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Stepping towards a borderless market? The future of the trans-Tasman market. Report to Australia New Zealand Business Council Inc.

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Stepping towards a borderless market?

The future of the trans-Tasman market

Report to Australia New Zealand Business Council Inc.

August 2003

NZ Trade Consortium Working Paper no 26

NZ INSTITUTE OF ECONOMIC RESEARCH (INC.)

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Preface

The New Zealand Institute of Economic Research (NZIER), based in Wellington, was founded in 1958 as a non-profit making trust to provide economic research and consultancy services. Best known for its long-established *Quarterly Survey of Business Opinion* and *Quarterly Predictions*, the Institute also undertakes a wide range of consultancy activities for government and private organisations. It obtains most of its income from research contracts obtained in a competitive market and trades on its reputation for delivering quality analysis in the right form, and at the right time, for its clients. Quality assurance is provided on the Institute's work:

- by the interaction of team members on individual projects;
- by exposure of the team's work to the critical review of a broader range of Institute staff members at internal seminars;
- by providing for peer review at various stages through a project by a senior staff member otherwise disinterested in the project;
- and sometimes by external peer reviewers at the request of a client, although this usually entails additional cost.

Authorship

This report has been prepared at NZIER by Chris Nixon and reviewed by John Yeabsley. The assistance of Sarah Spring, the Foundation for Research, Science, and Technology (FRST) for financial support, and the various interviewees who so willingly and enthusiastically gave up their time to talk to us, is gratefully acknowledged.

EXECUTIVE SUMMARY

Introduction

This paper sets out to describe the dynamic nature of the trans-Tasman trade and economic relationship and to develop an approach to quantify the costs and benefits of moving from CER to a wider concept of a “borderless market”.

To examine the dynamic nature of the relationship we have looked at the three relevant periods of modern trans-Tasman integration:

- the (past) NAFTA accords;
- the current period of CER;
- the (future) ideal of a borderless economy.

In these periods we have divided each aspect of the relationship into formal (tariffs, quotas etc.), and informal issues (company organisation, business strategy etc).

Information for this project was gathered using existing material on trans-Tasman issues, and interviews with businesses. With the help of the ANZBC approximately 20 businesses were surveyed to understand their attitudes towards the trans-Tasman relationship and how it should progress.

Background

The first serious attempt to develop a free trade area between Australia and New Zealand was the NAFTA. Unfortunately, the NAFTA was almost a free trade agreement in name only. Most goods still faced large tariff barriers and there was practically no movement of goods (and no services) onto the free trade schedule once it had been initially set. This period was characterised by two very insular economies taking the first halting steps towards liberalisation.

CER dismembered the tariff arrangements built up over a number of years on both sides of the Tasman and particularly in New Zealand. It was so successful that it was implemented ahead of schedule. Unfortunately, the success of CER has not been followed up with a consistent approach to the remaining issues that need addressing. Rules of origin, tax and its impact on investments, services, exemptions to the TTMRA, migration issues, and phyto-sanitary regulations all require attention to improve the efficiency of the wider trans-Tasman market.

Firms have not found the trans-Tasman market an easy place to operate. Both Australian and New Zealand firms have destroyed significant amounts of shareholder value in the attempt to be successful. Some businesses, from both sides of the Tasman, have seriously misjudged the market. However, other enterprises have managed to improve their competitive position in the market. There is no one successful way to conduct business in the trans-Tasman market and a variety of different strategies are being used.

The future

In a borderless trans-Tasman market there would be no formal trade barriers to contend with. However, the role of a competition authority with jurisdiction over the trans-Tasman market would become important, to ensure a sufficiently competitive market place for goods and services.

Costs and benefits

The benefits from moving from CER to a borderless market have been assessed against three types of efficiency (productive, allocative, and dynamic). Using some standard measures the benefits of moving towards a borderless market are assessed as lying somewhere between \$NZ256 million and \$NZ576 million. This is likely to be a conservative estimate, since it does not take into account further benefits that will occur over time.

On the other side of the ledger, the one-off costs of dislocation, as some industries contract, changing bureaucratic processes, and general uncertainty are likely to be between \$NZ64 million and \$NZ128 million.

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1. INTRODUCTION

This paper examines the role of market exchange and interlinkages in the trans-Tasman context – where it has been, where it is now, and where it is going. Of particular interest is the development of a joint market over time, and the opportunities and constraints that trans-Tasman businesses face in developing the market. The aim here is to develop an analytical framework that gives a broad outline of the costs and benefits associated with moving towards a borderless trans-Tasman market.

The paper outlines an approach to examine trans-Tasman market impediments and sets out some of the issues that need to be resolved.

This includes:

- reviewing the modern roots of the trans-Tasman market (i.e. the New Zealand Australia Free Trade Agreement (NAFTA))
- looking at current trading arrangements under Closer Economic Relations (CER).
- examining what issues need to be addressed to iterate smoothly towards a borderless market, and the “rule of thumb” tests that would show that this had occurred.
- setting up an estimation framework that gives a broad indication of what costs and benefits might result from moving towards a borderless market.

While the ideal of a borderless market may only be a goal to work toward, it does not mean that we should not attempt to examine, in economic efficiency terms, how it might improve trade between the trans-Tasman neighbours.

The approach has been to:

- use material already available on trans-Tasman trade to illustrate how it has changed over time;
- interview a range of Australian and New Zealand owned businesses to understand their views of the trans-Tasman market (the questionnaire that served as a basis for the interviews is in Appendix A); and
- show the interrelationship between legislation, regulations, and trade and economic outcomes.

This is a broad topic and it is beyond the scope of this paper to look at every aspect of the trans-Tasman economic relationship. We have taken some of the issues that businesses are concerned about, to illustrate the workings of the trans-Tasman economic relationship and what will need to be done to move towards a borderless market.

2. APPROACH AND METHOD

2.1 Introduction

The effective implementation of any trans-Tasman economic agreement depends on the attitudes towards the content of those agreements by businesses and government. Business perceptions of the quality and workability of any agreement are also key factors.

An understanding of how businesses view the trans-Tasman trade relationship will be useful for governments on both side of Tasman as they develop a way forward in the relationship. This is particularly timely given the report by the Foreign Affairs, Defence and Trade Committee in 2002 that recommended the development and establishment of an Australia New Zealand Economic Community (ANZEC). The ANZEC concept is similar to the concept of the development of a borderless market considered in this paper.

2.2 The setting

This report is a product of its designated scope and focus. We have set out in the next few sections some of the background to the way we approached the task.

2.2.1 Focus

The focus of this report is on the dynamics of the trans-Tasman economic relationship – where has the relationship come from, and where business would like to see it go. To do this we have divided the analysis up into three parts, covering obvious breaks in the relevant periods:

- pre CER, this is the period before 1983 and relates mainly to the New Zealand Australia Free Trade Agreement (NAFTA).
- the current CER period - 1983-2003.
- a borderless trans-Tasman economic environment, a vision for the future economic relationship.

For the purpose of the work here, we have distinguished the following aspects of the trans-Tasman economic relationship:

- the formal issues: tariffs, quotas, import licensing, customs procedures, immigration rules, impact on investment (mainly through tax legislation), and other technical agreements.
- the informal issues: company organisation, structure of business, and the types of strategies in play in the market.

The focus of this report is on the current situation (formal and informal issues) that exists under CER and what it would take to move from this, to produce a borderless market.

2.2.2 Changing trade patterns

Any assessment of the trans-Tasman relationship must be seen in the context of both countries' wider trading arrangements, and the changes these have, in some cases,

forced on the Australian and New Zealand domestic markets. The New Zealand market has changed markedly over the last 20 years.

For example:

- some businesses, which now dominate the private sector did not exist when CER was signed (e.g. private telecommunications companies and services trade).
- issues such as tax and its impact on investment only became an important issue after CER was signed and have been solely focused on and driven by domestic political and economic concerns
- market structures and the internal organisation of firms have changed (and sometimes changed a number of times) in response to competitive threats in the market. There is no one strategy that stands out as being universally successful.

One of the most noticeable unquantified improvements that have enhanced the level of trade has been to the quality of goods and services. As the Australian and New Zealand economies have opened up to greater degrees of competition, including from international firms from third countries, there has been a steadily increasing awareness of quality standards prevailing abroad, and improved service has become one of the avenues firms have followed to success.

We have all noticed the ability to have pizzas and printing jobs delivered promptly, and with a smile. These changes are similarly reflected in the increased flexibility competitive firms show in their dealings with customers in a global world with demanding clients.

2.2.3 Overview paper

This paper examines the trans-Tasman relationship “in its totality” – not just one aspect of the relationship. Therefore, the views held by business people varied depending on their firm’s or, indeed, their personal view of the relationship. We believe (and it was reinforced by our work on this project) that most of us form our expectations and views broadly rationally. That is, we have perceptions that are logically moulded by our experiences. And, in the case of the trans-Tasman relationship, it was predictable that we would receive a diverse set of answers based on these different experiences.

So the feedback we are drawing on will have a flavour that can inevitably be traced back, at least in large measure, to the actual people we spoke to. But the whole point of the consultation was that we were engaged to listen, to gather together material and to report it in an analytical context, that knowingly takes account of the way the data has been gathered.

2.2.4 Lightning rod

Another factor that needs to be mentioned is the inevitable result of being publicly involved in such a task as this one. We are, by the nature of the job undertaken here, a potential channel of communication with people and agencies that some groups are trying to contact. So, for a subset of those we talked to the opportunity of sending a message was seized. This can be seen as a form of “bias” or more proactively, as a vehicle for “gaming.”

Nothing wrong with this; we were asking for people’s time and they are able to use it as they see fit. But the possibility that the general method we used may have affected the information we received, for this specific reason, remains.

We note it as a possibility, but suggest its consideration fits alongside all the other theoretical problems with gathering real data from a non-random sample. To us, a consciousness of these weaknesses should carry into the way the information is presented and used, rather than force rejection of the information, or any conclusions drawn from it.

2.2.5 Which businesses and where do they operate?

We have selected roughly 20 businesses, with the help of the Australia New Zealand Business Council (ANZBC), operating in both the New Zealand and Australian markets.

The project scope has not allowed normal statistical sampling. That is related to its purpose. The objective has been to establish prevailing business perceptions with respect to the trans-Tasman relationship. The task has been to look for the recurring themes and determine whether opinion is sufficiently consistent across businesses to be relied upon. The questionnaire used as a guide the interview process is attached in Appendix A.

3. PRE CER

3.1 Introduction

In 1965 New Zealand and Australia signed the New Zealand Australia Free Trade Agreement (NAFTA) and started the modern trans-Tasman trade relationship. It was signed against the backdrop of:

- Britain announcing that it would attempt to join the European Economic Community – EEC (now the European Union - EU), and
- fast growing Australian trade with Asia (in particular Australian coal fuelling the rapidly expanding Japanese economy)

The NAFTA was recognition that both Australia and New Zealand needed to broaden their trade horizons (and, incidentally, try to develop more efficient domestic economies). In the 50 years previous to 1965 this had not been necessary since Britain had taken most of New Zealand's and Australia's farm exports. With the looming export restrictions or shut outs that would be imposed by Britain when it joined the EEC, both countries needed to diversify their export base.

According to Pomfret (1995) p178 the treaty attempted to:

“...promote a sustained and mutually beneficial expansion of trade ... [and ensure] ... as far as possible that trade within the Area takes place under conditions of fair trade.”

Unfortunately, the reality of the NAFTA only partly reflected the goal of closer economic ties. The NAFTA turned out to be virtually a free trade agreement in name only; it attempted to free up trade in some areas, but was unable to make any impression on industries that were “sensitive” to trans-Tasman competition.

The NAFTA's restricted coverage manifested itself by confining free trade to items listed in a schedule attached to the agreement (Schedule A). Attempts to move goods on to Schedule A was typically thwarted by the powerful vested interests (associated with the industry in question) located on either or both sides of the Tasman. Such a shift had to be agreed by both governments.

Despite this, the NAFTA was the first serious attempt by two extremely insular economies to develop a sustainable trans-Tasman trading relationship.

3.2 Formal issues

The pre CER world was highly insular and protected – essentially the structure of a two part economy prevailed, with a competitive export sector (essentially agricultural) and a sheltered domestic oriented sector (largely manufacturing). Australian tariffs were twice the OECD average and New Zealand's protection rates were above those of Australia.

The transaction costs were high. Officials met once every six months to micro-manage the trans-Tasman trade. They haggled about how many Holden cars should be swapped for pantyhose and tinkered with the regulations. There were tariffs on all manner of things, from sea water to buttons.¹

¹ For more information see Nixon & Yeabsley (2002).

3.2.1 Tariffs, Quotas, and quantitative restrictions

In New Zealand, an import licensing regime had been in place since 1938. These were measures that sharply restricted the entry of goods and imposed a regulatory structure that massively favoured local industries liable to competition from imports (sensitive goods). Those that held the limited number of import licenses available effectively controlled the import market for that particular product, stifling foreign competition.

The NAFTA agreement explicitly accommodated these industries into the text of the agreement (articles 4 and 5), negating the long term intention and spirit of the agreement. The assessments of the agreement by Bollard and McCormack (1985) and Lloyd (1984) suggest that it is difficult to conclude that the treaty by itself made much difference to overall trade. In particular, the treaty did little to free up trade in the highly protected New Zealand manufacturing sector.

Australian trade policy was more outward looking. Part of the reason for this was that it was becoming less reliant on agricultural commodity exports to improve welfare and spur growth. The scale of the domestic market, minerals, and agriculture drove growth in the Australian economy. With a relatively balanced economy, and growth coming from a number of different sectors the Australian economy could look to lowering protection as a strategy. This was reflected in their trade policy with the move from import licensing in 1960 followed by reductions in tariffs (except in motor vehicles and parts, clothing and textiles, and footwear) beginning in the early 1970s².

3.2.2 Other formal measures

The import licensing regime in New Zealand was all pervasive. It covered all locally made products³, therefore there was little need to use anti-dumping legislation, debate the merits of harmonisation and mutual recognition, or be serious about the use of any other import restricting devices. Furthermore, partly because the goods trade was limited, there was relatively little trade in services.

One area that was particularly susceptible to political interference was the movement of people via the nationally owned airlines. In the New Zealand case, politicians interfered with business decisions, dictating where they should fly, and even the source of engines they could buy.

As tariffs were reduced in Australia, other forms of formal measures to limit the impact of foreign competition were used more frequently. Prominent amongst them, was a strict anti-dumping regime.

3.3 Informal issues

3.3.1 Treatment of market

The New Zealand regulatory rules were designed to foster development of locally domiciled business in an internationally uncompetitive market. When the NAFTA was signed, there was a widely held amongst policy makers that this policy approach would gradually lead to a more competitive market – after all, the focus was to shift to the matter of moving the sensitive goods in a sensible and measured way onto the Schedule A list. This dynamic was seen as the work of the future.

² The political economy of this move is interesting, as it was sold as part of an attack on inflation.

³ In fact, in theory, though less frequently in practice, the coverage was even wider. It started as totally comprehensive, but was gradually concentrated toward involving all goods that **could** be made locally.

Unfortunately, the opposite was the case. Schedule A remained effectively “frozen” - with any real attempt to make progress easily stifled by businesses lobbying the Minister directly and the requirement for trans-Tasman unanimity providing the formal structure for a regular series of blocks to all proposed movements.

3.3.2 Business perceptions/culture

With little competition, importing licensing, and a focus on protecting infant industries, the New Zealand (and to a lesser extent Australian) market was focused on the producer (and employee) needs. The needs of the consumer were secondary, so products and services were not always of a very high standard, and their prices often well above world levels⁴.

Also, the import licensing system altered the incentives of businesses and manufacturers in particular . It was more profitable for license holders to import high value niche products and manufacture low quality products. By concentrating on low value added products (with which they would never be able to compete on world markets) and ignoring the high value products (where New Zealand may have had the potential to develop or even already had some competitive advantage) the manufacturing system became notably internationally uncompetitive. This contributed to making the adjustment process that much more difficult when the NAFTA was replaced by CER.

3.3.3 Business strategies

The controls on the New Zealand market meant that consumers were effectively rationed. Manufacturers controlled the market by rationing stores based on their output. Waiting lists for appliances and other consumer goods were common and choice was limited. Producers dominated the market and little incentive to innovate. Motor vehicles were the extreme case and a number of ill-starred schemes and wheezes were put in place to try and manage the political economic fall out from the restrictions. None addressed the fundamental problem - the disparity between the local and international costs causing prices to be out of line.

⁴ Motor vehicles provide the most prominent examples, but price ratios of well over 100% between local wholesale and potential import prices were common across many products.

4. CER

“Like switching on a light”

One businessperson’s view of the move from NAFTA to CER.

4.1 Introduction

The Australians tore up the NAFTA in the late 1970’s, stating that it was unwieldy, out of step with a changing world, and took up to many scarce bureaucratic resources. Being the junior partner, New Zealand had little choice but to acquiesce to the Australian demands. However, it was New Zealand officials who insisted on having a FTA rather than a customs union. For New Zealand this was crucial, since it enabled consistency between its trade policy with Australia and the rest of the world. This is why CER is the cornerstone of New Zealand’s trade policy.⁵

For Australia, it put its trade relationship with New Zealand on a sustainable basis, and ensured that necessary reform to formal trade barriers occurred in line with OECD trends in both jurisdictions.

Signed in 1982, the CER trade agreement went beyond many other FTAs. In the preamble to the agreement it committed the trans-Tasman neighbours to an “outward-looking approach to trade” which could be extended further into the Pacific and Asia. It mentioned investment, marketing, movement of people, and tourism - in short an all-embracing agreement that encompassed all trade and migration.

4.2 Formal issues

4.2.1 Tariffs, Quotas, and quantitative restrictions

The CER agreement completely changed the nature of the trans-Tasman trading relationship.

It:

- eliminated most tariffs on goods traded across the Tasman over 5 years;
- immediately eliminated tariffs on all goods with tariffs under 5 percent;
- meant that tariffs and quantitative restrictions could not be increased;
- gradually phased out quantitative barriers by 1995; and
- eliminated subsidies and incentives on goods traded across the Tasman by 1987.

This was a huge change to the trading environment, particularly for New Zealand firms who, for the first time since 1938, eventually faced significant, uncontrolled import competition – albeit from a limited source. Its outward-looking nature meant that firms either adapted or failed.

Furthermore, the automatic structure of the tariff cuts and the decision that it would be comprehensive, meant that vested interests could no longer lobby ministers on both sides of the Tasman to stop the trade policy initiatives. With lobbying being ineffective the opposition to the agreement collapsed and the agreement was implemented ahead of schedule.

⁵ For more detail see Nixon (2003) and Nixon & Yeabsley (2002).

The changing nature of world trade also impacted on CER. In the original agreement, services were not included. However, services were incorporated in the 1988 review. This reflected the increased tradable nature of services globally and their increased importance in the “newer” industries such as telecommunications.

4.2.2 Competition policies

Competition policies have a major impact on the conduct of trade, therefore understanding the detail of how they impact on the effectiveness of the trading relationship is extremely important. Despite the fact that New Zealand competition policies are similar to Australian competition laws, and have many common provisions, there are inevitably differences in the way the policies are enacted in each jurisdiction. In particular, both pieces of legislation that regulate competition practices in Australia and New Zealand are nationalistic in character focusing on the costs and benefits of company actions in their respective jurisdictions only. While there are co-ordinated attempts to look at some issues concerning trans-Tasman trade, the ACCC and NZCC operate as-if independently within their own jurisdictions.

Businesses reported that in the pre 1988 period “anti-dumping” was a major issue with Australian and New Zealand companies being very active. However, once anti-dumping actions were prohibited on trans-Tasman trade it removed one of the major trade impediments. Therefore, the attention of policy makers examining competition policies in both jurisdictions is focused elsewhere.

4.2.3 Rules of Origin

One of the trade-offs for having a free trade agreement is to have a Rules of Origin code (ROO). In its most basic form, a ROO requires the good being exported to a FTA partner has a certain percentage of “domestic content⁶.” It is designed to preserve political economic support for the agreement by stopping third countries re-exporting via one of the FTA partners to bypass tariffs (and other restrictions) that are in place for third country trade. Its aim, in short, is to preserve the benefits to those who are engaged.

The CER ROO requires a 50% local content for goods crossing the Tasman to qualify. In 1983, this was considered to be reasonable, however, the dynamic nature of international trade has meant that exporters on both sides of the Tasman are demanding a re-think of the ROO.

This is because:

- to remain competitive in their own domestic market, manufactures are having increasingly to source raw materials and intermediate products at the lowest cost – usually outside the two partners. This means that the value New Zealand and Australian businesses bring to a product are design capability, innovative processes, and other competitive attributes. The sum of value contributed by these additions may not reach the ROO threshold, and therefore mean that the product cannot be exported under the FTA rules to a partner;
- rules that govern the ROO can be strictly interpreted. Therefore, if a product is produced in Australia or New Zealand and there is no documentation on the last part of the production chain (even if it has, in fact, been produced domestically) entry is refused because the ROO requires complete documentation;

⁶ In a FTA, it usually is defined as including all value added in either country party to the FTA.

- a volatile exchange rate can alter the proportional value of raw materials and intermediate products used in the production process. If a product is close to the 50% threshold then changes in the rate can push content around from over the 50% one month, to under it in other months.

These are just some of the issues that businesses describe as being important when considering how to produce products for the trans-Tasman market. While no one issue is considered to push firms over the ROO threshold, a combination of issues means that re-location is being considered as an option for some companies. This is particularly relevant for companies right on the threshold limit and those companies whose third markets are growing. They cannot get the advantages of scale or are troubled by costs, because of the restrictions on where they source raw material and inputs to meet trans-Tasman ROO requirements.

The ROO details, in some cases, are counter to the general spirit of the CER agreement and what it sets out to achieve.

4.2.4 Harmonisation and mutual recognition

Ironically, the success of the CER agreement has meant that it has been very difficult for both trans-Tasman governments to focus on the remaining CER trade issues. Over the past 10 years, there has been no coherent strategic plan on a way forward. In hindsight, what has emerged are trade agreements, separate legislation, and codes of conduct that have led to a mixture of convergence and divergence to and from enhanced integration. We have highlighted some of the issues that businesses are concerned about below.

a) Tax regimes

Investment (including investments that support trade as well as stand-alone investment) is crucial for a successful economic trans-Tasman economic relationship – it is the concrete embodiment of the successful working through of one of the dynamic benefits from the arrangement, which is to allow trans-Tasman firms to deploy different strategies in the joint market.

Tax has a major impact on the type, quality, and size of investment flowing between New Zealand and Australia. Most businesses that have taken part in the survey mentioned the divergent tax regimes. In fact, tax issues totally dominated some discussions. The issues include both personal and business tax. While not an issue when CER was first signed, the divergent views about tax have evolved over time depending on the political environment on both sides of the Tasman.

Some of the main issues are⁷:

- absence of mutual recognition of imputation credits;
- the triangular imputation credit problem (New Zealand shareholders in Australian companies do not gain imputation relief for New Zealand tax paid by a New Zealand subsidiary);
- the taxation of conduit investment (e.g. Australian shareholders in a New Zealand company with investments outside New Zealand);
- the taxation of superannuation funds, contributions and pensions in circumstances where employees move across the Tasman, either to work or retire.

⁷ These issues are taken from a letter sent to the ANZBC by John Shewan in 1997.

According to Shewan (1997), there are a number of other issues ranging from franking credits on dividends received by Australian subsidiaries of New Zealand companies and the capital gains tax in Australia, to the taxation of unrealised foreign exchange gains.

The impact of these rules according to Shewan (2003) is to cause problems for:

- employees;
 - double taxation in some instances;
 - very high compliance costs; and
 - those contemplating temporary transfers.
- Corporates.
 - Non Residents Withholding Tax (NRWT) applies to cross-boarder flows of interest and dividends;
 - NRWT acts as an impediment to capital structuring, and often drives the form of funding used; and
 - The NRWT is extremely confusing for Australian investors.

At present, the Australian government is conducting a far reaching tax review. Some concern was voiced that this review could mean that New Zealand companies might find it more profitable to relocate across the Tasman. However, most business people believed that a proper evaluation and analysis of all tax issues showed that taxation levels in New Zealand were lower and more transparent.

The issues surrounding taxation and its impact on investment do represent an impediment to trans-Tasman trade – perhaps more through the complications they create for firms trying to design and select appropriate strategies to best respond to the CER (or wider) possibilities.

Like the issues above, associated with the ROO, the details matter and can act to diverge from the spirit and drive created by the CER agreement.

b) Aviation markets

The aviation market has gone through major changes since 1983. The evolution of both regulatory regimes has had been the most important influence on the structure, conduct, and performance of the airlines operating in both jurisdictions.

Seemingly random political interference (e.g. Australia's decision to stop the commitment to an open skies policy in the mid 1990s) has meant that decisions taken have not been consistent with the spirit or the intent of the CER agreement.

c) Food standards

Australia and New Zealand Agreement on Joint Food Standards (ANZFA) was set up to administer an independent food safety standards regime. In Australia, the constitution effectively gives the states control of food standards.

The states and the Federal government have though, established a common structure in which all states participate. ANZFA links into this structure, which means New Zealand has a representation similar to that enjoyed by the Australian states. The rationale for New Zealand not setting up its own structure was that the costs were very high, and that the expertise to operate such a programme was limited in New Zealand.

Businesses operating under ANZFA report that regulations have greatly assisted their businesses. It has reduced the transaction costs by increasing certainty and aided the ability to achieve scale since they have one set of rules covering both jurisdictions. They believe that influence on the food standards is by those with knowledge and capability rather than being governed by political influences.

ANZFA also shows that New Zealand can successfully deal with Australian states on trade regulation issues. In the past, dealing with the separate Australian states has been seen as unwieldy (relative to dealing with the Federal Government). The ANZFA regulations demonstrate that agreeing to regulations at the state level can be economically efficient.

However, deeper integration (and consistency with the CER agreement) has come at a cost of independence and perceived sovereignty (at least for New Zealand) and may be a continuing source of future political irritation (e.g. protests in parliament about labelling GE foods).

d) TTMRA and MRA

The trans-Tasman Mutual Recognition Arrangement (TTMRA) and the Mutual Recognition Agreement (MRA) were designed to deepen integration and preserve independence in both jurisdictions. They cover regulations affecting the sale of goods and the registration of occupations (services).

The TTMRA had its origins in the MRA and the CER agreement. They have the objectives of:

- increasing trade and workforce mobility;
- contributing to integration;
- enhancing competitiveness;
- decreasing costs to industry;
- increasing access to economies of scale.

A recent review by the Productivity Commission (2003) commented that:

“while ‘hard’ data are limited, there are indications that these schemes have been effective overall in achieving these objectives”

In addition, the costs of compliance to the TTMRA and MRA are the front-end-loaded one-off costs of adapting to the regulations, whereas the benefits accrue in successive years.

However, businesses point to areas that are exempt from the TTMRA as being an area of some concern. The Productivity Commission suggests:

“Significant further progress in relation to the TTMRA special exemptions will require greater cooperation across agencies and jurisdictions to address inconsistent and cumbersome regulatory practices”.

Typically, problems have occurred when legislation or codes of practice have been developed in their own jurisdiction with little understanding of how they might be integrated into wider trans-Tasman economic relationship.

The Productivity Commission (2003) comments that:

“The effectiveness of the schemes would be enhanced by undertaking an awareness program on the obligations and benefits of mutual recognition, aimed at regulators, policy advisors and relevant industries and professions”.

New Zealand based businesses have been concerned about two areas:

- the current temporary exemption on water heaters. The Productivity Commission records that there were initial attempts to develop a joint Australian and New Zealand standard. However, New Zealand had adopted a higher standard in support of its National Energy Efficiency and Conservation Strategy. Unfortunately, the impact of this is that, Australian water heater manufactures can qualify under the agreement and compete in the New Zealand market with a lower cost structure and a product best suited to the fast growing apartment market. New Zealand water manufactures have to comply with the higher standards and produce product not well suited to fast growing market segment demands. This places them at a competitive disadvantage.
- the Hazardous Substances and New Organisms Act (HSNO) has been developed over a number years to protect the environment and communities from the improper use of chemicals and new organisms in New Zealand. As a number of studies have shown (Penman et al (1989), NZIER (2000), & NZIER (2003)) the result is having a negative impact on industry and it is doubtful whether the benefits claimed are being achieved. Furthermore, its approach is out of step with the more pragmatic approach being taken across the Tasman.

While the TTMRA and MRA have been positive for both New Zealand and Australia (and in line with the goals of CER) there are areas where policy has not considered how it might fit into the trans-Tasman context or how it might impact on the competitive position of some industries facing international competition.

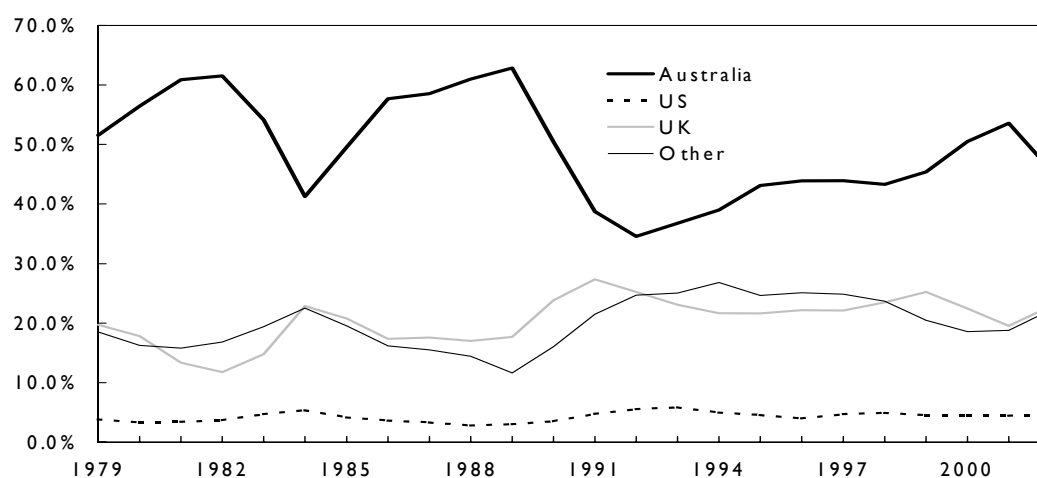
e) Migration

The driving factor in trans-Tasman migration is the different economic circumstances being experienced in each country. Expansions and contractions of each economy have sent strong “pull” and “push” signals to the trans-Tasman labour market.

Recently in 2001, Australia made legislative changes making it more difficult for New Zealanders to claim social welfare benefits in Australia. Whilst New Zealanders continue to be able to live and work in Australia indefinitely, social security payments would be restricted to New Zealanders who became permanent Australian residents. The impact of this policy change is visible in Figure 1; the number of departures leapt in late 2000-early 2001 as people moved in advance of the policy taking effect in February 2001.

Figure 1 Permanent and long term departures by country of next permanent residence

Annual, per cent of total PLT departures



Source: Statistics New Zealand

f) Phytosanitary regulations

Phytosanitary issues pre-date the CER agreement. There is a long history of trans-Tasman trade tension over phytosanitary regulations, which goes back to the 1920s. Therefore, the current long running dispute on New Zealand apples being banned from sale in the Australian market because of fireblight is nothing new.

These issues are more likely to be solved by pressure from the multilateral process or decisions made in other markets that involve the bigger players (e.g. the European Union and United States). This is because of the strongly held views of well entrenched domestic interests.

4.3 Informal issues

4.3.1 Treatment of market

CER was designed as an outward looking process to enable Australian and New Zealand firms to compete in each others domestic market and then be able to expand into third markets.

Because of CER, there has been a fundamental change to the way businesses have approached the market. When interviewed, most businesses sent a clear message about the treatment of the market. The Australian and New Zealand market is a single market. This allowed businesses to reap the economies of scale. However, there are some differences in the way each country's businesses viewed exporting to the other market:

- most Australian businesses viewed the New Zealand market as a place to generate increased sales and diversify their portfolio of markets (virtually another domestic market, alongside others in Australian states).
- New Zealand firms saw the Australian market as a stepping stone towards third markets (an export market, of a completely different character to their existing

territories). Previous studies by Infometrics (1995) and BERL (1995) support the wide spread nature of this view.

4.3.2 Business perceptions/culture

A number of businesses were concerned about the amount of shareholder value that has been destroyed by New Zealand and Australian firms in each market. There was a consensus amongst businesses interviewed that the following approaches intensified this problem:

- if Australian firms thought that New Zealand was just another state market where they could roll out the same sort of business plan previously used, then they would make costly errors. The hard experience suggested that understanding the various business aspects associated with the market (both how to motivate employees, the way businesses interacted with government, and the approach customers take to the buying process) were vital in succeeding in New Zealand.
- New Zealand firms who thought that Australia was “just a bigger New Zealand” would also find difficulty being successful in the Australian market. Specifically, the more complicated regulatory structure caused major problems for New Zealand companies. Also, a lack of understanding about the motivations of Australian employees and the type of product that would be successful in the Australian market were major factors in the failure of New Zealand businesses in the Australian market.

This “groping” for successful approaches to the market is a reflection of the isolation of both markets for most of the last 100 years. Despite the fact that there have been many successful firms operating in both countries for years, many of these have been subsidiaries of multinationals with third country roots (oil companies, financial agencies, and manufacturing, for example)

Since the beginning of the 20th Century, it has only been in the last twenty years that markets have opened fully. This has coincided with unprecedented opening up of markets all over the world and has led to sharper competition in all markets, relative to what has gone before. The learning process and sharper competition have meant that companies on both sides of the Tasman have had a lot of catching up to do.

4.3.3 Business strategies

There were a lot of different strategies at play in the market, in fact, nearly as many as there are companies. This is a healthy sign since no one can predict which strategy will work.

Some of these strategies include:

- Australian owned subsidiaries that are relatively independent in the New Zealand market. These subsidiaries retain policy functions in New Zealand and actively recruit New Zealanders who know the New Zealand goods and services market;
- Australian subsidiaries that are controlled from Australia and only have operational people in New Zealand;
- New Zealand companies that operate in both markets but have very little trade between different parts of the company;
- New Zealand companies that have migrated to Australia but still have predominately New Zealand shareholders. Typically, these companies have Australian management;

- New Zealand companies that have a production base in New Zealand and export to Australia. Some of these companies also have joint ventures that allow them better access to the political and regulatory agencies in Australia.

5. BORDERLESS MARKET?

5.1 Introduction

In this section, we first have to have sketch out the implications of a borderless market and what that would mean for business going forward. Important in this process is to set out a “rule of thumb” test as to what a borderless economy would look like.

5.2 Formal issues

5.2.1 Tariffs, Quotas, and quantitative restrictions

Under the APEC Bogor Accord, both Australian and New Zealand have committed to reduce tariffs to zero by 2010. Assuming this happens, we would expect there to be no sensitive industries with tariff protection, and the ROO would no longer be required.

What then is the point of CER if all tariffs in the partners are reduced to zero? Under the CER agreement, in the post 1988 period, both countries agreed to do away with anti-dumping regimes. These had been major impediments to the trans-Tasman trade and their abolition represented a significant advancement in trans-Tasman economic development.

5.2.2 Competition policies

A borderless market will have a big impact on competition policy in the two jurisdictions. In a borderless market, we would expect that there would be only one body that regulated both markets with uniform regulations that are consistent over both markets – with some variation to allow for regional differences.⁸

This goes beyond general competition policy to include the emerging specialist regimes looking at networks and other natural monopoly markets. This means that there would be a common regime for all the business sectors in both countries that are considered in need of specific regulation. The candidates might include: retail, airlines, agri-businesses, mining, utilities (electricity, gas, water, telecomms), banking, and insurance etc. Each of these industries has particular competition issues that would have to be dealt before a borderless economy could operate successfully e.g. how would such a body deal with competition issues in utilities?

The rule of thumb test for a trans-Tasman competition policy involves consistent application across all jurisdictions. If the regulatory rules governing the goods and services between Queensland and Western Australia are similar to those operating between Australia and New Zealand then the competition policy would be supporting a borderless market.

As an example of the mechanics of such regulations, if we take the New Zealand Commerce Commission’s practice note 4 (Figure 1), as standard template for a take-over code, we would need to consider the following:

- define the relevant markets: The markets would have to be defined in terms of the (where applicable) trans-Tasman market. This means, if this is the relevant market definition, looking at the benefits and detriments of both New Zealand and

⁸ These regional differences, whatever they may be, must be limited and not negate either the spirit or letter of a trans-Tasman competition law.

Australian business and including them in the calculations. Issues such as defining the market boundaries would have to be considered and where those boundaries are drawn in the trans-Tasman market.

- determining market share. Once the market had been determined, the quality of the information available to determine market shares may become an issue – particularly if information on market share is more readily obtainable in one jurisdiction than the other.
- consideration of import competition. There would be little change, except Australia would be excluded from this equation, since its supply potential is automatically part of the ‘domestic’ market.
- consideration of barriers to entry. In a borderless market more competition may exist in particular industries therefore, market power may be mitigated more often in take-overs and acquisition cases.
- consideration of other factors such as countervailing power, efficiencies, and failing firm arguments. The specifics of the case will determine what is required in each situation, however it will be set in a wider potential context of the trans-Tasman market.
- consideration of enforcement criteria. A bigger market may mean that the stakes are higher and, consequently, penalty provision for transgressions may be need to be stiffer.

One of the advantages of one (wider) jurisdiction would be the likely larger number of cases that could be called upon as precedent – and thus lower uncertainty for businesses. This is often over looked as a benefit, but is keenly felt in “thin markets” for regulatory measures such as New Zealand.

5.2.3 Harmonisation and mutual recognition

a) Tax regimes

The taxation regimes on both sides of the Tasman have diverged considerably over the past 15 years. Full harmonisation may not be possible, given the track to which each government is committed. However, if there could be a common approach that iterated towards a solution, for each of the issues that impedes trans-Tasman trade, progress could be made so that tax issues have less impact on the efficiency of investment flows.

The details matter in these tax arrangements, therefore:

- simple solutions will reduce transaction costs;
- ensuring that any new tax initiatives, before implementation, clearly demonstrate how they fit into (and reinforce) the trans-Tasman economic relationship;
- ensuring that policy is reflected in operational performance, with the necessary flexibility to review, and if necessary change, those rules, after a set amount of time to ‘work in.’

Bringing together both tax systems into a workable framework that allows for diversity, and, at the same time, reduces transaction costs is an important and politically difficult issue to overcome, before a borderless market is achieved.

b) Food standards

Food standards regulation has reached a point where they operate as if there are no borders. This has created some efficiency gains that have helped trans-Tasman businesses reduce transaction costs.

From an economic perspective, this is an ideal solution. However, in a political-economic context, is this sustainable over the long run, particularly given that every now and then politicians will make political capital out of New Zealand's dependence on Australian based standards (e.g. the GE labelling debate).

c) TTMRA

The TTMRA and MRA have been a success in terms of standardising procedures for goods, services and acceptance of New Zealand and Australian qualifications. Progress needs to be made on the areas where legislation has not taken account of the trans-Tasman relationship, that where industries are exempt from the TTMRA. Movement towards a borderless market in these areas, will test both governments' willingness to advance in general towards a borderless market.

d) Migration

Recent moves by the Australian government to limit New Zealanders' access to social security payments while living in Australia have had a broadly detrimental impact on migration flows. The test of a borderless market is whether or not this legislation will be relaxed at a latter date.

e) Phytosanitary regulations

Phytosanitary issues are some of the most problematic areas to overcome in any trading relationship. This is particularly so for New Zealand and Australia because of the relative dependence on agricultural exports.

For a borderless market to work the rules must apply equally between Australian States and between New Zealand and Australia.⁹

5.3 Informal issues

It is difficult to speculate what behaviours and strategies would be successful in a borderless market.

However, we would expect that:

- transaction costs imposed by governments would be kept to a minimum allowing businesses to focus on the market;
- firms would be more sophisticated on how they approached the trans-Tasman market, therefore destroying less shareholder value, relative to what has occurred in the last twenty years; and
- competitive markets assist in increasing the size and number of competitive firms, relative to the protected or less competitive situation.

⁹ Phytosanitary regulations would need to reflect the different concerns of each jurisdiction e.g. barriers would be kept in place to prevent harmful pests from crossing the Tasman.

6. COST AND BENEFITS

At the highest level, further trans-Tasman integration is efficient only if the costs outweigh the benefits. The strength of an economic approach (in this case cost benefit analysis) is not that it provides an answer – which may be elusive any way given limited information – but rather that it helps clarify the effects which are implicit in all decisions. Economic appraisal is most valuable if used as an informative, rather than prescriptive tool, since it provides a consistent approach to harnessing available information and ordering priorities.

In this section, we will concentrate on illustrating the main areas where costs and benefits fall and make some general estimates so that we understand the magnitude of the costs and benefits involved. These estimates are based NZCC (1998) experience when evaluating public benefits and detriments under the Commerce Act. The estimates involve examining the gains and losses when moving from the current CER environment to a borderless trans-Tasman economy.

6.1 The benefits

Efficiency is an important issue in economics because a more efficient economy contributes directly to greater welfare (a rising tide raises all boats effect). Economics is primarily concerned with highlighting where impediments to improved efficiency occur.

Three types of efficiency are important:

- **Productive efficiency** deals with the examination of the costs in relation to the process of producing one “unit” of a good or service (*Cost minimisation*). One of the ways of reducing per unit costs is by achieving an optimal scale. In the New Zealand and Australian markets, achieving scale is a crucial component of profitability in most business. By creating a trading environment where businesses can seamlessly move between the trans-Tasman economic environment and third markets without sourcing different raw materials for different markets will create efficiencies in the order of 0.5% - 1.5% of total trade. This will enable firms to make business decisions (e.g. location of plant) based on profitability rather than the impact of a trade agreement.
- **Allocative efficiency** examines whether resources are applied to their best use and how those resources are used for different purposes (*Matching*). Maintaining the “optimal” mix of resources even without the influence of trade rules is a difficult task for firms at the best of times. However, with details of the CER agreement that impact on allocation choices, the costs of doing business can impact on international competitiveness (e.g. tax regulations that determine what is produced where and deciding on how much should be manufactured in each country to meet rules of origin constraints). By moving from the current CER environment to a borderless trans-Tasman market will improve allocative efficiency by between 0.5%-1.5%.
- **Dynamic efficiency**, examines the deployment of resources over time to reflect environmental changes (*Innovation*). One of the more difficult economic concepts to measure and get across in general debate is the concept of dynamic efficiency i.e. innovation at the margin. It is difficult to see, because it consists of a myriad of small, sometimes imperceptible changes to economies, industries, and firms that

advance economic performance. Economics has yet to come up with a way of generally assessing dynamic efficiency because of the data difficulties of measuring performance over time. However, since dynamic efficiency is about maximising the present value of current and future welfare, a dynamically inefficient economy will clearly have less economic advancement over the long run. Since economists have long realised that dynamic gains are extremely important estimates of moving from CER to a borderless trans-Tasman market are in the range of 1% - 2.5%.

6.2 The costs

The costs from changing systems (both within in firms and government) and possible exposure of others to more intense competition (relative to the current conditions under CER) are relatively significant in terms of the total trans-Tasman trade. The costs also depend on the design of a new regulatory system.

For example:

- keeping regulatory systems as simple as possible;
- ensuring that laws governing similar issues on both sides of the Tasman are translated into each jurisdiction in a commonly accepted way (the details matter); and
- businesses behave in an economically rationale way in response to perceived competitive threats (e.g. shifting resources to concentrate on their competitive advantage rather than lobbying governments).

We expect the cost of changing systems and firm adjustment to be approximately 0.5% - 1% of total trans-Tasman trade.

6.3 Estimates of costs and benefits

Table 1 sets out the approximate costs and benefits associated with moving from CER to a borderless market - note that these estimates are the costs and benefits associated with both markets. It is important to note that the costs are likely to be one-off costs of transition while the benefits could reoccur over a number of years, albeit at a lower level. Therefore, the benefits are conservatively estimated and are likely to be understated.

Table 1: Estimated costs and benefits of moving from CER to a borderless trans-Tasman market

Millions of NZ\$

Costs		Benefits	
Cost of transition	64 – 128	Productive	64 – 128
		Allocative	64 – 128
		Dynamic	128 – 320
Total	64 – 128	Total	256 – 576

Notes: (1) Total merchandise trade between Australia and New Zealand was 12,830 million in value in the June Year 2003

Source: NZIER and Statistics New Zealand

6.4 Other issues

While not quantifiable, there are number of other issues that need to be factored into assessing the criteria for the merits of closer integration.

6.4.1 Clear and achievable objectives

It is well recognised that greater integration between the New Zealand and Australian economies should improve welfare on both sides of the Tasman. Therefore, when laws, regulations, and codes of practice are devised on both sides of the Tasman there should be recognition of the global and trans-Tasman context in which they operate.

6.4.2 Effectiveness

To judge the effectiveness of attempts to further integrate the trans-Tasman economies schemes need to consider:

- coverage: the spectrum of activities covered by the proposed arrangements.
- operation: the procedures used and the available appeal mechanisms.
- monitoring: how is it done and what are the impacts?
- machinery: what are the ways in which changes are applied, the way exceptions and exclusions are operated, and at what intervals should schemes be reviewed.
- mechanisms: when policy is being developed in either jurisdiction, how will policy makers take account of the schemes put in place to enhance integration?

The design features mentioned above all impact on effectiveness of an integration scheme. They emphasise the importance of a schemes practical nature, how on-going changes to schemes take place, and the importance of scheme flexibility.

6.4.3 Practicality

Any scheme must be achievable in a practical sense. If for different cultural, historical, or locational reasons a scheme is not able to achieve further integration then it should not be pursued.

Important are:

- the degree of compatibility of trans-Tasman jurisdictions. This will also dictate the ability to integrate further.
- in small and medium sized economies such as New Zealand and Australia it is particularly important to reduce the transaction costs of any particular piece of legislation or voluntary scheme that are aimed at increasing integration. If transaction costs are large or changes incur further substantial transaction costs then further integration should only be considered if the benefits are substantial.

6.4.4 Sovereignty

Integration does mean giving up some sovereignty. One of the key issues for both trans-Tasman economies is how much sovereignty to give up to obtain the economic benefits of further integrating the two markets.

While the two cultures are relatively similar, there are some significant differences that have occurred for different cultural, historical, and locational specific reasons. These factors need to be considered when considering further integration.

6.4.5 International competitiveness

The aim of a free trade agreement is to consistently treat the trade relations with the FTA partner and the rest of the world in a similar manner. In this way, both economies can remain exposed to international competition that spur a competitive economy. All schemes that foster further integration should adhere to and be sufficiently able to adapt to changing international competitiveness.

7. CONCLUSIONS

CER is important to both Australian and New Zealand businesses. Freer trade across the Tasman has improved consumer choice and lowered cost, increased business opportunities, salaries and wages, and has had a “raising all boats” effect on economic growth of both economies. While this has been a major success further changes are required to “get the trans-Tasman relationship right” so that it is consistent in its dealings with third countries and global trading practices.

Using efficiency as the main criteria we have estimated the benefits of moving towards a borderless market at between NZ\$256 million and NZ\$576 million. This is a conservative since it does not include the benefits that would be reaped in successive years. The one-off costs while significant are much smaller, between NZ\$64 and NZ\$128 million.

Since 1965 the trans-Tasman market has become more integrated. From the first halting steps of the NAFTA to the world’s best practice of CER, the trans-Tasman market has developed relatively quickly. However, there has been a lack of coherency when dealing with the outstanding issues on the trans-Tasman trade agenda. Steps have been taken on both sides of the Tasman that converge and diverge from integrating more closely. For a borderless market to develop further consideration should be given to:

- rules of origin that were designed before the globalisation process developed momentum
- the divergent tax systems and their impact on investment
- design of internal regulation within New Zealand and Australia that takes no account of the trans-Tasman trading relationship (and are presently exempt from the TTMRA).
- the ad hoc development of air rules
- recent migration laws, and
- continuing phytosanitary issues.

Key to the development of a borderless market would be the creation of a single body that governed competition law in both jurisdictions for goods and services. A common regime for all the major business sectors in both countries would be required. Each industry has particular competition issues that would have to be dealt before a borderless economy could operate successfully.

Despite being world’s best practice, CER has not stopped businesses from making miscalculations about each market. Large amounts of shareholder value have been destroyed by companies on both sides of Tasman when attempting set up the marketing infrastructure and sell goods and services into each other’s market. Those Australian companies that perceive New Zealand to be the same market as other states in Australia or New Zealand companies thinking that Australia is just a bigger New Zealand have usually been disappointed in their expectations of market sales.

The structure of business has changed markedly from pre-CER days. The major impact has been the impact of globalisation. However, it should be noted that some major business did not exist in 1983 when CER was signed (e.g. private telecommunications firms). Also, it has been observed that there have been successive

waves of different strategies in play as different management regimes respond to the competitive market.

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APPENDIX A: QUESTIONNAIRE

The NZ Institute of Economic Research has been engaged by the Australia New Zealand Business Council to investigate the changes that have occurred and could potentially occur in the trans-Tasman market. In particular, we are interested in the changes to business operation over time as the rules governing trade have changed. To this end, the project will investigate conditions faced by businesses in the:

- pre-CER period – restricted trade
- the CER period – free trade in most goods and services
- post-CER period – borderless market

We have divided the questions into two areas that impact on trans-Tasman business activity. Firstly, there are a set of questions that focus on external trade issues to the firm (quotas, tariffs, non tariff barriers, migration, investment, tax and other significant issues) and secondly, questions related to the internal firm organisational issues (structure of business, marketing, manufacturing, distribution, human resources, finance, ownership, and other issues).

The same questions will apply to each period.

A.1 External trade issues

1. How do trade protection measures (tariffs, quotas, and non tariff barriers) impact on the business?
2. Has migration helped or hindered business development? In what ways?
3. How has the different treatment of tax impacted on the business?
4. What are the issues involved in investment and ownership?
5. Do any other formal trade issues impact on the business?

A.2 Internal organisational issues

How has the trading relationship impacted on the structure of business? (perhaps use a business map)

1. What has been the impact on marketing? e.g. price, packaging, and promotion
2. What has been the impact on manufacturing? (or in the case of service related firms the type of services provided)
3. What has been the impact on distribution?
4. How have the changing trade rules impacted on the way human resources are managed?
5. Has it changed the way the businesses are financed?
6. Has there been any changes to ownership?
7. Are there any other changes to the way the business is operated because of changes in the trans-Tasman market?
8. How has the trans-Tasman relationship impacted on R&D investment?