

OTAGO FOREIGN POLICY SCHOOL

**THE NEW ZEALAND-AUSTRALIA
RELATIONSHIP: A BUSINESS PERSPECTIVE**

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Introduction

This paper looks at the relationship between New Zealand and Australia from a business perspective. Given the dominant impact that government policy has on business and economic outcomes, it begins with a survey of the way the relationship between the New Zealand and Australian governments has evolved over the last two decades. The paper then explores the growing interconnections between New Zealand and Australian businesses. Finally, it considers what deeper relationships at the political level may and may not have to offer New Zealand.

Government relationships

It hardly needs to be said that public policies in Australia and New Zealand have moved a long way towards greater openness since the Closer Economic Relations agreement came into force in 1983. At that time policies were insular and highly interventionist in both countries. Both were becoming increasingly embarrassed by international comparisons of their economic performance, having once been (like Britain) among the wealthiest countries in the world. They were by no means equal underperformers: Australia had merely become a slow learner in OECD terms, while New Zealand was around the bottom of the class.

To the extent that Australians thought about New Zealand, it was seen as a millstone around Australia's neck. The country was becoming less important to Australia as a trading partner. Australian politicians and government officials had become frustrated with their New Zealand counterparts' petty-minded and bureaucratic approach to trade liberalisation under the New Zealand-Australia Free Trade Agreement, and with the seemingly incurable protectionist attitudes of New Zealand manufacturers. They effectively confronted the New Zealand government with a choice: either accept a comprehensive free trade agreement, or Australia would lose interest in efforts to free up bilateral trade. Some on the New Zealand side saw that stance as an opportunity to be grasped.

Looking back at the way the relationship between the two governments has developed since then, it seems that in many ways things have come full circle.

The Muldoon government in New Zealand prevaricated over CER but eventually bit the bullet. New Zealand firms adjusted and became more competitive, and the extended timetable for the removal of import licensing and tariffs soon became academic. With the Labour government's economic policy reforms from the mid-1980s, New Zealand started to re-emerge as a credible economic partner and Australian politicians and business people began to look at New Zealand in a new light. The New Zealand government followed Australia in freeing up financial markets, floating the exchange rate and implementing general tariff reductions. In some areas, such as privatisation, it implemented market-oriented economic reforms ahead of Australia. The country that Australians had virtually written off was being noticed internationally for the quality of its economic reform programme.

By the early 1990s, it was the New Zealand government that was wanting to force the pace of economic integration. Many Australian politicians crossed the Tasman to investigate New Zealand's economic reforms. A series of Australian firms relocated to New Zealand or set up operations here. The Employment Contracts Act of 1991 – which contrasted with Australia's inefficient and cumbersome labour market regime – was one major drawcard. New Zealand reformers were to be found working in Australia. Indeed key features of New Zealand's reforms were copied in many parts of the Australian public sector, particularly Victoria. The former rust-belt state was transformed with a programme of fiscal reform, privatisation and major changes to the way many government entities were run. There was a loss of momentum in the later Kennett years, but it is interesting that the Bracks Labor government that followed shows few signs of fundamentally reversing the earlier changes.

New Zealand's economic performance lifted substantially from 1992 with strong rates of economic growth, rapidly falling unemployment, low inflation, a comfortable external position, a turnaround in net migration and a credit rating upgrade. However, the reform efforts of New Zealand governments were stop-start

in nature and the programme progressively lost coherence and momentum. As former Treasury secretary Graham Scott recently put it:

The notion that New Zealand has had 15 years of relentless 'free market' reform glosses over an untidy reality. We have had two periods of radical policy announcements to reform the role of the state – the mid-1980s and 1991-92. In between these two periods there have been consolidations, policy modifications, policy reversal, changes in leadership at various levels and a return to more familiar pragmatism driven by political resistance to some of the changes.¹

By 1997 the growth momentum was falling away, imbalances were showing up and the economy was in a weak position to cope with the Asian downturn.

As a consequence, the new-found respect for New Zealand in Australia faded. The loss of interest has been compounded since the change of government in 1999, as New Zealand has been perceived as becoming more insular in its economic, defence and welfare policies. Economic policy changes that have attracted attention in Australia include New Zealand's halt to the removal of tariffs, despite the overwhelming evidence of the benefits of free trade;² the changes to employment law, which have made New Zealand's labour regime less attractive overall than Australia's according to experienced practitioners; and the increase in the top income tax rate. Although Australia has a higher top statutory tax rate than New Zealand – and this is a serious weakness in its tax system – there are many tax concessions that better-off individuals can take advantage of, just as they could in New Zealand prior to 1984.

Since the mid-1990s Australian governments have done a better job overall than New Zealand's in advancing economic reform. Spending by governments at all levels in Australia has been reduced from 35 percent of gross domestic product (GDP) in 1994 to 31 percent in 2000, according to the OECD. In contrast, total government spending in New Zealand is now much higher at around 41 percent of GDP (see the accompanying table), around the same level as in 1994. Australia is a

¹ Graham Scott, keynote address, Public Service Senior Management Conference, 1999.

² For example, a paper by Jeffrey Frankel and David Romer published in the *American Economic Review* in 1999 (Vol 89 No 3) estimates that every one percentage point increase in the ratio of trade to GDP raises income per person by between one-half and two percent. Similarly, the OECD (1988) estimates that nations relatively open to trade grow about twice as fast as those that are relatively closed.

much more lightly taxed country than New Zealand, since government spending is the best measure of the overall tax burden.

Australia has made good progress in the last 10 years in dismantling most of its statutory marketing authorities whereas producer board reform in New Zealand has been slow, tentative and lacking in quality – particularly in respect of the dairy industry. Australia is in the lead in the privatisation and commercial operation of electricity, roading and water – industries that are still largely under political control in New Zealand. Australia's education system is ranked well above New Zealand's for meeting the needs of a competitive economy,³ and its welfare system is less expensive and less conducive to dependency than New Zealand's,⁴ although much needs to be done in both areas in both countries.

³ In the World Competitiveness Yearbook 2000, New Zealand ranked in 15th place on the criterion 'Availability and qualifications of human resources' while Australia was in 6th position (International Institute for Management Development, Lausanne, Switzerland).

⁴ See Cox, James, *Towards Personal Independence and Prosperity: Income Support for Persons of Working Age*, New Zealand Business Roundtable, 1998.

**Australia – New Zealand Comparisons
Key Indicators**

	Australia	New Zealand	Difference	
	\$	\$	\$	%
GDP per capita at current prices US dollars. Purchasing power basis. 1998	24,192	17,597	6,595	37.5
GDP per capita at current prices US dollars. Current exchange rates basis. 1998	19,900	13,936	5,964	42.8
	%	%	Percentage Points	
General government spending as a percentage of nominal GDP (est) 2000	31.4	40.8	-9.1	

Source:

National Accounts of OECD countries, main aggregates www.oecd.org/std/gdpperca.htm
 General government total outlays as a percentage of nominal GDP, *OECD Economic Outlook 68*, Paris, December 2000.

Given the present public policy malaise in New Zealand, it would be helpful if Australia stood out as a shining light. In some ways the Howard government was showing the way again in its early years. Substantial progress was made, especially with fiscal policy, even though there were messy compromises in areas such as telecommunications and the introduction of a goods and services tax. Over the last year, however, the momentum of reform has been lost. The Howard government's recent budget was aptly described in the *Sydney Morning Herald* as a "big spending election Budget" with \$A3 billion in giveaways for the elderly alone. Industry policy is becoming interventionist again, with subsidies to loss-making companies, bailouts to insurance company policyholders and vote-catching regional policies such as the

absurd 'Darwin to nowhere' railway which will service about one train a day. Competition policy is in disarray, and opposition parties with policies that would set the clock back in areas like industrial relations and privatisation are polling strongly. New Zealand has been living off the benefits of its past reform efforts in recent years. The OECD assessed in 1999 that, as a result of its economic reforms, New Zealand's potential economic growth rate had risen to around 3 percent per annum, about double its sustainable pre-reform growth rate.⁵ The idea that the reform programme failed to deliver significant benefits is simply untenable. But as a result of further policy slippage, the government's own projections suggest the economy is now set to grow by only 2-3 percent a year in the medium term, and the risks of a worse performance are significant. Yet to reach the government's goal of restoring New Zealand's income levels to the top half of the OECD countries, New Zealand would have to achieve annual growth in per capita income of around 7 percent per annum for the next decade. That level of performance is simply not attainable on current policy settings. It is irresponsible even to be floating such a goal without acknowledging and signalling the sweeping policy changes that would be needed to achieve it.

Australia has been doing better than New Zealand in recent years largely because Australian governments have continued to improve their policy framework while New Zealand governments have allowed theirs to deteriorate. This is contrary to the situation only five or so years ago. Average per capita incomes in Australia are now around 40 percent higher than in New Zealand (as the table shows). The performance gap between the two countries seems likely to widen further in Australia's favour, even though its growth rates over the next few years are expected to be below those achieved in the 1990s.

The challenges of globalisation

There is growing concern in Australia about the challenges of globalisation. Writing recently in the *Australian Financial Review*, the respected business commentator Alan Kohler said:

Australia's place is increasingly peripheral: no replacement has been found for its leadership in basic commodities; very few Australian

⁵ *OECD Economic Surveys: New Zealand*, OECD, Paris, 1999.

companies have successfully built global businesses ... [After News Corporation, Rio Tinto and National Australia Bank, the list of Australian corporations either moving abroad or thinking about it] is beginning to look like a list of the ASX Top 20: AMP, Amcor, AXA Asia, BHP, Brambles, Cochlear, CSL, CSR, Foster's, James Hardie, Lend Lease ... Globalisation is without doubt the number one issue for Australian businesses as the new century begins and the difficulty of running a global business from Australia is the number one problem associated with it ... The rest of the world is just too far away and our own consumer and capital markets are too small.

These challenges are magnified for smaller, peripheral and poorly run economies, such as South Australia and Tasmania, and they loom large for New Zealand. There is no doubt that governments can implement policies that reverse a drain of investment and people. Ireland proved that after its economic reforms of the late 1980s, as did New Zealand in the early 1990s. But equally, the problem can become endemic: Tasmania has been losing people for many years, and official projections suggest its population could halve by 2050. Of course many supporters of Green parties would regard this as a good thing, but their vision of Tasmania or New Zealand being poor and depopulated is hardly shared by the bulk of the population.

The fact is that governments are competing with each other in terms of the quality of their institutions (such as their electoral systems and their laws) and the policies that are put in place. Governments cannot ignore the fact that capital and skilled people are mobile and that both will tend to go to countries with more stable and secure property rights, lower tax rates and with business environments that are conducive to entrepreneurship and wealth creation. Commenting recently on his company's plans, the managing director of CSR said that "Australia's restrictive competition law, tax system and unwillingness to embrace globalisation could prompt CSR to move offshore after 146 years of locally based operation".⁶

Even with the best institutions and policies in the world, New Zealand faces the reality that it will make sense for some companies to move to other countries as they go through the product and business lifecycle. Both New Zealand and Australia have been called 'branch office' economies. But what does that term really mean? In a world of overlapping global networks, every country becomes a 'branch' for some activities. With open economies, head offices and production will be globally distributed. Do people in North Carolina worry that most of the products they buy

are made by firms with headquarters in Atlanta or Chicago? Should Southlanders worry that they are customers of firms based in Christchurch or Auckland? Should I worry that I deal with the local branch of an accounting firm whose head office is in New York? Even if firms shift their head offices their production and distribution facilities are not necessarily affected. Moreover, their New Zealand and Australian shareholders benefit from successful international expansion. Many New Zealanders and Australians also benefit from improvements in their career prospects when companies go global. The real focus of any concern should be with poorly conceived tax, regulatory or other policies that bias decisions about where firms operate and

⁶ 'Now CSR is considering a move overseas', *Sydney Morning Herald*, June 23, 2001.

adversely affect production and employment and domestic incomes.

Despite the vagaries in the pace and even direction of public policies in the two countries, many businesses are becoming increasingly integrated on a trans-Tasman basis. Air New Zealand, Lion Nathan, Fisher and Paykel, Carter Holt Harvey, The Warehouse, BHP-Billiton, CSR, James Hardie, most of the major Australian banks and insurance companies and several Australian retailers all have a major presence on both sides of the Tasman. The New Zealand and Australian dairy industries are moving closer together. Telecom NZ now derives around one third of its revenues from Australia. It has set up its mobile and internet businesses on the two sides of the Tasman as single trans-Tasman business units, largely to serve its trans-Tasman business customers more effectively. Many New Zealand and Australian firms are also integrated on a much wider global basis.

I expect the business relationship between New Zealand and Australia to continue to expand and deepen over the coming years. This is part of the process of overcoming New Zealand's disadvantages of size and location. To offset these factors New Zealand also has to strive to be superior in the skills and effort of its workforce, the quality of its business management and, above all, in its institutions and public policies. These decisively influence whether countries prosper or languish. It takes years, if not decades, to build confidence in institutions and policies, and that confidence can be easily undermined. New Zealanders will pay a price for many years for the erratic stances of successive governments on immigration and employment law, to cite just two examples.

The trans-Tasman government relationship

At the government level there is a lot of room for improvement in the relationship between Australia and New Zealand. There have recently been serious signs of deterioration. Likely reasons include the different ideological orientation of the incumbent governments and the general loss of interest among key Australian policymakers and business leaders in a slow-coach New Zealand. In many respects Australian attitudes of the 1970s have returned. Manifestations of the deterioration are numerous.

- In the labour market, the recent trans-Tasman Social Security Agreement marks an important change in the Anzac relationship. New Zealanders have now lost the right to Australian residency that they have enjoyed since 1948. They no longer automatically have the right to receive benefits like Australian citizens. These changes were effectively dictated by Australia and had a certain logic from an Australian perspective. Nevertheless, they represent a loss of opportunities to New Zealanders who will now be treated more like citizens of other countries. In Europe the trend is in the opposite direction as the single market is being complemented by greater opportunities for travel and work.
- The Australian government did not take kindly to the New Zealand government's decision to allow an amnesty for overstayers and lower the bar on immigration by allowing low-skilled migrants to become New Zealand citizens and thus enter the trans-Tasman labour market.
- In defence, New Zealand is strategically important to Australia and Australia is strategically vital to New Zealand. Given the end of the Cold War, many Australians consider the burden of promoting stability and order in a region that includes Fiji and East Timor will increasingly devolve to Australia. Defence expenditure in Australia is expected to increase and Australians will be concerned if New Zealand is perceived to be following a neutralist and free-rider path.
- In financial markets, changes in Australian securities law passed last year disadvantage New Zealand companies wanting to raise capital in Australia. The 2000 legislation reversed earlier (1991) reforms that provided New Zealand companies with national treatment when issuing securities in Australia. While the Australian Securities and Investment Commission can exempt New Zealand companies from the new restrictions, it has been reluctant to date to do so, despite New Zealand having similar securities and prospectus disclosure requirements to Australia.
- In food standards, the Australian government is proposing legislation that would give it the power to unilaterally overrule the decisions on food safety

standards that are currently made by a joint body, the Australia New Zealand Food Safety Standards Authority.

- Perhaps most significantly, in trade policy New Zealand has been excluded from initiatives to negotiate a bilateral trade agreement between Australia and the United States.

It should not be too difficult to sweep away many of these policy irritations if serious efforts were made to deepen cooperation between Australia and New Zealand.

One priority should be to remove the remaining restrictions on the free flow of capital between the two countries. As Peter Lloyd has noted, the absence of a bilateral provision guaranteeing the free movement of capital is "the most glaring omission from CER".⁷ In contrast, the Treaty of Rome guarantees the 'four freedoms' of movement of goods, services, capital and labour for the members of the European Union. The North American Free Trade Agreement also has a chapter relating to foreign investment.

Other priorities include removing New Zealand's and Australia's remaining exceptions from CER for goods and services and progressing mutual recognition of business and other laws as quickly as possible.

There is also a strong case for removing the irksome requirement for passports for travel between the two countries. It is bizarre that European nationals do not require passports to travel within the European Union whereas two countries as close as Australia and New Zealand maintain passport controls. A prerequisite for such a move would probably be some alignment of immigration criteria between the two countries so that one did not become a backdoor means of entry to the other.

Why not, as some people suggest, adopt a more 'ambitious' agenda and aim for currency union or even a political union between New Zealand and Australia? After all, there are trends towards currency blocs in other parts of the world (as well as

⁷ Lloyd, P, 'Foreign Investment, Competition Policy and Labour Issues', CEDA/APEC Studies Centres of Australia and New Zealand Roundtable Discussion of the CERTA, Melbourne, 30 April 1997.

moves towards more freely floating currencies) and there is a provision in the Australian constitution for New Zealand to become part of the Australian federation.

Such ideas, however, are not panaceas and they have the potential to distract attention from more important issues. They appear to have profound economic significance whereas the economic benefits involved are not likely to be great. The 'poor-cousin' status of regions like Tasmania, southern Italy and some US states are more than ample evidence that a common currency or a political union does not necessarily equate with economic success.

Nevertheless, proposals for common currencies are worth considering. Countries that have a history of poor monetary policies may benefit from adopting the currency and hence monetary policies of another country. This argument would have had some relevance to New Zealand 15 years ago. However, over the past decade New Zealand's monetary policy record has been relatively good by international standards.

If New Zealand adopted the Australian or US dollar as its currency this would reduce the transactions costs incurred by investors, traders and travellers in exchanging New Zealand dollars for other currencies. The gains from adopting the US dollar would be larger because much international trade is conducted in US dollars and the real cost of capital in New Zealand would be reduced. A recent study suggested the reduction in New Zealand's real interest rate could be of the order of one-and-a-half percentage points.⁸ Adoption of the Australian dollar would not have this effect.

However, as Donald Brash, the governor of the Reserve Bank of New Zealand, has pointed out, the idea that a currency union would make New Zealanders instantly richer is nonsense:

The fundamental driver of living standards in New Zealand is the rate at which we can improve productivity. This in turn depends on

⁸ See Martin Lally (2000), 'The Real cost of Capital in New Zealand: Is it too high?', New Zealand Business Roundtable, Wellington.

the quality of our education system, the quality of New Zealand management, the incentives provided by the tax and benefit system to work and acquire skills, attitudes to work and leisure, the pace of innovation, and so on. Currency union would have little effect on these matters.⁹

There are also some disadvantages associated with the adoption of common currencies in the face of fluctuations in international terms of trade and shifts in investor views about the prospects of different industries, regions and countries. Some countries that have tied their currencies to the US dollar have had a rough ride as it has soared in recent years. In the absence of adjustments in the exchange rate between the New Zealand and US dollars, a substantial downward adjustment in New Zealand prices and wages would probably have been necessary in the wake of the 1998 Asian crises to avoid a major recession. Moreover, recent moves that have made the New Zealand economy less flexible, including the government's higher long-term objective for government spending, its moves to re-regulate the labour market and increased regulation in other areas, do not constitute a satisfactory overall framework for operating a currency union. A forthcoming Business Roundtable study concludes that:

... a practical strategy for New Zealand to follow in the short term is to improve its fiscal and labour market policies, which ought to be done in any case ... In the meantime New Zealand should monitor international developments in the formation of monetary unions or currency boards while exploring the attitudes of potential partner countries.

If a free trade agreement between the United States and New Zealand is negotiated (with Australia also being part of the same free trade area) the case for adopting the US dollar would become stronger for New Zealand, and perhaps for Australia as well.

Would New Zealand have anything to gain from a political union with Australia? The case for such a union has recently been argued in a book *Waltzing with Matilda* by Bob Catley of the University of Otago. Catley has suggested that:

There would ... be a substantial psychological impact for both countries and for world markets. Both countries would look as

⁹ Donald Brash, 'United We Stand? The Pros and Cons of Currency Union', *Policy*, Spring 2000, Centre for Independent Studies, St Leonards, NSW.

though they were making a substantial effort to get somewhere. At present, it is hard to get that impression on this side of the Tasman.¹⁰

In practice it is clear that, as the larger partner, Australia would dictate the general shape of the institutions of any political union. In respect of federal elections, for example, New Zealand would probably be forced to drop its mixed member proportional (MMP) voting system and adopt Australia's version of a Westminster system. Many in the New Zealand business community would count that as a plus. On the other hand, the business community in general sets considerable store by retaining access to the resources, expertise and judicial culture of the Privy Council in respect of commercial law. What would the Australian High Court have to offer compared with the Privy Council? The potential advantages of federal systems of government are worth further consideration. However, it is easy to agree with Geoffrey Brennan, an expert in constitutional and political theory, when he writes:

To suggest that ... Australians live, constitutionally speaking, in the best of all possible worlds may be a trifle extravagant ...¹¹

The absence of an Australasian federation does not seem to have been a serious handicap to consideration of various proposals for harmonisation of business and other laws. There are large costs to business in complying with different regulatory requirements in the different jurisdictions in which they operate. But harmonisation

¹⁰ Article in the *National Business Review*, April 20, 2001.

¹¹ Geoffrey Brennan, 'The Dynamics of Constitutional Incentives', a review of *The Strategic Constitution* by Robert Cooter, *Policy*, Autumn 2001, Centre for Independent Studies, St Leonards, NSW.

should not be implemented for its own sake. The cost of bad policies can far exceed the benefits of consistency. The aim should be to have the best possible public policies, rather than necessarily replicate the policies of another country. Where Australia has the best policies New Zealand should, by all means, adopt them. But it doesn't make sense to adopt policies just because they are Australian.

Conclusion: the case for wider perspectives

Any sober assessment must conclude that New Zealand and Australia are simply far too small for moves toward closer economic or political integration to make much difference, by themselves, to their economic futures. New Zealand has to implement superior policies to Australia if it is not to be simply another Tasmania. Conversely, if New Zealand is merely another Tasmania, it is no spur to better economic policies in Australia. Any discussion of trans-Tasman developments needs to be set in a wider context.

The reality is that the prosperity of either country will depend fundamentally on its own decisions – its ability to develop competitive institutions and implement the major policy changes that would deliver large economic gains. Standard of living comparisons indicate that both countries are laggards, but New Zealand is very significantly worse. The problem for both countries as their relative living standards have fallen has been to shake off the 'British disease' of ossified institutions (such as state-run and protected industries and regulated labour markets), nationalised health and education systems, and welfarism. Progress has been made in the past two decades – the move from protectionism to a position of close to free trade is an historic change – but the still-dominant beliefs in politics and bureaucracy, and the resistance to changing features of the welfare state that have demonstrably failed, hold both countries back. Ideas for change in the direction of less state control are still demonised as 'new right' or 'economically rationalist', despite the fact that they continue to gain ground around the world.

New Zealand and Australia could both benefit from deeper international linkages, such as a free trade area with the United States. But once again we should be careful not to view such agreements as the answer to all our problems. Free international

trade is highly desirable but it is not the only aspect of economic freedom that is important in fostering economic growth. Moreover, free trade agreements are inferior to multilateral and even unilateral free trade. A free trade agreement with the United States could, however, heighten general business and investment interest by US firms in this part of the world. It might also help to lock in the gains from unilateral trade liberalisation.

The indirect benefits of new initiatives could be much more important. In the light of New Zealand's experience with CER, there might be grounds to hope that a free trade agreement with the United States would lead to more profound economic reform efforts, as well as to changes in our security relationship and to greater acceptance of the features of American culture that underpin its economic success. The most important contribution of CER was, arguably, in providing an impetus to break away from the insularity that had previously characterised economic policy in New Zealand.

Moreover, when New Zealanders looked outwards to Australia and beyond in the early 1980s, they saw Britain and the United States undertaking major economic reforms. If we look toward the same places today, we see Britain and especially the United States taking important steps to build on them. The United States has implemented major welfare reforms in recent years and the Bush administration is moving further in the direction of smaller government with cuts in income taxes and reforms to social security and education. Britain seems to be moving to reform its education and health systems by introducing improved economic incentives and more private sector participation. It should be a matter of more than casual interest to New Zealanders that continuing policy changes are occurring in countries that they know and understand. The formula for economic success is now well established – greater economic freedom and less and more focused state intervention are the crucial ingredients. The United States is once again leading the way and countries in Europe and elsewhere seem bound to follow.

Whether we like it or not we also have choices to make. We can continue our policy siesta for a few more years and allow our relative income levels to deteriorate further. If we are lucky, our previous reform efforts and growth in the world

economy will save us from an absolute decline in our standard of living. Alternatively, we can get back on the track toward greater economic freedom, competition and choice, with a smaller role for the government, and raise our prospects of achieving greater prosperity. The choices we face today are less stark than those we faced in the early 1980s only because of the subsequent reform efforts. We cannot ensure future economic success by hitching a ride with Australia or even the United States. At the end of the day, New Zealand's economic success remains, as always, in our own hands.

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