

Free Trade Agreements and Free Trade

A very interesting and important report by the Australian Productivity Commission was released last month. Implicitly, its conclusions call into question the emphasis of New Zealand's trade policy.

The Productivity Commission was asked by the Australian government to undertake a study on the impact of bilateral and regional trade agreements (FTAs) on Australia's trade and economic performance. One aspect was the relative weight to be given to FTAs vis-à-vis unilateral trade liberalisation.

What immediately follows is essentially a summary of the report's findings.

The Commission noted that theoretical and quantitative analysis suggests that tariff preferences in FTAs can significantly increase trade flows between partner countries, although some of this increase is typically offset by trade diversion from other countries (meaning trade is diverted from the cheapest source of imports). However, it concluded that the increase in national income from preferential agreements is likely to be modest.

It reported that it had received little evidence from business to indicate that bilateral agreements to date had provided substantial commercial benefits.

While FTAs can reduce trade barriers and help meet other objectives, the report said that the potential impact is limited and other options may often be more cost-effective. Moreover, current processes for assessing and prioritising FTAs lack transparency and tend to oversell the likely benefits.

Crucially, the Commission advised that domestic trade liberalisation offers relatively large economic benefits and should not be delayed to retain 'bargaining coin'.

Finally, the report recommended that in the international arena, the Australian government should continue to pursue progress in the Doha Round. It said that building the case for substantive reductions in trade

barriers internationally requires improvements in domestic transparency and policy analysis *within* each country.

In its report the Productivity Commission shows that the unilateral removal of all tariffs would be almost five times more beneficial to Australia than a bilateral agreement to remove all tariffs between Australia and the United States, and over 100 times more beneficial than an agreement with a small country.

The Australia Treasury has also supported a “repositioning” of Australia’s trade policy away from FTAs, which it says are “not meeting Australia’s needs.”

Australian trade minister Craig Emerson has endorsed these findings and foreshadowed a fundamental shake-up of Australia’s trade policy.

He noted that under the Howard government, a view developed that Australia’s remaining tariffs should be retained and used as bargaining chips in FTA negotiations.

This view was wrong, Dr Emerson argued. “I want to reconnect with the Hawke-Keating government’s first guiding principle in economic reform that competition is good and dispense with the bargaining chip approach to the remaining Australian tariffs.”

The bargaining chip approach has been favoured by our government. It has stated that remaining tariffs will not be reviewed before 2015.

But views similar to those of the Productivity Commission have been expressed on this side of the Tasman.

One of the recommendations of the 2025 Taskforce was that all remaining tariffs should be speedily removed.

The New Zealand Institute of Economic Research recently released a study which found that, while tariffs are now low (and roughly in line with Australian tariffs), eliminating them would produce economic benefits.

Its chief executive, Jeane-Pierre de Raad, said that if New Zealand moved to full free trade, “we’d hardly feel a thing”, and that, like free-trading Hong Kong and Singapore, we would send a clear signal to our trading and investment partners that New Zealand is truly “open for business”.

There is merit in these arguments. Now that New Zealand is in an FTA with China we are effectively heading towards free trade with the world in industries to which tariffs still apply. Little in the way of additional adjustment would be required of them if tariffs were generally removed. The Chinese government would have no grounds for objecting to such a move.

The current low tariffs involve unnecessary costs by way of Customs administration and private sector compliance. They also constitute a small tax on exporters (because they raise domestic costs) at a time when everything possible needs to be done to improve export profitability and rein in New Zealand’s dangerously high current account deficit.

Like its counterpart in Australia, the Ministry of Foreign Affairs and Trade has given priority to the mercantilist ‘negotiating coin’ argument. But the government could still pursue worthwhile FTAs (like the governments of Hong Kong and Singapore) because they involve other elements such as investment, competition law and intellectual property.

The Treasury’s views are in line with those of the Australian Treasury.

If the government is serious about its goal of catching up with Australian income levels by 2025, tariff reform is low hanging fruit.

And if it disputes the analysis of the Productivity Commission, it should refer the issue to the New Zealand Productivity Commission when it is up and running this year.

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