

Insight

NZ, the US and trade liberalisation: don't panic!

If one was to believe some of the recent media articles in New Zealand, it would be easy to think that we're completely mad to be negotiating a free trade agreement with the US. We beg to differ.

While no trade deal will keep everyone happy, and some difficult trade-offs will be required to seal the deal, New Zealand won't accept a deal that makes us worse off. This note takes a pragmatic look at the current negotiations with the US via the Trans-Pacific Partnership regional agreement.

What's in a letter?

Globalisation and trade liberalisation are two topics that generate a huge amount of controversy, probably because they are the point where xenophobia meets domestic protectionism. The recent letter signed by 30 US senators expressing deep concern about entering a free trade agreement (FTA) with New Zealand because our dairy farmers are more efficient than theirs, is a typical piece of politicking.

We should by now be used to this from the citizens of the world's largest economy; they still are finding their way into the real international world of trade and are anxious to please their parochial constituents. But what has been surprising is that some New Zealand commentators seem not to have seen this gesture for the cynical opening negotiation manoeuvre it is.

It's not NZ versus US

Let's be clear about what sort of trade agreement we are discussing. New Zealand is not negotiating with the US bilaterally.¹ New Zealand is negotiating with the US as part of the Trans-Pacific Partnership (TPP). The TPP is an extension of the P4 regional trade agreement already in place between New Zealand, Singapore, Chile and Brunei². The US, Australia and Peru are committed to joining the TPP. Viet Nam has joined as an associated member. The negotiations in Melbourne this week are a starting point for this expansion. But this is a regional or plurilateral agreement, not a bilateral one. The US will certainly have a significant influence on the negotiations, of course, but there are seven other smart, savvy and strategic negotiators at the table. The US won't have it all its own way.

¹ Strictly speaking, the market access schedules will be negotiated on a bilateral basis, but the TPP's framework and modalities will be agreed between all participants.

² P4 was signed in 2005.

We're not starting from scratch

The P4 has been liberalising trade between the four partner countries since 2005. There are already 'modalities' or negotiating frameworks in place that are legally binding. Acceding countries, including the US, will need to agree to the existing structure already in place under the P4. That includes the liberalisation of agriculture, albeit with some phasing and other transitory mechanisms. The current P4 doesn't exclude dairy or beef. Neither will the TPP.

Always look on the bright side of life

It's easy to unduly worry about the threats of trade liberalisation. But don't forget about the benefits of signing a trade agreement with the US under the TPP. Using NZIER's GTAP general equilibrium model of the world economy, a basic estimate suggests gains to New Zealand of around \$650 million per year.³ Not too shabby at all.

It's all about strategy

In addition, expanding the TPP places New Zealand at the heart of Asia-Pacific regional integration. We know that global economic growth is set to be dominated by the wider Asian region, and we need to be close to it. Given the lack of progress at the World Trade Organisation and the slim likelihood of an APEC-wide FTA any time soon, the TPP has the potential to be a valuable vehicle for regional economic integration. It's a tent that New Zealand needs to be inside. Aligning with the US via the TPP does not preclude us from being closely linked into the Asian growth hub via the East Asia Summit and the Closer Economic Partnership of East Asia (CEPEA).

Level playing field

FTAs are proliferating around the world, and in the Asia Pacific region in particular. These agreements can give New Zealand's competitors preferential treatment into key markets (e.g. Australia into the US; Chile into Korea). New Zealand needs to be a part of the trend so that we are not left out in the cold waiting, possibly in vain, for a multilateral solution via the World Trade Organisation (WTO). The latter remains New Zealand's number one trade priority, but we have to investigate alternative approaches to liberalisation until the big boys decide they want to play nicely again in Geneva.

Tough negotiations on dairy but no blocks

There is a perception that the US will seek to "block" New Zealand dairy products from the TPP negotiations due to strong lobbying pressure. This is very unlikely. How can an FTA end up being

³ Indicative results only. These results are from a scenario where all tariffs amongst TPP members are reduced to zero. In this respect, it's over-optimistic. However, the estimate of benefits is from goods liberalisation only, and doesn't take into account the gains from services liberalisation, investment liberalisation and other dynamic gains from trade. A much more detailed modelling exercise is required to look at multiple potential outcomes and to examine issues such as Pharmac, but this ballpark estimate does at least highlight the potential gains to the NZ economy from liberalisation with the US under a TPP.

more trade restrictive than the current access arrangement? Moreover, New Zealand might be small but we are sovereign. Why would we (and other TPP partners) accept such an outcome?

Furthermore, all FTAs have to cover “substantially all trade” to be consistent with international trade law. While the precise definition of substantially all trade has never been tightly defined, it is highly unlikely that a TPP that excluded agriculture would pass the laugh test, let alone the substantially all trade test. In general, US FTAs are high quality and ambitious. Of course they seek to promote their interests, and their FTAs contain some safeguards, but they usually play by the rules. Their approach to TPP should be no different.

The Australia-US FTA: not an Ocker shocker

The Australia-US FTA does not necessarily set a precedent for what might be delivered by the TPP. Implying that the Australia-US FTA caused Australian exports to grow more slowly or fall is simply misleading and mischievous. There’s a correlation perhaps, but no causation. Attributing the slow export growth to the FTA is simply not possible without in-depth analysis.

To determine the effect of the FTA on Australia’s exports to the US following the FTA, you first need to determine the counterfactual – what would have happened in the absence of the FTA? Strong growth in Australian exports to other countries such as China and Japan have necessarily drawn resources away from other markets such as the US. But that’s nothing to do with the Australia-US FTA. In addition, the counterfactual would need to consider what tariff lines have been liberalised, what has happened to commodity prices, exchange rates, US growth relative to other markets, etc. Ex-post empirical analysis of FTAs is therefore rarely attempted.⁴

Know when to hold ‘em; know when to fold ‘em...

To be an effective international player, New Zealand needs to be grown up – in other words, recognise what we are and what we are not. We are small beer internationally; the USA is BIG. In negotiations all countries seek to use whatever they can to get an edge. Thus the US can regularly be seen “strong-arming” smaller countries like New Zealand into accepting outcomes that aren’t ideal. Welcome to the real world of trade negotiations, as it happens to a small country.

No one doubts that a global WTO deal that eliminated agricultural subsidies and reduced tariffs in developed and developing countries would be the optimal trade solution for New Zealand. But it’s not going to happen any time soon, and even when it does, it will be far from free trade, and the rules will have quirks that favour the big battalions.

So we need to look for second-best solutions, and that includes FTAs. Negotiations between small and large countries are never easy. New Zealand has limited negotiating coin, but that hasn’t stopped us signing recent agreements with major global players such as China, Indonesia, Malaysia and others, in addition to older agreements with Australia, Singapore and Thailand.

⁴ Mischievously, a quick look at the growth in New Zealand exports to China since the New Zealand-China FTA entered into force (up 60% in the first year after implementation) provides an interesting counter-argument. What do they say about lies, damned lies and trade statistics again?!

In each of these negotiations, we've had to deal with sensitive areas, strong lobby groups and seemingly immovable negotiating positions. And there are always pockets of the New Zealand economy that experience adjustment costs following liberalisation (although given New Zealand's very low tariff levels, the vast majority of this adjustment has already taken place).

But in each case, our trade negotiators have found a way through the blockages. They're a cunning bunch, and have cunning plans to know what to trade off, and when, to generate outcomes that will benefit New Zealand. Strong opening positions from prospective FTA partners are nothing new. It's like buying a house – you never start with your real offer. You start tough and then you work towards a compromise solution. That's what will happen in the TPP.

In a nutshell: don't believe the hype

Trade deals are never perfect, and some of the necessary trade-offs are not ideal. We may have to face some rather tricky IP restrictions to get (say) a meat or dairy access deal. But that shouldn't obscure the fact that the TPP offers New Zealand businesses some significant economic and strategic opportunities. And these opportunities (and threats) should be identified through robust economic analysis and consultation with New Zealand businesses, not by rhetorical arguments and scaremongering.

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25 March 2010