During the AEM, Australia again quietly defied the principles of imperial economic cooperation. Saburō Kurusu, Director of the Commercial Bureau in the Japanese Department of Foreign Affairs, expressed his government's 'keen appreciation' for Australia's decision not to implement anti-dumping duties. Arthur Moore, an information officer from the Department of Trade and Customs who was part of the AEM, emphasised 'the difficult political position' in which Australia had been placed as a result of rejecting the Tariff Board's recommendations, remarking that this 'showed very clearly its regard for maintaining friendly relations with Japan' and was 'concrete evidence of the value placed on Japanese trading relations with our country'.⁴⁰

Britain made a renewed effort to emphasise the expectations of imperial economic reciprocity in 1935. As preparations for the 1935 Leaders' Meeting began, the British government indicated that trade measures to strengthen imperial economic relations would take precedence in the forthcoming discussions. Australia's poor performance in implementing the Ottawa Agreements was singled out by Secretary of State for Dominion Affairs James Henry Thomas. He described it as 'a source of difficulty to the commercial relations between the two countries', which had given 'rise to much dissatisfaction on the part of trade organisations in the United Kingdom'.⁴¹ Lyons responded to Thomas's criticism with his own litany of complaints about the Ottawa system. The Australian government was preparing for trade treaty negotiations with Japan and Lyons informed Thomas that the Ottawa Agreements presented 'obstacles which at present appear unsurmountable' as the ambit of imperial preferences left Australia with little scope to offer foreign countries greater access to its market. Australia's restricted access to foreign markets would make it difficult for the nation to increase export revenue and, in turn, increase purchases from the British market.⁴² Lyons asked that some of the Ottawa preference margins be narrowed and requested that Bruce 'stress' in London that

40 'Confidential Report on Trade, 30 July 1934', NAA: A981, Far 5 Part 16.

41 'Thomas to Lyons, 2 January 1935', NAA: A1667, 430/B/22A.

42 'Lyons to Thomas, 4 January 1935', NAA: A1667, 430/B/22A.

a ‘number of foreign countries have been penalising Australia because of Ottawa Margins’.⁴³ The British government resolved that the margins would remain unchanged.⁴⁴ This appeal indicates Australia’s seriousness in its approach to trade treaty negotiations with Japan and that the nation had not, as Tweedie suggests, entered into negotiations under duress. Moreover, the reluctance to act against Japan despite British pressure suggests Australia judged the value of close economic and diplomatic relations with Japan outweighed the ideal of imperial reciprocity.

Trade promotion in Britain

There was a marked change in Australia’s position towards the Ottawa Agreements and British textiles from early 1936. The reason for this can be found in Australia’s overseas trade position. In 1935, foreign markets accounted for most of Britain’s beef supply. Britain’s trade treaty with Argentina, a major beef exporter, was due to expire in December 1935 and the nation was looking to increase frozen and tinned beef purchases in the renewed treaty. The new treaty would result in a further reduction of British purchases from Australia and the other dominions. With meat making up a significant portion of Australian exports, the Australian government deemed Britain’s plans to be ‘inconsistent with the spirit and intention of the Ottawa Agreement’.⁴⁵ While in London for the Leaders’ Meeting, Lyons and Gullett lobbied the British government to introduce higher import duties and quotas in the interest of improving the position of Australian beef. They were unsuccessful in this undertaking.⁴⁶

Lyons remained in London for some weeks following the Leaders’ Meeting. During this time, he met with representatives from the Tariff Board and the Lancashire Chamber of Commerce. While little detail was given about these meetings in the local press, a cable from the Dominions Office reveals the representatives urged Lyons to ‘take action that will safeguard Lancashire’s important trade to Australia’, making clear that unless Australia upheld the principles of economic reciprocity, the nation

43 ‘Lyons to Bruce, 7 February 1935’, NAA: A981, Trad 68 Part 2.

44 Drummond, *Imperial Economic Policy, 1917–1939*, 397–8.

45 ‘Lyons to Thomas, 4 January 1935’, NAA: A1667, 430/B/22A.

46 Sissons, ‘Manchester v. Japan’, 495–6; Tsokhas, *Markets, Money and Empire*, 107.

could expect its share in the British market to shrink.⁴⁷ In view of Australia's narrow range of primary exports and reliance on British purchases, the British government and Lancashire had sent a clear message: Australia would not long survive without the British market for its goods. Lyons indicated that he would bring the issues discussed before his government.⁴⁸

The months following Lyons' return home from London were marked by grim news. The US had again rejected Australia's offer of a trade agreement.⁴⁹ This was exacerbated by low wool sales in 1934–35, which greatly depleted Australia's reserves, and a rise in the prices of wool and wheat in 1935–36, triggering an escalation of imports while exports increased only marginally. It seemed likely that Australia would, for the second consecutive year, face a balance-of-payments deficit and be forced to default on loan repayments to Britain and the US.⁵⁰ Faced with this situation, Cabinet conceded on 23 January 1936 that some action should be taken to reduce the volume of Japanese textile purchases in favour of British exporters.⁵¹

Soon after Gullett began drafting proposed quotas for Japanese textiles, a delegation from the Manchester Chamber of Commerce arrived in Australia. The Manchester Mission was headed by H.C.N. Ellis, Special Commissioner for Trade for the Manchester Chamber of Commerce, and Ernest Thompson, the chamber's former president. The mission was designed to mobilise support for prohibitive measures against the Japanese textiles that had 'invaded' the Australian market and discuss measures to 'secure the maximum demand' for Australian exports in the British market.⁵² With the Australian government having already decided to introduce quantitative restrictions, this pressure was no longer

47 'Thomas to Isaacs (Governor-General) 15 August 1935', in Records created or inherited by the Dominions Office, and of the Commonwealth Relations and Foreign and Commonwealth Offices, General Records of the Dominions Office, TNA: DO 35/284/1.

48 'Mr Lyons in Manchester', *Telegraph*, [Brisbane], 13 June 1935, 13.

49 Australia's offer of a trade treaty had been rejected in January 1935, yet the nation continued to inquire throughout 1935 and early 1936 whether the US had changed its position. 'Doc. 13, Memorandum by Hull (Secretary of State), 9 July 1935' and 'Doc. 14, Hull to Moffatt (Consul-General Sydney), 23 September 1935', in Churchill and Sappington, *FRUS 1935*.

50 'Adoption of Trade Diversion Policy, 1937', NAA: A1667, 430/B/52A; 'Doc. 582, Moffat to Hull, 4 March 1936', in Matilda F. Axton, Rogers P. Churchill, N.O. Sappington, John G. Reid, Francis C. Prescott and Shirley L. Phillips (eds), *Foreign Relations of the United States Diplomatic Papers, 1936, General, British Commonwealth, Volume I* (Washington, DC: US Government Printing Office, 1953).

51 'Cabinet Meeting, 23 January 1936', in Secretary to Cabinet/Cabinet Secretariat: Lyons and Page Ministries—Folders and bundles of minutes and submissions, 1932–39, NAA: A2694, 245.

52 'Plea for Trade', *Sydney Morning Herald*, 13 March 1936, 11.

necessary. Nevertheless, the Manchester Mission highlights the logic that had influenced the Australian government's decision to act against Japan: Britain could not be expected to continue its preference for Australian goods without reciprocal treatment.

The Australian government was candid in its expectation that trade diversion would afford inroads for Australian beef into the British market. In a 10 May 1936 cable to British Prime Minister Stanley Baldwin, Lyons outlined the trade diversion measures. He couched the policy in the language of imperial economic cooperation and stressed his expectation that his government's actions would 'receive full compensation in [the form of] increased British imports from Australia'.⁵³ Lyons restated this in a cable sent to Baldwin the following week, writing that the trade diversion measures concerning textiles had been 'made to meet the express wishes of your government' and were expected to result in 'very substantial and increasing benefits' for British textile manufacturers. Lyons, noting that these measures would likely elicit retaliatory action from Japan, stressed that his government looked 'to these restrictions to confer benefit upon Australia by increasing opportunity for our exports in the United Kingdom'.⁵⁴ There was a willingness among Australian policymakers to act in favour of imperial interests on the basis of what would be received in return. Baldwin replied that the trade diversion measures would 'be of material assistance ... and we greatly appreciate them'. He also informed Lyons that 'we share your hope' that trade diversion will 'help to solve the particular problems of Australia'.⁵⁵ It appeared that Britain endorsed Australia's actions and the anticipated returns in the British market. This enthusiasm soon dissipated.

In April 1936, Page and Robert Menzies, the Attorney-General and Minister for Industry, left for London to discuss Australian beef sales. The British government offered an increased duty on foreign beef and a restriction on the volume of Argentinian chilled beef sales in favour of cheaper frozen beef. The dominions would be free to fill this newly vacant market for chilled beef. However, the actual volume of dominion and Argentinian beef sales would not change, being set at existing levels.⁵⁶

53 'Lyons to Baldwin, 10 May 1936', TNA: DO 35/278/3.

54 'Lyons to Baldwin, 18 May 1936', TNA: DO 35/278/3.

55 'MacDonald (Under-Secretary of State for Dominion Affairs) to Prime Minister's Department, 20 May 1936', in Department of Trade and Customs: Correspondence files, annual single number series [Main correspondence files series of the agency], 1935–, NAA: A425, 1939/2673. MacDonald was speaking on behalf of Baldwin.

56 Sissons, 'Manchester v. Japan', 496–7.

Page described this offer as ‘useless’ and a betrayal of the principles of Ottawa.⁵⁷ It was only through the intervention of Lyons—who stressed that a failure to deliver on beef and legitimate the trade war with Japan would likely lead to a loss of government—that Australia was able to secure a small concession. The British Cabinet agreed to a 5 per cent increase in Australia’s chilled beef exports over three years at the expense of foreign suppliers.⁵⁸ Australia’s hard-fought concession suggests trade diversion was introduced with an implied rather than a clear agreement that Britain would reciprocate with preferential treatment of Australian beef.⁵⁹ The Australian government ultimately misjudged the dynamics of the imperial relationship, in which Australia was expected to make sacrifices in the name of imperial economic cooperation, while Britain would not necessarily reciprocate.

Defence and Australia’s secondary industries

The Trade Diversion Policy cannot be divorced from defence planning and Australia’s strategic outlook. The year 1936 was one of turmoil in international affairs. Nazi Germany violated the Treaty of Versailles, Locarno Treaties and League of Nations Covenant when the German Army reoccupied and remilitarised the Rhineland in March 1936. The year also marked the lapse of the Washington Treaties and Japan’s withdrawal from the second London Naval Conference and the Treaty for the Limitation and Reduction of Naval Armament following Britain and the United States’ rejection of Japan’s demand for naval parity. These developments spelt doom for collective security, drew attention to the influence of the military in the Japanese government’s policymaking and, as Melbourne’s *Herald* grimly concluded, left Japan with ‘a free hand in the Pacific’.⁶⁰

57 ‘Telephone call, Page, Lyons and Gullett, 24 June 1936’, in Papers of J.A. Lyons, NLA: MS 4851/1/10.

58 ‘Minutes of Meeting, Cabinet Committee on Trade and Agriculture, 24 June 1936, TNA: CAB 27/619’, cited in Sissons, ‘Manchester v. Japan’, 498.

59 O’Brien, ‘Empire v. National Interest in Australian–British Relations During the 1930s’, 582; Paul Jones, ‘Trading in a “Fool’s Paradise”? White Australia and the Trade Diversion Dispute of 1936’, in *Relationships: Japan and Australia, 1870s – 1950s*, eds Vera Mackie and Paul Jones (Melbourne: University of Melbourne, Department of History, 2001), 137.

60 ‘Japan Upsets Naval Parleys’, *The Herald*, [Melbourne], 15 January 1936, 1.

Australia began rearming in 1933, with a particular focus on modernising its defence equipment. Rearmament depended on a stable financial situation—achieved through consistently strong exports—and an established domestic secondary industry with access to strategic materials such as steel and iron. That defence and rearmament considerations influenced trade diversion is evidenced in Gullett’s remark that the policy, in promoting the development of Australia’s secondary industries, would ‘make a significant indirect contribution to defence’.⁶¹ Lyons also spoke to the relationship between trade diversion and imperial defence, invoking the maxim of ‘Men, Money and Markets’ in a cable to Baldwin by suggesting that the growth in Australia’s secondary industries prompted by trade diversion would encourage intra-empire migration, making ‘a useful and timely ... contribution to Empire defence’.⁶² While trade diversion was not predicated on defence considerations, it was certainly shaped by Australia’s pre-existing concerns about regional stability and defence planning for the Asia-Pacific region.

Australia’s strategic outlook in the aftermath of trade diversion

The Australia–Japan trade war was short-lived, arguably because the conclusion of the semi-successful beef negotiations in June removed the imperative for a hardline position towards Japan. In August, Australia amended the duties on foreign textiles ‘as a gesture of amiability’ and, by December, a settlement had been made.⁶³ Japan removed the 50 per cent tariff on Australian goods and the boycott on Australian wool, while Australian duties on foreign textiles were again lowered. In the 18 months from 1 January 1937, Japanese cotton and rayon exports entering Australia were restricted to a total of 102.5 million square yards (85.7 million sq m)—compared with the 152 million square yards (127 million sq m) Australia had purchased the previous year. Australia also granted Japan

61 *CPD: Representatives*, 22 May 1936, No. 21, 2211–12.

62 ‘Lyons to Baldwin, 18 May 1936’, NAA: A425, 1939/2673. The Bruce–Page coalition adopted ‘Men, Money and Markets’ as the basis for economic development. The premise was that, in obtaining labour and capital from Britain for Australia’s expanding secondary industries, products would be produced for purchase in British Empire markets with the benefit of protection under preferential tariffs. Growth in population from British migration could service Australia’s new industries and could be called on to defend Australia and the Empire in the event of war.

63 ‘Abbott (Comptroller-General of Customs) to DEA, 24 August 1936’, NAA: A981, Trad 68, Part 2.

the intermediate tariff rate. Japan agreed to purchase 800,000 bales of Australian wool for the same 18-month period. This quota fell well below the 1935–36 export volume when Japan had purchased 750,000 bales for the financial year.⁶⁴

The new restriction on textile purchases accomplished Gullett's initial aim of a textile quota system that served to reserve a place for British textiles in the Australian market. Yet in achieving this goal, the Australian–Japanese trade relationship was seriously damaged and Australia's sales to Japan steadily decreased over the coming years.

Table 3.1 Two-way trade between Australia and Japan, 1935–36 to 1938–39, pound sterling value and as a percentage of Australia's total exports

Fiscal year	Australian exports to Japan	
	%	Value (£ million, rounded up to nearest pound)
1935–36	14.19	17.1
1936–37	6.54	9.7
1937–38	4.16	5.9
1938–39	3.97	4.9
Australian imports from Japan		
1935–36	4.9	6.1
1936–37	4.0	4.5
1937–38	5.3	4.9
1938–39	4.1	4.2

Source: *Official Year Book of the Commonwealth of Australia*, No. 32 (Canberra: Commonwealth Government Printer, 1939), 507–10.

Along with the economic implications of trade diversion, the episode created fissures in Australian–Japanese diplomatic relations. In May 1936, on learning of Australia's intentions, Baron Goh, President of the Japanese Chamber of Commerce in Sydney, contacted Minister for External Affairs George Pearce. Goh believed the Japanese government regretted trade diversion and believed it would not only harm economic relations, but also 'invariably react on friendship and goodwill existing between us'.⁶⁵

⁶⁴ 'Abbott to DEA, 22 September 1936' and 'Statement by Gullett, 27 December 1936', both in NAA: A981, Trad 68 Part 2. It was also agreed that Australia would purchase an extra 2 million square yards (1.82 million sq m) of cotton and rayon for every additional 10,000 bales of wool Japan purchased.

⁶⁵ 'Baron Goh (President of the Japanese Chamber of Commerce) to Pearce, 13 May 1936', NAA: A981, Trad 68 Part 2.

Australia's trade commissioner in Tokyo reported a similar feeling in Japan, noting the hostile and 'rather reckless attitude' of Japan's highly influential press.⁶⁶ From the Australian perspective, the risk was that trade diversion, having affronted Japan, could threaten national security. In the weeks before the policy was announced, Gullett himself acknowledged this threat when he confided in the British High Commissioner, Geoffrey Whiskard. This conversation was then reported to the Dominions Secretary, with Whiskard remarking that Gullett was 'definitely apprehensive' that trade diversion would 'lead eventually to trouble between Japan and Australia'. Gullett reportedly 'expounded at some length ... the indefensibility of Australia against Japanese attack'.⁶⁷

Australia's security concerns were no doubt amplified by developments on the international stage. In addition to broken and lapsed treaties, 1936 saw the Japanese government give official standing to the policy of *Nanshin-ron* ('southern advance' or 'southern road'), which defined the area south of Japan as 'indispensable' to the nation's industrial development, defence and growing population.⁶⁸ The diplomatic implications of trade diversion were all the more pressing against this backdrop of international uneasiness.

From May to June 1937, an Imperial Conference was convened to discuss imperial policy in light of the recent developments in Europe and the Asia-Pacific. The Australian delegation's performance at the conference can be best understood in the context of the diplomatic damage of trade diversion and Japan's increasingly outspoken foreign policy. The Australian delegation used the Imperial Conference as an opportunity to revisit and clarify imperial defence planning, submitting a list of defence-related questions to the Chiefs of Staff Committee (COS). Particular attention was given to the Far East and the intended strategy in the event of a two-ocean war. Australia requested 'a clear definition of the strategic objective of the Empire forces in a war with Japan or with Japan and another first-class power'. Britain's response was discouraging, stating that, in the event of war with Japan and Germany, Europe would be the priority and 'we cannot count on being able to support anything more

66 'Longfield Lloyd to Murphy, 28 May 1936', NAA: A601, 402/17/28.

67 'Whiskard to MacDonald, 24 April 1936, TNA: FO 3097/119/23', cited in Sissons, 'Manchester v. Japan', 482.

68 Henry P. Frei, *Japan's Southward Advance and Australia: From the Sixteenth Century to World War II* (Melbourne: Melbourne University Press, 1991), 140–3. *Nanshin-ron* was codified in two documents, the 'Fundamentals of National Policy' and 'Guidelines of Imperial Diplomacy'.

than a defensive policy in the Far East'. The British also noted that 'a very considerable period may elapse' before the situation in Europe was settled and 'the redistribution of our forces permit[s] of a fleet arriving in the Far East'.⁶⁹ The 1937 Imperial Conference confirmed that the Singapore Naval Strategy was not the bastion of imperial defence it was purported to have been and Australia was left to face an increasingly uncertain future in its region.

Prime Minister Lyons used the Imperial Conference to promote diplomacy to offset reservations about imperial defence planning for the Asia-Pacific. Following the lapse of the Washington Treaties and Japan's withdrawal from the London Naval Conference, Yoshida Shigeru, the Japanese Ambassador in London, proposed an Anglo-Japanese agreement be negotiated as a replacement. He proposed mutual recognition of all existing Japanese territorial claims in China, an open-door policy and the settlement of trade competition 'on a basis of goodwill and mutual understanding of each other's difficulties'.⁷⁰ This proposal was 'naturally desirable' to the Australian government. Britain's response, however, was, according to a DEA memorandum, 'lukewarm'.⁷¹ Lyons took it on himself to find a solution to Asia-Pacific peace. In his opening address to the first plenary session of the Imperial Conference, Lyons revived his 'Pacific pact'. His proposal was based on a broad vision of regional understanding and non-aggression between the British Empire, Japan and the US.⁷² The proposal was received with only middling support and it faced insurmountable challenges: chiefly, the United States' and Britain's fraught relations with Japan, particularly in the wake of the London Naval Conference, and the ongoing question of Chinese-Japanese relations made negotiating a Pacific pact difficult. As had been the case at the 1935 Leaders' Meeting, Lyons' plans for Asia-Pacific peace were laid aside.⁷³ Despite the failure of the Pacific pact, on reflection, the episode is insightful. It underscores the shift in approaches to integrate Australia's national interest within the imperial policymaking framework at a time

69 "Questions Raised by the Australian Delegation", Report of British COS, 9 June 1937, NAA: A5954, 1064/3.

70 R.G. Neale (ed.), *Documents on Australian Foreign Policy, 1937-49. Volume 1: 1937-1938* (Canberra: AGPS, 1976) [hereinafter *DAFP*, vol. 1], 36n.1.

71 'Doc. 13, "Review of Relations with Particular Countries having Special Significance vis-a-vis the United Kingdom or Particular Dominions", Memorandum prepared for Delegation to Imperial Conference, [n.d. (on or before 6 March 1937)]', in Neale, *DAFP*, vol. 1.

72 'Doc. 25, Speech by Lyons, First plenary session of Imperial Conference, 14 May 1937', in Neale, *DAFP*, vol. 1.

73 Bird, *J.A. Lyons*, 203-4; Waters, *Australia and Appeasement*, 21-5.

when many scholars suggest the nation's policymakers had neither the appetite nor the aptitude for such thinking. The Pacific pact episode also highlights the challenges the small nation faced in attempting to influence its powerful allies.

Both the diplomatic shortfalls of trade diversion and the disappointing outcome of the 1937 Imperial Conference were more pressing in the face of the outbreak of the Second Sino-Japanese War. In July, soon after the Australian delegation returned from the Imperial Conference, Japanese troops attacked and eventually invaded China. Lyons lamented the conflict, even suggesting it could have been avoided had his Pacific pact been taken up:

I am very sorry that some action on the line of the Pact I proposed was not taken earlier. If something of this kind had been in existence before this trouble in the east, it is possible that some pressure might have been applied to prevent the tragic events that are now occurring.⁷⁴

At the time, international affairs commentator Jack Shepherd drew a link between the Trade Diversion Policy and Japan's attack on China. Trade diversion served to exclude Japan from an important market, contributing to a sense that it was being 'deprived of the very means of her existence'. According to Shepherd, this hastened Japan's campaign for regional conquest in pursuit of raw materials.⁷⁵

While Shepherd's theory is a striking one and Japan's need for raw resources was a motivating factor in its policy of aggressive expansion, it is difficult to substantiate the link between trade diversion and the outbreak of the Second Sino-Japanese War. It can, however, be reasonably concluded that Japan saw in trade diversion an attempt to build an exclusive imperial economic bloc, contributing to a sense of being threatened and a subsequent need to economically and territorially penetrate the Far East. This proposition is in part supported by a letter Lyons received from A.C.V. Melbourne, who liaised with the Australian government and Japanese Consul-General in Australia during the settlement of the Trade

74 'Fighting Speech', *Sydney Morning Herald*, 1 October 1937, 9.

75 Shepherd, *Australia's Interests and Policies in the Far East*, 190–1.

Diversion Policy. Melbourne wrote that the 'British aspect' of Australian foreign policy had been 'overemphasised' and subsequently estranged and offended Japan.⁷⁶

At any rate, the trade diversion episode was a significant lesson for Australian policymakers, highlighting the liability of relying on the Empire for economic and physical security. Indeed, it informed experimentation by policymakers as accommodating Japan came to dominate Australia's foreign policy approach in the coming years as the Asia-Pacific region moved towards war.

76 'Melbourne to Lyons, 22 July 1936, Papers of A.C.V. Melbourne, NLA: Mfm G 14442-14446', cited in Cotton, *The Australian School of International Relations*, 82.

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