SHOULD WE HAVE FREE TRADE BETWEEN AUSTRALIA AND NEW ZEALAND

?

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N.Z. INSTITUTE OF ECONOMIC RESEARCH INC.

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SUMMARY

1. The object of this paper is not to suggest how we may narrow the trade deficit of New Zealand with Australia, but to examine possible changes in trade policies with the objects of improving the efficiency of the two economies, speeding up rates of growth, and improving the standards of living of the growing populations. Co-operation in trade policies has not been great in recent years, despite the trend towards regional free trade in other parts of the world.

2. Free trade between Australia and New Zealand could stimulate efficiency through increased specialization, through economies of scale, and through increased competition. The costs of economic integration—uneconomic trade diversion, and disruption of industry and farming—are unlikely to be high. Barriers to trade could be eliminated gradually, overseas investment in New Zealand would be stimulated by greater efficiency, and the capacity of New Zealand to export to Australia would be increased.

3. There is a *prima facie* case for increased specialization and exchange between Australia and New Zealand, and a partial test of the desirability of free trade could take the form of freeing trade in some groups of products.

PREFACE

In planning its research programme, the Institute has been mindful of the importance of trade to our economy. Public discussion of the significance of Britain's application to join the European Economic Community serves to underline New Zealand's dependence on trade. To assist the proper appreciation of the present trade problems, the Institute, in the next few months, will be publishing two research papers, one on the effect on New Zealand dairy product exports of European agricultural policies, and another on New Zealand market prospects in Asia.

There is also a need for informed discussion of trade policies: of the action that New Zealand herself can take. To meet this need, this paper has been prepared, based on a talk given by Professor F. W. Holmes to the Association of Economists in February, 1961, on the subject of free trade between Australia and New Zealand. It is designed to survey the economic issues involved in such free trade, and provide material for public discussion.

It is planned at a later date to publish another discussion paper, prepared by a staff member, on bilateral trade agreements.

November, 1961. C. A. Blyth.

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The Pattern of Trade

It is an old New Zealand custom, when discussing trade with Australians, to draw attention to the wide and growing deficit between New Zealand's exports to and imports from their country. The Table (p. 27) indicates the general trend of exports to and imports from Australia over the past three or four decades. It shows a gradually widening deficit since the late 'twenties; from about £400,000 on average between 1927 and 1929 to over £30 million on average between 1957 and 1959.

During the 'twenties New Zealand used to send about 5 per cent of her exports to Australia; in 1927, the proportion reached the unusually high figure of 7.6 per cent. But for about 25 years after 1927, the share of New Zealand's exports going to Australia gradually declined, reaching the low proportion of 1.6 per cent in 1952. Since then, the value of exports has increased significantly —from £5m p.a. between 1952 and 1954 to over £10m p.a. between 1957 and 1959. This is attributable mainly to the development of trade in newsprint and woodpulp, which now comprise almost 50 per cent of our total exports to Australia. Apart from newsprint and woodpulp (worth just over £5m in 1959), the only export bringing in over £1m in recent years has been timber. Wool, seeds and fish usually exceed the half million mark and a variety of manufactured articles earned a record £704,000 in Australia in 1959. So the range of exports of any significance is narrow. The growth of the value of exports in the last few years has made Australia our fourth best customer; but the proportion of our total exports going there (3.7 per cent in 1959) is still low, both absolutely and in comparison with the position in the 1920s.

By contrast, Australia's share of the New Zealand market for imports has been growing considerably over that period. She is our second largest source of supply, providing over 18 per cent of our total imports in 1959, as against Britain's 47 per cent. Among our major imports from her are essential foodstuffs like wheat, sugar and tropical fruits and increasing quantities of the metals and metal manufactures, petroleum products, machinery and transport equipment, which are required for the development of our own industries and services and which our producers find it worthwhile to buy from Australia rather than elsewhere.

From Australia's viewpoint, we are fifth in importance as a market for her exports, taking between 5 per cent and 6 per cent of the total; but we have been providing the major market for her manufactured goods in recent years. On the other hand, we supply less than 2 per cent of her imports.

The foregoing recital of facts is designed merely to indicate the nature and magnitude of trade between the two countries. If a country is to maximize its income from overseas trading by buying and selling in the best available markets, it can expect to run surpluses with some countries and deficits with others; consequently, so long as we can keep our overall balance of payments in reasonable equilibrium, we have no real cause for concern if we buy a good deal more from Australia than we sell there. This is not to say, of course, that we should not be concerned about restrictions which that country, or any other country, imposes on our ability to export to its markets goods which we are particularly well fitted to produce. An Australian would, in reply, refer to some aspects of our policy of import selection and to our current procedures in valuing Australian imports when assessing duty on them.* The important question which we should discuss when we are considering trade between Australia and New Zealand, is, not how we can narrow the trade deficit between the two countries, but whether we can suggest any changes which should be made in our respective trade policies, which would enable us to assist

* Now to be changed: see below.

one another to improve the efficiency of our economies, to speed up our rates of growth, and thereby to acccelerate the improvement of the standard of living of a rapidly growing number of Australians and New Zealanders.

Co-operation in Trade and Development

Although negotiations on matters of trade between New Zealand and Australia have not always been harmonious, Governments of the two countries have indicated, in the agreements and understandings which they have reached, that they have some desire to be of mutual assistance to one another and some disposition to work reasonably closely together in matters of common concern. But, so far, the extent to which they have been prepared to act jointly in economic matters or to make trade concessions to one another has been decidedly limited.

The Canberra Pact of 1944, although concerned largely with the prosecution of the war, contained provision for permanent machinery for collaboration and co-operation between Australia and New Zealand. *Inter alia,* it was envisaged that there should be "co-ordination of policy for the production of munitions, aircraft and supply items, and for shipping to ensure the greatest degree of mutual aid consistent with the maintenance of the policy of self-sufficiency in local production"; that the development of commerce between the countries and their industrial development should be pursued by consultation and in agreed cases by joint planning; and that there should be co-operation in achieving full employment and the highest standards of social security. To these ends, the Agreement provided for conferences of Ministers at least twice a year, as well as for periodic conferences of departmental officers and standing inter-governmental committees, a regular exchange of information and officers and "the development of institutions in either country serving the common purposes of both." A permanent Australia-New Zealand Affairs Secretariat was to be established in each country to ensure that these things were done.

The degree of co-operation envisaged in this Agreement did not in fact eventuate. In matters of trade and economic policy there have been occasional meetings, both at Departmental and Ministerial levels, but not with the regularity suggested in the pact; and there has been nothing approaching joint planning of development of industry and commerce.

However, recent developments in international trade, and especially the movements towards regional groupings in Europe and elsewhere, appear to have re-awakened a realisation of the similarity of interests of the two countries and of the value of closer co-operation between them. In August 1960, after Ministerial talks in Wellington an Australian/New Zealand Consultative Committee on Trade was established. Comprised of senior officials it is to meet regularly to undertake detailed studies of international trade issues in which both countries have important interests and to examine opportunities for a greater exchange of trade between them.

The Trade Agreement

The tariff relationships of the two countries are at present governed by the Australia/New Zealand Trade Agreement 1933.* In brief, this agreement provided for each partner to accord to the other the benefits of its British Preferential Tariff, except in the case of products for which special rates were provided. Most of the special rates (originally on 54 items) provided for Australia in the New Zealand tariff were, and remain, above the British Preferential (B.P.) rate but below the most favoured nation (M.F.N.) rate.

In the late 'thirties, New Zealand raised rates of duty on several items, after negotiation with Australia, in order to provide more protection for New Zealand industries against Australian compe-

* For a fuller account see J. L. Nicholson: Australia's Trade Relations (Cheshire, 1955), pp. 39-45.

tition. We should note, too, that Australian exports generally have been subject to some disadvantage as a result of our method of valuation for duty purposes. Duty is calculated at current domestic value in the country of export, plus 10 per cent; but when duty is assessed on the Australian current domestic value, it is charged without any exchange conversion, although currencies not expressed in pounds, shillings and pence are converted to sterling for purposes of arriving at the duty to be charged. Thus a product with a current domestic value of £A.125 is valued at £125 for duty purposes, not at £100 as the Australians claim it should, given their exchange rate. New Zealand has now accepted the Australian contention; Ministers agreed last year that, when new tariff schedules are introduced the method of valuing Australian goods for duty would be adjusted.

The special rates (originally on 118 items) applied to New Zealand products by Australia under the Agreement were in most cases below the Australian British Preferential (B.P.) tariff, though there were some instances where rates above the B.P. tariff were applied. This broadly remains the position, though on several items, each individually of little significance in New Zealand's trade, the Australian Government has raised special duties to the B.P. rate, with New Zealand's concurrence. Under the original agreement, New Zealand was accorded a further privilege by being granted exemption from the primage duty levied on products from other countries (usually 5 per cent or 10 per cent). The value of this concession has since been substantially reduced because Australia's policy has been gradually to eliminate the primage duties, and this has already been done over the greater part of the tariff. Both countries have also reduced margins of preference in negotiations under the auspices of the General Agreement on Tariffs and Trade and this process is likely to go further, since both countries have obtained the agreement of the United Kingdom to reductions in contractual margins of preference, and are likely to use this right in bargaining with foreign countries for freer access to their markets. Rates of duty on special agreement items may not be increased except by mutual consent or following three months' notice. It is specifically stated, however, that nothing in the Agreement can be construed to affect the right of either party to impose duties on any goods for the protection of any new industry, or proposed new industry, provided the rates imposed do not exceed those charged on similar goods from the United Kingdom. It is to be noted also that several of the preferential and special rates are quite high and that rates, other than special rates, are not bound against increase. As a result, tariffs on many items of interest to the other party may at any time be raised.

As an example, in 1958 rates of duty on wrapping papers were increased by Australia, and more recently in the case of tissue paper, a by-law exemption from duty was discontinued, both increases adversely affecting New Zealand. New Zealand for its part has also raised duties to protect its own pulp and paper industry. Moreover, of course, the value of any tariff preferences can be, and has been, reduced or nullified by the imposition of quantitative restrictions on imports by both parties. Thus, not only can a high degree of protection against competition from the industry of the other partner be maintained, but there is little safeguard against an increase in the extent of protection at any time.

The existence of import licensing has led to negotiations from time to time between the parties to try to secure special treatment for selected products which were being adversely affected by the restrictions imposed. For example, early in 1956, the then Prime Minister, Mr Holland, visited the Australian Prime Minister to seek freer access to the Australian market for New Zealand products subject to restriction under Australia's import controls. An understanding was reached, through which it was estimated that New Zealand exports would increase by 40 per cent to £9.5m in 1956 and further to £11m in 1957. New Zealand agreed to "match" the increase in her own exports by taking new and additional imports from Australia. In fact, with the liberalization of import licensing in New Zealand (in 1957, about 95 per cent of New Zealand's imports from Australia did not require a licence) New Zealand's imports rose by much more than the amount envisaged in the understanding, while her exports to Australia failed to reach the estimated values. With the intensification of import licensing in New Zealand, however, Australian exports declined somewhat in 1958 and 1959.

Last year, of course, the Australian Government removed quantitative restrictions from most imports, thus greatly reducing any possibility of Australia's according further administrative preference for New Zealand products. On the face of it, New Zealand should have little ground for complaint about access to the Australian market in the new circumstances. But in the case of at least one group of products of major potential significance, i.e. dairy produce, it is understood from industry sources that Australia has let it be known in no uncertain terms that restrictions would be rapidly re-imposed if New Zealand attempted to take advantage of her apparent freedom to export to Australia's relatively high-priced markets. This, of course, is a particularly sensitive area of production and trade for Australia; but even in the case of other, less politically significant commodities, there is obvious uncertainty in the minds of New Zealand producers as to the security of the market in Australia for imported products. The post-war history of alternating relaxation and intensification of import controls in New Zealand must have erected similar uncertainties in the minds of Australian producers.

The foregoing review of the arrangements made between the two countries indicates, then, that there has so far been no real endeavour to work very closely together in matters of economic development and trans-Tasman trade; that margins of preference are tending to decline; and that trade is hampered both by protective duties and restrictions and the fear that protection might at any time be increased.

Review of the Agreement

The question arises whether more could and should be done to foster trade and economic co-operation between the two countries. At the least, it would seem desirable to review the existing trade agreement, with a view to attempting to lower existing barriers to trade and to reduce some of the uncertainties which at present hamper trade. Uncertainty could be reduced, for example, by reaching agreement to bind rates of duty for a reasonable period on selected items; by providing for prior consultation when either party is contemplating the reduction or elimination of non-contractual preferences or the imposition or intensification of quantitative restrictions on items of active interest to the other country; and perhaps by negotiating commitments not to impose quantitative restrictions on selected items.

It is doubtful, however, whether results of any great significance could be expected from such a review of the existing Agreement. In particular, the extent to which the level of protection could be reduced would be limited by the fact that, under the rules of GATT, neither country is permitted to create new tariff preferences or to discriminate in favour of the other in the application of import restrictions. Thus, unless the countries elected to ignore these rules, concessions given to Australia or New Zealand would have to be extended to all members of GATT and, given the present philosophy on protection in both countries, no appreciable concessions of universal application could be expected.

The Trend Towards Regional Free Trade Elsewhere

This reluctance to make concessions of universal application is by no means confined to Australia and New Zealand. The record of GATT in achieving reductions of barriers to trade under the most-favoured nation rule has not been particularly impressive, particularly after the first round of negotiations. Yet many nations have not been unaware of the advantages to be derived from increased international specialization and exchange. And among the most interesting developments in the world today are the regional free trade arrangements which are emerging in Western Europe and Latin America, and which are being discussed in parts of Africa and Asia. There seems to be increasing acceptance of the idea that countries in the same general region, at relatively similar stages of economic development, and with common political and strategic interests have something to gain by agreeing to break down the barriers to trade between them. Although the rules of GATT ban new preferences, they have always allowed for the development of customs unions and free trade areas, subject to certain safeguards for the interests of outside countries. Thus Australia and New Zealand, who certainly share common political and strategic interests, who are in the same general region and who are at relatively similar stages of development, could, if they wished, agree to form a customs union or free trade area, without prejudice to their international commitments.

It is important for Australians and New Zealanders to give careful thought as to whether a regional free trade arrangement between their countries could be to their mutual advantage, because several of the arguments which have induced Western Europeans and Latin Americans to take such action are decidedly relevant to the problems with which Australia and New Zealand are likely to be confronted in the years ahead.

Economic Problems Confronting New Zealand and Australia

In New Zealand's case, the rate of growth of productivity has been one of the slowest in the world in the past decade.* The economy remains extremely dependent upon a narrow range of export products subject to wide fluctuations of price, and prospects for the future of several of these products are clouded by the prevalence of agricultural protectionism in overseas countries. There has been pressure to industrialize, so that New Zealand might make at home some products previously imported. But far from reducing the vulnerability of the economy, industrialization has so far merely created a new kind of vulnerability. It has not significantly widened the range of our export products. It has led to some change in the nature of our imports so that

* See C. A. Blyth: Economic Growth 1950-1960. N.Z.I.E.R. Research Paper No. 1. Jan. 1961.

imports are now, in the main, "essential" consumer goods and materials and equipment for our industries and services. Consequently, if exports fall, the country is quickly in danger of a contraction of economic activity and of the emergence of unemployment due to lack of imported supplies—unless adequate reserves of overseas exchange are available to draw upon, or unless the country is able and willing to borrow overseas sufficient to bring in the imports needed to maintain activity and employment.

New Zealand's ability to maintain employment and improve the living standards of her rather rapidly growing number of people is at present then very dependent upon our ability to maintain an inflow of imports which rises at least in step with the rise in population. If, because of failure to achieve an adequate increase in the volume of exports or through adverse movements in the terms of trade, we are unable to do this, our ability to maintain an adequate rate of growth will depend very heavily on our rate of increase of production of efficient domestic substitutes for goods previously imported. New Zealand's dilemma is that the further the process of import substitution is pushed, behind a wall of protection and within the confines of a relatively small market, the greater are the attendant difficulties likely to be and the more likely we are to prejudice the development of our existing export industries, and of our industries and services generally, by raising their costs of production. For we should be driven to attempt to produce at home more capital goods, intermediate products such as chemical and petrochemical products and components for durable consumer goods for which, because of their technical complexity, the size of the market is a most important condition of productivity. Faced with a similar problem, the Economic Commission for Latin America was driven to the conclusion that "the continued development of production in watertight compartments" (i.e. within the confines of the individual national markets of Latin America) . . . "will steadily widen the gap between the yield of the new capital investment necessitated by the march of industrialization and the results obtained in the great industrial centres with broader markets at their disposal."

Australia is confronted with difficulties not by any means dissimilar from New Zealand's. Her rate of growth has recently been a good deal higher than ours, but it is by no means high by world standards. She, too, has a vulnerable economy, with its rate of growth still fairly heavily dependent on the country's capacity to maintain an adequate rate of increase of imports. And her home market, though a good deal larger than ours, is still relatively small by the standards of the more advanced industrial countries.

The Benefits of Regional Free Trade

In the light of these considerations, the question which Australia and New Zealand can discuss is this: Shall we proceed with our own independent policies of industrialization and tariff protection, each of us building up similar sorts of industries with little regard for the natural advantages and potentialities of our respective economies, or could we perhaps, through an agreement gradually to abolish the barriers to trade between us, raise the efficiency of our economies, and thus improve our rate of growth and reduce our vulnerability?

Such an agreement could stimulate efficiency in three main ways:—

(1) Through increased specialization by both countries in the types of farming and industry for which they were best fitted. The fact that both countries had undertaken gradually to remove duties and other restrictions on trade, and equally important not to re-impose them, would give confidence to efficient producers to undertake the extra investment necessary to cater for the wider market, specializing much more than they do today on the production of materials, components or finished goods which they are especially well-fitted to produce, and buying from the partner country goods which can be made only at relatively high expense at home.

(2) Through economies of scale. Anyone who has read the symposium edited by Austin Robinson, for the International Economic Association on "The Economic Consequences of the Size of Nations", will appreciate that one cannot, in the present state of economic knowledge, be dogmatic about the importance of the scale of the economy, or the size of the domestic market, in raising productivity. Professor Robinson asserted, after listening to a discussion on the problem by a group of the world's leading economists, that he was left with the "general impression that most of the major industrial economies of scale could be achieved by a relatively high income nation of 50 millions; that nations of 10-15 millions were probably too small to get all the technical economies available; (and) that the industrial economies of scale beyond a size of 50 million were mainly those that derive from a change in the character of competition and specialization . . ." "There are probably significant economies" he said "in integrating nations of the size of 10-15 millions." Of course, even without the creation of a free trade area with its neighbours, a small nation can obtain some escape from the penalties of smallness, and enjoy some of the economies of scale, through external trade in industrial products. But the risks and difficulties are great when the nation is separated by long distances from major markets and when markets may be restricted by the intervention of national governments to protect local producers. It is probable that New Zealand industrial producers, at least, would require the guarantee provided by a free trade arrangement with Australia before they would begin, in significant numbers, to undertake the investment necessary for specialized, large-scale production for a wider market.

There would seem little doubt, then, that significant economies of scale can be derived from the integration of the growing Australian and New Zealand economies.

(3) One of the most beneficial effects of the breaking down of barriers to trade would be the extra competition to which

producers would be gradually subjected as barriers were reduced. As a result of being protected from overseas competition in an inflated market, some Australian and New Zealand producers may not be adopting the most efficient methods of production or giving adequate attention to holding or reducing costs. If they are forced into competition with more enterprising firms from the other country, their efficiency in the use of resources is likely to increase. A free trade arrangement would assist greatly in creating a better climate for growth, both in this way and by making Governments more immediately aware of the disadvantages of permitting inflationary conditions to develop which would weaken the competitive position of their own producers.

The reduction of costs which should be achieved as a result of specialization, larger scale and increased competition should improve the capacity of both countries to export, and to produce goods able to compete successfully with imports. This would be a positive contribution towards reducing their present vulnerability to external fluctuations.

The Costs of Integration

These are the advantages which should accrue from a free trade arrangement between the two countries. But the advantages would not be achieved without some cost. The major questions which must be considered are the following:—

(a) Would such an arrangement lead to uneconomic trade diversion, i.e. from New Zealand's point of view, would it lead us to buy too many imports from Australian sources which could be purchased with less expenditure of overseas exchange from other countries?

(b) What would be the reaction of the United Kingdom, in particular, and of other countries with which we trade, to the increased discrimination against their exports to Australia and New Zealand?

(c) Would the gradual abolition of trade barriers seriously disrupt industry or farming in either country and prejudice its ability to maintain full employment and an adequate rate of growth, especially in the case of the smaller partner?

(a) Trade Diversion

If two countries break down barriers to trade between them, while maintaining existing restrictions on trade with outside nations, two conflicting effects occur. (1) They give their citizens a greater inducement than before to buy goods from the partner country rather than from less efficient domestic sources, thus tending to increase welfare through greater specialization and exchange. (2) They give their citizens a greater inducement to buy from the partner country rather than from countries outside the union, even though, in the absence of discriminatory restrictions against them, these countries would be cheaper or more efficient sources of supply of the products concerned. This tends to reduce welfare.

To decide whether any particular customs union or free trade area will increase or decrease welfare, one has to make some assessment, inter alia, of the relative strength of the forces causing trade creation and trade diversion. In an Australia/New Zealand free trade area it is likely that, especially when the effects of greater competition and economies of scale are taken into account, the welfare creating effects of such an arrangement would outweigh the welfare reducing effects. The commodities in which trade between the two countries would be most likely to expand are those in which domestic industries are already accorded a high (and growing) level of protection against imports from all sources. Exports from the partner country are therefore more likely to replace domestically-produced articles than to replace articles which are now imported from overseas or which would be so imported if the countries formed no free trade area and maintained their separate systems of protection in the future.*

* This view might not be accepted by some economists. For example, Mr R. G. Lipsey, in a review of the theory of customs unions, in the *Economic Journal* for September 1960, has advanced the view that countries are likely to lose by the formation of a customs union if a relatively low proportion of their total trade is domestic and if the customs union does not include a high proportion of their foreign trade, as might be the case with Australia and New Zealand.

Obviously, the danger of trade diversion depends a great deal upon the severity of the restrictions which are maintained against imports from outside countries. If integration took the form of a free trade area, in which each partner was left reasonably free to determine its own tariff and trade policies towards countries outside the area, then it would be in a position—after consultation with its partner and in negotiation with other countries which had been affected—to take steps to reduce any serious diversion which might occur by lowering barriers to trade with others. Indeed, if successful, the regional freeing of trade should eventually improve the capacity of the partners to export to and import from the rest of the world and diminish resistances to a lowering of barriers to trade on a wider front.

(b) The Reaction of the United Kingdom and Other Countries

If the foregoing argument is accepted, the reaction of other countries to such an arrangement should not be adverse. Assuming that tariffs on their exports would at least not be increased in either market, they would be in no worse position than they are now in relation to other overseas suppliers or to domestic competitors in Australia or New Zealand, although their position in relation to Australian exporters to New Zealand or New Zealand exporters to Australia would of course deteriorate. But any adverse effects of this should be offset by an improvement of the import capacity of both countries. Given the importance of the United Kingdom to both countries as a market and source of supply, and given their preferential arrangements with that country, it should be obvious that close consultation and co-operation with the United Kingdom in exploring the desirability of a regional free trade arrangement would be essential. If the reaction of the United Kingdom were adverse, and in particular, if such an arrangement seemed likely, directly or indirectly, to provoke the United Kingdom to modify the preferential advantages which we enjoy in her market, the case for such an arrangement would be seriously weakened.

On the other hand, if the United Kingdom forms an association with the European Economic Community on terms which involved a substantial reduction in the value of the trade concessions which she accords to Australia and New Zealand, the case for a free trade arrangement between these countries would be strengthened and the grounds for any objection to it by the United Kingdom greatly reduced.

(c) Effects of Integration on Existing Industries and on the Economy of the Smaller Partner

The gradual abolition of barriers to trade would mean that some less efficient enterprises in each country would be unable to survive in the more competitive environment, and that others would grow less rapidly than before. On the other hand, the more efficient enterprises in each country would have greater scope for expansion, and if the foregoing argument is correct, the gains from greater specialization by each country on its relatively efficient enterprises should outweigh the losses caused by the relative contraction of the less efficient.

Although it is highly unlikely that any industry would be completely exterminated, there is no doubt that sections of some industries in both countries which have received substantial protection would find it difficult to survive or to make the profits to which they have become accustomed. Understandably, those likely to be adversely affected would put up considerable political resistance to any proposal for integration and, in some cases—for example, the Australian dairy industry—those protesting would carry considerable political weight.

It has been suggested that there is more likelihood of reaching agreement on a measure of integration between the two countries by creating a partial free trade area, excluding industries which would be particularly sensitive to the reduction of barriers to trade. Our GATT obligations do not require the complete abolition of all barriers to trade between the parties in a free trade area; Article

XXIV stipulates that "substantially all the trade between the constituent territories" should be freed and this has been interpreted in Europe to mean 80 per cent or more of the trade. It would probably be easy, by excluding 15-20 per cent of the goods traded between Australia and New Zealand, to avoid any serious injury to any industry in either country. Nevertheless, if this sort of thing were done, we should be denying ourselves the major advantages to be derived from the freeing of trade, namely the transfer of labour and resources from less to more efficient industries in each country. And if, for example, Australia insisted on the exclusion of dairy products from the arrangements, they would look considerably less attractive from New Zealand's point of view. If a free trade area is to work satisfactorily, there has to be reasonable reciprocity between the members—each partner must feel assured that the arrangement will not merely involve it in increasing imports from the other member, but that it will also provide scope for a significant expansion of its own exports to the other's markets.

The major fear in New Zealand about any proposal for integration would be that this reciprocity would not in fact be achieved. It has been said

(1) that the major benefits would accrue to Australia, who could greatly increase her exports to the New Zealand market; (2) that New Zealand industry would be unlikely to expand its exports significantly to Australia; and (3) that the New Zealand economy would be weakened (a) by a reduction in our ability to shelter infant industries against competition and to protect our balance of payments by trade restrictions and (b) by a reduction in the inflow of private capital from overseas which would tend to be diverted to Australia if its products were guaranteed free access to New Zealand's smaller market.

These fears are likely to be exaggerated. The first point to make is that, if both parties positively gained from any arrangement, it would not greatly matter if one partner gained rather more than the other. But would New Zealand gain?

Since barriers to trade would be eliminated gradually, over a period of ten or fifteen years, and affect only imports from Australia, there would be no sudden influx of imports into the economy as a result of any arrangements made. Enterprises in New Zealand would have ample time to take steps to increase their efficiency as much as possible to meet the additional competition.

It can be assumed that policies directed to the maintenance of full employment and an adequate rate of growth would continue to be pursued in both countries. Indeed, one would hope that policies of mutual assistance would be formulated to foster the achievement of these objectives in any arrangement which was made. The elimination of trade barriers would therefore take place in the context of a growing market provided by a rapidly rising population with a high and increasing per capita income, a market equivalent in purchasing capacity to those in much larger but less prosperous countries overseas. In such a situation of general industrial expansion, the process of gradual transfer of resources from less to more efficient industries would clearly be much less difficult than it would be in a relatively static economy. In these circumstances, it would seem to be unnecessary to write into the agreement special safeguards for New Zealand, such as the right to slow up the rate of reduction of barriers to trade in the event of difficulty; but this has been done in other regional arrangements and no doubt could be in the case of an arrangement between Australia and New Zealand.

New Zealand industry stands to gain more than Australian from the stimulus to efficiency which a free trade arrangement would provide. Protection and our propensity to inflate are two of the major factors responsible for the relatively slow rate of growth in New Zealand in recent years, because they have raised our capital requirements per worker and led to inefficient use of capital through labour shortages, insufficient specialization and the survival of too many relatively inefficient small-scale enterprises. A lowering of barriers to trade with Australia would not only reduce protection to some extent, but also make New

Zealand Governments more actively concerned with preventing inflation and avoiding budgetary or other economic policies which hamper productivity growth. There is almost certainly more room for improving productivity in New Zealand in these and other ways than in Australia.

This consideration is relevant to the question of the relative attractiveness of the two economies to overseas investors. A relatively greater improvement in productivity in New Zealand would offset, at least to some extent, the tendency for overseas investors to prefer to place their funds in Australia if trade were freed. In this connection, it should be recalled that transport costs between New Zealand and Australia are not greatly different from those between the main Australian ports. The factory in New Zealand shipping to Sydney should not therefore be at much disadvantage in this respect compared with the factory in Brisbane or Adelaide, given adequate shipping services. The adequacy of transport services between the two countries would of course be a major matter to be considered when the possibility of a free trade area was being examined. But on grounds of cost of transport, there seems little reason why a reasonable share of overseas investment should not come to New Zealand, provided of course that New Zealand governments made conditions reasonably attractive for it. In any case, if New Zealand wished, capital from overseas could be obtained in forms other than direct private investment. Indeed, one of the topics to be considered in negotiations with Australia would be the possibility of joint participation in the planning *and* financing of major investment projects as part of a policy of ensuring an adequate rate of growth and full employment in both countries.

Greater specialization and an improvement in productivity, other things being equal, would increase the capacity of New Zealand industry to export as well as to compete with imports from Australia. A regional free trading arrangement would also be likely to develop more fully in New Zealand producers that attitude of "export-mindedness" which is so vital a factor in increasing a country's ability to develop markets overseas. There is no need to stress the vital importance to New Zealand of the maintenance of free entry to Australia, if we are to make full and efficient use of the potential of our rapidly developing forest industries. Again, current trends overseas should make us consider the advantages of integration from the point of view of one of our largest industries, the dairy industry. An arrangement which gradually gave our dairy products freer entry to the Australian market would be of considerable value to the whole New Zealand economy. And one can envisage the growth of exports of a wide range of other primary and manufactured products, if free entry were assured and New Zealand industry was thus encouraged to specialize in production for a wider market. Take our projected cotton industry, for example. This would be much more economic, and therefore more beneficial to New Zealand, if it could specialize in a narrow range of cotton products and export a fair proportion of them to Australia than if it attempted to make a wide range of different products for the New Zealand market alone. Likewise, a number of existing industries would gain if each plant tended more to specialize on the products for which it was best fitted and aimed to supply the whole Australasian market. We should not be pessimistic about the ability of New Zealand manufacturers generally to compete on level terms with their Australian competitors.

In this connection, an important factor to be considered, if a regional free trade area were contemplated, would be whether the existing exchange rate was appropriate. It has been suggested that a pre-condition of free trade between Australia and New Zealand would be to bring the two currencies to parity with one another. Certainly a devaluation of the New Zealand pound would improve the competitive position of New Zealand producers in relation to their Australian competitors. But a decision to vary the exchange rate could obviously not be taken on this ground alone, given the relative unimportance of trade with Australia in New Zealand's overall balance of payments. However, the existing rate cannot be regarded as sacrosanct and it would be important before a free trade area was established to determine whether any change was justified.

The exchange rate also directly affects the investment decisions of overseas firms with subsidiaries in both Australia and New Zealand (or of Australian firms with subsidiaries in New Zealand). Would these firms close up their New Zealand plants and concentrate production in Australia? Would they—and others—favour Australia rather than New Zealand as the location for new factories? The advantages in the matter of manufacturing location depend—among other things—on the exchange rate between the Australian and New Zealand currencies. Overseas investments which provide the basis for sound industrial developments and adequate employment opportunities can be safeguarded and stimulated by the choice of a suitable rate of exchange.

Conclusion

New Zealand would not enter any free trade arrangement as a relatively poor, underdeveloped rural region. It is a country with a high per capita income, giving it great capacity for saving and investment; a country with a wide range of growing manufacturing enterprises already in existence, which have scope for considerable improvements in productivity, especially if they have access to a wide market; a country with a skilled labour force, whose skills can be further improved by development of our education and extension services. Moreover, we would retain our own Government, which could give, and would be induced by the agreement to give, considerable assistance to industry by methods which would have more positive effects than protection in increasing efficiency. In addition it is to be hoped that provision would be made in any free trade agreement for mutual assistance, where necessary, to maintain full employment and an adequate rate of development in each country and to ensure that each country received adequate benefit from the agreement.

It is probably the case that the political climate in both countries is not at present conducive to rapid progress towards complete free trade. However, if the possibility is admitted that there might be advantages in complete free trade in the not too distant future, it is likely that we shall take more interest than we have so far in making in the immediate future co-operative arrangements, less far-reaching than a free trade area, which might provide a partial test of the desirability of going further. For example, we might give consideration to the possibility of freeing trade in one or two selected groups of products. The six members of EEC began the process of integration by creating a Coal and Steel Community, and this was given the blessing of GATT. Could Australia and New Zealand do something similar in the case of pulp and paper or perhaps iron and steel? Other measures which might be taken, both by Governments and by business interests, to create closer ties between the two countries and to help to break down the fears which cloud our vision at present, are more likely to receive positive attention if we see a complete freeing of trade as an ultimate possibility, than if we rule out this possibility entirely.

It has not been the intention here to argue that making arrangements for increased specialization and exchange between Australia and New Zealand would provide any panacea for the problems with which our countries are confronted. What matters most in reducing our vulnerability and raising our standards of living is that each country should make better use of its available resources. Other things, such as the level and nature of our capital investment, and our ability to improve the skill and enterprise of our labour force are more important than our international trading arrangements in achieving this objective. It does appear, however, that there is a *prima facie* case that increased specialization and exchange between Australia and New Zealand would make a useful contribution to improving the efficiency of our economies and that, therefore, our Governments and peoples might look much more seriously than they have in the past at the possibility of achieving a greater measure of integration of our economies.

Table

NEW ZEALAND'S TRADE WITH AUSTRALIA

Total Trade—1921 to 1960

Calendar Year	Exports (i) £NZ000	Exports (i) % N.Z.'s Total Exports	Imports (ii) £NZ000	Imports (ii) % N.Z.'s Total Imports	Deficit £NZ000
1921	2,070	4.6	5,460	15.1	3,390
1922	2,208	5.2	3,294	12.0	1,086
1923	2,642	5.7	3,655	9.8	1,011
1924	2,509	4.8	5,651	11.6	3,142
1925	2,502	4.5	5,249	10.0	2,747
1926	3,054	6.8	4,825	9.3	1,571
1927	3,666	7.6	3,869	8.6	203
1928	3,403	5.2	3,499	7.8	96
1929	2,338	4.3	3,259	6.7	921
1930	1,562	3.5	3,309	6.8	1,747
1931	1,169	3.3	2,438	7.8	1,269
1932	1,445	4.1	2,691	9.6	1,246
1933	1,393	3.4	2,675	10.1	1,282
1934	1,883	4.0	3,238	10.3	1,355
1935	1,782	3.8	3,957	10.9	2,175
1936	1,843	3.3	4,941	11.2	3,098
1937	1,824	2.8	6,596	11.7	4,772
1938	2,189	3.8	7,159	12.9	4,970
1939	2,256	3.9	6,419	13.0	4,163
1940	2,159	3.0	7,818	15.9	5,659
1941	2,400	3.6	8,024	16.3	5,624
1942	2,718	3.4	8,142	15.1	5,424
1943	2,849	4.0	10,160	10.7	7,211
1944	3,093	4.0	10,277	11.9	7,184
1945	4,195	5.2	8,326	15.1	4,131
1946	3,631	3.6	10,424	14.6	6,793
1947	4,096	3.2	14,941	11.6	10,845
1948	3,954	2.7	14,308	11.1	10,354
1949	3,748	2.6	15,674	12.8	11,926
1950	4,779	2.6	19,026	12.1	14,247
1951	3,113	2.1	21,254	10.3	16,141
1952	3,930	1.6	24,365	10.6	20,435
1953	4,655	2.0	23,638	14.5	18,983
1954	6,445	2.6	27,492	12.9	21,047
1955	6,692	2.6	30,478	12.3	23,786
1956	8,431	3.1	33,305	14.2	24,872
1957	10,113	3.7	45,185	17.3	35,072
1958	10,266	4.1	43,680	17.3	33,414
1959	10,944	3.7	37,104	18.1	26,160
1960	13,477	4.5	45,366	18.0	31,889

(i) F.O.B.

(ii) 1921-51 = c.d.v. plus 10%; 1952 onwards = c.d.v. only.

Source: New Zealand Department of Statistics.

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26 Kelburn Parade,
Wellington,
New Zealand

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