

**Australia - New Zealand Business Council**

**A Common External Tariff External Trade And  
Industrial Development Policies**

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## **A COMMON EXTERNAL TARIFF, EXTERNAL TRADE AND INDUSTRIAL DEVELOPMENT POLICIES**

I think it is important to put this topic into context by recalling some of the basics about CER and the gains from trade.

First, CER has been of great value to New Zealand, and to a lesser extent to Australia, primarily as a catalyst in the process of opening up the economy in the last 10 years. Neither country was a particularly bright star for the other to hitch its wagon to. The gains have come in part from competition in the wider market but more particularly from giving both countries the confidence to open their economies to the world.

It follows, secondly, that the main gains have not arisen from the reduction in barriers to the partner country's market. Protection harms mainly those who practise it. Making a 'concession' in trade negotiations is really doing oneself a favour. The benefits of a reduction in protection take the form of bringing domestic and world prices closer together so that we put our resources into activities we are good at, encourage investment in optimal scale plants that can sell on world markets, and provide a competitive spur to domestic producers.

Thirdly, the smaller partner in a trade agreement is always the biggest winner. Again this is not primarily because of export gains. People are mistaken in thinking they are ahead of the game by swapping a small 'home' market for a larger 'single' market. The mistake is that markets in a competitive environment do not belong to anyone but have to be won every day. Rather, the small country gains most from the greater stimulus of competition. It is not just the height of the tariff that matters but its length. Germany would be harmed by a high tariff wall but Luxembourg would suffer far greater damage.

Fourthly, the argument that New Zealand or Australia should not reduce protection because other countries still protect some of their industries is based on a fallacy. Suppose an American pharmaceutical company were to discover a cure for heart disease and a Japanese competitor one for cancer. Suppose also that the Japanese government were, for some inscrutable reason, to keep the American cure out of Japan. Would it then be sensible for the United States to keep the Japanese cure for cancer out of the American market? The answer is obvious. Small countries like New Zealand and Australia have to take the rest of the world as we find it. Our exporters have a hard enough job as it is in world markets without being doubly penalised by the self-inflicted cost burden of protection.

Fifthly, the gains from trade are of course measured in terms of greater efficiency in the use of economic resources and hence higher living standards. They are not measured in terms of changes in the balance of trade. Whether New Zealand has a trade deficit with Australia or vice versa is no more relevant than whether I have a deficit or surplus in my transactions with my drycleaner, butcher or local service station.

Finally, adjustment to lower protection is not a problem in an economy that is working properly. All sorts of dire predictions were made about CER. Our Manufacturers

Federation believed many New Zealand industries could not cope with Australian competition and argued strenuously to retain import licensing after 1995. Now we are facing world competition without import licensing. Those who are worried about adjustment should focus instead on the effects on industry competitiveness of things like inflexible work practices and wage bargaining arrangements, poor fiscal policies and inadequate education and training systems.

Coming to the topic of this session and the background paper which you have, I think its analysis is generally sound and in line with these points. I will comment, however, on one general matter not so much because of its importance in the present context as because it is a pervasive and misleading feature of the wider protection debate.

The matter I refer to is the use of statistics based on tariff revenues as a proportion of either total imports or dutiable imports as a measure of an economy's level of protection. For example, the paper indicates tariff revenues for Australia in 1987 were 9.2 percent of total imports and for New Zealand were 2.6 percent. This could be taken to imply that New Zealand's average level of protection was lower than Australia's. That may or may not be the case, but making such an inference from this comparison would be totally misleading.

The easiest way to see this is to imagine the two cases of a free trade economy and one with absolute protection that shuts out all imports. In both cases tariff revenues are zero. Clearly a statistic based on tariff revenues is useless as a measure of protection.

Alternatively, consider a hypothetical economy with, say, a 10 percent tariff on all imports and a 10 percent subsidy on all exports. The tariff revenue ratio would be 10 percent - higher than the figures quoted for either Australia or New Zealand - yet the economy would have an allocation of resources approximating the pattern under free trade.

A better measure of the incidence of trade restrictions is the average effective rate of assistance or protection to industry. The paper gives figures of 19 percent and 17 percent currently for New Zealand and Australia respectively, with the New Zealand average coming down more rapidly in recent years. But the paper goes on to acknowledge that average measures of effective assistance are themselves of limited value in assessing distortions and the losses of economic efficiency resulting from protection. As it says, the crucial factor for any country is the internal disparities in assistance. Quite low average figures can mask very high levels of assistance to selected industries, involving a major misallocation of resources. This has been the pattern in Australia and New Zealand.

The CER agreement has contributed to a reduction of these distortions in both countries. Because each started out with high and variable levels of tariffs, and of industry assistance more generally, there was concern that freeing trade between them would not always work to bring about a more efficient industry structure in both countries. For example, a producer of a consumer good in Australia might be more efficient - in the sense of using fewer resources per dollar of value added at world prices - than the counterpart New Zealand producer. However, because the Australian producer used tariff-protected inputs from the more broad-based Australian

manufacturing sector whereas the New Zealand producer used duty-free imported inputs, the latter might be more competitive and expand relative to the Australian producer. From the point of view of efficient resource use in the two countries, this would be an undesirable situation.

This particular distortion, the so-called intermediate goods problem, was catered for in the CER agreement. It was a major issue at the time, especially on the Australian side. One possible measure foreseen to deal with it was the establishment of a common external tariff. As the paper notes, this measure has never been invoked and the intermediate goods problem has not turned out to be a real difficulty. As tariff rates come down further in both countries, it is receding further in importance as a distorting factor and source of contention.

More generally, distorting factors in trade between the two countries have on the whole diminished over time. The paper notes that, for Australian industry generally, non-tariff assistance by way of bounties, export incentives and quotas has substantially declined. The same is true of New Zealand. There are still irritants such as the export facilitation arrangements for Australian motor vehicles. While these can be regarded as a subsidy from the Australian taxpayer which New Zealand consumers should accept with gratitude, such a policy is not part of a desirable assistance environment. Australia and New Zealand should be steadily reducing all forms of assistance to their motor vehicle industries, along with others industries, including export facilitation schemes. The Australian Industry Commission has recommended the phase-out of export credits to New Zealand but only by 1996, which seems unduly long.

The background paper rehearses the standard arguments for and against a common external tariff and I do not have a lot to add to them. It leans towards the conclusion that the arguments in favour are not strong, and points out that a *de facto* harmonisation is occurring anyway. I do not believe that the possible advantages cited, namely greater negotiating power, the ability to dispense with rules of origin and tariff simplification carry much weight.

The paper notes that a CET would not necessarily improve resource allocation decisions, though it is wrong in suggesting that this will hinge only on whether the higher or lower of the two tariff rates is chosen. The outcome would actually depend on a whole host of factors, including the levels of other tariffs, export subsidies and other assistance measures, as well as issues of industry structure such as the pattern of production of intermediate and final goods.

Probably the most basic point to make is that with ongoing tariff reduction programmes in both countries, the issue of a CET is becoming academic. A move in that direction would also carry the risk that one country would be handicapped by the other if it faltered in its efforts at trade liberalisation. Both countries' interests are best served by continued efforts to reduce their overall levels of protection, particularly in the case of the most highly protected industries.

In Australia, tariffs are heading down to levels of 15 or 10 percent by 1992, with the exception of textiles, clothing, footwear and motor vehicles. Further reductions are

expected. The Liberal party has committed itself to a virtual elimination of tariffs, by the year 2000.

In New Zealand, general tariff levels are scheduled to reduce to a maximum of 10 percent by 1996, and rates on the few industries exempted from this programme are also reducing. This programme is challenging but I believe that most manufacturers are quite capable of coping with it provided other policies are in good shape. The National government is committed to ongoing reductions in tariffs to encourage further improvements in efficiency. However, it has also said that it will review the post-1992 programme, essentially in the light of progress in other policy areas. The logic of this position is somewhat back to front. The government is correct in asserting that the benefits of trade liberalisation have been undermined by unbalanced policies. However, the remedy is to fix the unbalanced policies, not to fix what ain't broke. For example, there is ample time to address the budgetary problems and to free up the labour market before the post-1992 tariff cuts occur. It should also be noted that there are important interactions between these policies. Labour market reform, for example, will not yield the full benefits it is capable of yielding unless firms face strong domestic and international competition and are forced to develop better employment relationships.

With both countries heading south, as it were, in their tariff policies, to the point where duties seem likely to be eliminated or reduced to low levels in the period ahead, there seems little point in artificial harmonisation exercises. Indeed there are serious dangers in many of the proposals for harmonisation that are made in the CER context. I want to round out this discussion with a word on these.

The proper lessons about harmonisation can be learned from the experience of the European Community. For the first 20 or so years of its existence it embarked on a policy of harmonisation of laws, regulations, standards and sometimes even prices (especially agricultural prices) based on a belief that these things had to be achieved before goods, services, people and capital could be allowed to move freely from one country to another. This was the period of the interminable Euro-sausage debates. Even if more agreement had been possible, the end result would not have been market integration. This can only take place as a result of trade - and trade only occurs as a result of differences. Harmonisation kills trade. If labour costs, energy costs, regulatory costs and so forth were identical across countries there would be little basis for trade.

This simple point was belatedly recognised in 1985 when the Community decided to move swiftly to a single market in 1992, relying not on the principle of harmonisation but on that of mutual recognition. This holds out the prospect of competition based on differences. It is a much more market-friendly approach - implying the withdrawal of heavy government direction and assigning the task of integration to markets.

Australia has recently, if belatedly, acknowledged the merits of mutual recognition in inter-state trade. The Brisbane Special Premiers' conference was called by the prime minister to explore the realities of cooperative federalism. A major outcome has been an agreement between the Commonwealth and states to adopt mutual recognition principles in their regulatory practices. For the present the focus is on traded goods and

government-controlled occupations. However, the power of competition is pervasive and it might be expected that the implications of this decision will ripple across all regulation, and across the Tasman.

This approach has powerful consequences. Free trade in goods and services, free movement of people, capital and information, based on different institutional structures and in an increasingly mobile society, mean that all institutions are subjected to intense competition. The choice between a high tax/low risk or low tax/high risk environment, or a high regulation/low growth versus a low regulation/high growth environment, will start having a noticeable effect on the mobile factors in the economy.

We shall be forced to think far more carefully than was necessary in the past about the various trade-offs.

It has been suggested that two institutions are particularly at risk in this new competitive environment: the discretionary power of governments and the monopoly power of organised labour. An over-expansion of government will make people vote with their feet for a warmer fiscal climate. The taxman will not want to see the tax base disappear. Trade unions will come under pressure : if a car manufacturer suffers strikes or excessive wage demands in the United Kingdom, it will locate its next plant in Germany or Spain. Trade union members will not want their jobs to walk away.

These lessons are very relevant in the CER context. The last thing we want, for example, is harmonisation of New Zealand's and Australia's labour laws, at least on any existing basis. Both are disasters. New Zealand now stands a good prospect of achieving fundamental reforms. The consequences could be dramatic. As one Australian businessman has put it:

"If New Zealand moves quickly and accepts the efficiency of the law of contract in the labour market, it will gain an advantage over Australia. I do not believe Australia could watch New Zealand growth rates of 7 or 8 percent per annum (the minimum result of labour market deregulation in my view) and not quickly follow suit. It would be impossible for Australia to persist with its present labour market institutions and do nothing as capital, and brains, flowed easterly across the Tasman."

My feeling is that this estimate of the effect of labour market deregulation on growth is on the high side, but experience with even the partial reforms on the waterfront shows that staggering productivity gains are possible.

What holds for labour law also holds for other areas of policy. We need competition to create the warmest fiscal climate - not through artificial inducements to invest in one country or the other but by cutting government spending and lowering tax burdens. In the area of business law Geoffrey Palmer had things precisely the wrong way round. He seemed to believe that economic welfare can be made compulsory by law and that harmonisation should be pursued for its own sake. But the last thing New Zealand needs, for example, is Australia's cumbersome companies and securities codes. Both countries should be competing to find the lowest cost forms of regulation so that

companies are attracted to locate and do business in them. Efficient tax and regulatory regimes are one form of comparative advantage that a country can create.

None of this is to say that there is anything wrong with both countries striving to achieve best-practice policies in any area and, if successful, discovering that they have a lot in common. This is effectively what has been happening with trade liberalisation. No-one would deny that there are some additional gains in the lower transactions costs associated with common regimes. My argument is simply that there is little merit in uniformity for its own sake, and that there can be major benefits from having an environment which allows for experimentation and competition between institutions and jurisdictions.

If this argument is valid, then ideas such as a common external tariff are backward-looking rather than the way of the future. Both countries would do better to press on with the task of opening up their economies and, in respect of external trade policies, look at the possibilities of free trade agreements with North American or Asian countries in the post-Uruguay Round period. Such moves could reduce further the distortions that motivate proposals such as a CET. They would also do well to remove other distorting forms of assistance such as bounties and tax preferences where these have no economic justification. In doing so each country would help itself in the first instance, and its CER partner as a by-product.

There are still some important if unspectacular issues on the CER agenda to be worked through. However, the main determinants of the economic performance of both countries, and hence their value to each other as a trading partner, now lie elsewhere, in the domestic policy arena. Both countries have made haste too slowly in the 1980s while the rest of the world has continued to change. Both are now again on the edge of an economic precipice.

If either is to reverse its relative long run decline, its priorities must be things such as achieving and sustaining low inflation, deregulating labour markets, shrinking the size of the public sector and making it more efficient, radically improving education standards and rethinking the role of the welfare state. As we consider the CER relationship in this forum, we should perhaps keep in mind these priorities and consider whether anything can be done jointly to encourage our governments to give them the attention they deserve.