

**Commentary on:**

**AUSTRALIA — NEW ZEALAND RELATIONS:  
THE CLOSER ECONOMIC RELATIONS  
AGREEMENT IN CONTEXT**

Paper presented by Alan Burnett — Page 59, Part I.

by

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## AUSTRALIA-NEW ZEALAND RELATIONS: THE CER IN CONTEXT

Commentary by Kerrin M. Vautier Consulting Research Economist

"CER In Context" is one of those deliciously broad topics that allows considerable freedom to authors and commentators in the way it is interpreted. Which context? Alan Burnett chooses three.

First, the CER Agreement is viewed as part of the wider ANZ community relationship that has developed historically. Secondly, CER is viewed amidst speculation ("perhaps an expectation") that, as NAFTA was a stepping stone to CER, so might CER be a stepping stone to a customs union, with all that that implies. What is lacking in this area, however, is a time context, although the gradual evolution which Mr Burnett refers to implies a longer term perspective.

Thirdly, the paper brings the political context to the fore - that is the context which, in Mr Burnett's view, will have a marked influence on whether CER falters or flourishes; and, if the latter, a marked influence on what form the new growth takes.

Three aspects of the political context are identified. First, political structures - the institutional and constitutional arrangements that distinguish Australia and New Zealand; secondly, political style - although I am reluctant to assume that stylistic aberrations will be typical of the future style of New Zealand politics; and, thirdly, political "realities" - the various pressures that can be applied to politicians, particularly when there is poor economic performance and unemployment on the home front. First and foremost, politicians have to be seen to be accountable to their electorates. This point lies behind Mr Burnett's statement that even the present labour mobility across the Tasman should not be taken for granted;

although, if there were a dramatic change in this respect, the whole ANZ community concept - and not just CER - would presumably be weakened. The political realities serve as a timely reminder of the fragility of international arrangements.

Now let me focus on the second context to which I referred: the possible path of the stepping stones. There are those who adhere to the view that New Zealand and Australia have a free trade agreement that is planned, certain and open-ended, but that is the end of the path as far as a formal development of the trans-Tasman relationship is concerned. There are those who recognize that while a customs union has been foreshadowed in the Agreement, it has not been made an explicit objective; theirs is a cautious approach to what could be a very slippery stone. Then there are those who see as inevitable much broader economic harmonisation and, ultimately, political union.

The boundaries are not as clear-cut as this catalogue of views implies. There is a certain logic in the progression from one step to the other. For example, a common external tariff may be the best response to the problem of "intermediate goods"; but then there are exchange rate and political implications, as the paper points out.

By asking whether it is sensible for Australia and New Zealand either to hasten the progress of CER into a customs union, or to allow it gradually to come about, Mr Burnett appears to be eliminating the option of no customs union. But, even to be suggesting possible out-growths from CER is indicative of the marked change in attitudes that has taken place since New Zealand manufacturers made those tentative steps through NAFTA to widen their home-base. The nature and pace of future change will very much depend on the amount of confidence

that can be engendered in the business sector from CER in operation.

The paper does not cover what benefits might follow an even closer economic relationship between Australia and New Zealand. But, a better understanding of these would be an essential pre-requisite to moving in that direction.

In exploring some of the broad implications of greater policy harmonisation, Mr Burnett sounds a warning note; at least that is the conclusion I draw from his discussion of the EEC. That experience suggests that despite commitment, structures, and gradualism (or maybe because of structures and gradualism!) the EEC is not functioning as an effective customs union. Even if you resist the analogy, it highlights the distance and the rough passage between a free trade agreement, a customs union and an economic union. The paper thereby gives us a better idea of the long term implications for policy and economic management of coming to grips with the second generation issues arising from CER.

If there is to be a harmonisation game, it follows that the member countries will be starting from different positions; and they will have different views as to who is serving. Do we change or do they? I would like to pursue this question in the context of foreign investment - an issue which now has "one-and-a-half generation" status.

At present, there is definitely an unevenness in the opportunities available to Australian and New Zealand firms respectively to invest across the Tasman. At the same time, there appears to be an increasing presumption, at least in the business community, that trans-Tasman direct investment policies ought to be harmonised.

But this presumption does not seem to be based on a full understanding of the policy options or their implications (trans-Tasman and global).

Let us start with Mr Burnett's perspective on the issue. He points to a growing confidence on the part of Australian enterprises in New Zealand's medium to long term economic prospects, leading to investment; and to New Zealand's capacity (and I would add "desire") to invest offshore. The certainty of the CER trade provisions will itself have an impact on trans-Tasman investment decisions.

The paper also points to the collective freedoms provided in the Treaty of Rome, including free movement of capital and freedom of establishment. Indeed, there is a certain logic in coupling these features with the free movement of goods and labour. This logic rests on the assumption that the over-riding reason for promoting free trade is to encourage competitiveness through specialisation, and hence rationalisation, of production and production facilities. The location of capital, therefore, is an important parameter in the context of efficient resource allocation. But, of course, the issue is more than that. It is also one of ownership.

Mr Burnett mentions the possibility of the free movement of capital between Australia and New Zealand becoming a "right", expressed by amendment to CER. Later in the paper, however, he concludes that such an amendment, covering free movement of capital and freedom of establishment, is really outside the realm of the possible - mainly because of New Zealand fears of a net emigration of capital. But also, there is an Australian anxiety about pursuing a discriminatory foreign investment policy - discriminatory, that is, between different sources of foreign capital.

Australia has cited its Treaty of Friendship and Co-operation with Japan as an important constraint on its ability to change its investment rules with respect to New Zealand. But, to quote an optimist on these matters, "if the spirit is willing the text is weak"!

As well as looking at the trans-Tasman position, it is important to consider the global dimension of the foreign investment issue. If resources are internationally mobile, then it can be assumed that they will be attracted to the highest rate of return (assuming also a wide knowledge of investment opportunities). The question then arises as to whether or not it is to either Australia's or New Zealand's net economic advantage for at least one of those countries to discriminate in favour of foreign investment from the other. Might not firms undertake some investment because it is easier, rather than as a result of comparative economics, thereby foregoing more profitable opportunities in third countries? And, might not a preference for investment from, say, New Zealand, sometimes be at the expense of investment with a comparative advantage from third countries?

The OECD, for one, argues that the desirable direction of change - internationally - is the general freeing up of capital flows. But, accepting Mr Burnett's conclusion that this is unlikely to happen in the trans-Tasman context in the near future, might it not be appropriate to consider possible intermediate positions? A greater airing of the options would seem to be a necessary response to the presumption that trans-Tasman investment policies ought to be harmonised.

Important differences between the Foreign Investment Review Board's (FIRB) and the Overseas Investment Commission's (OIC) policy implementation are, first: takeovers by foreign companies come under FIRB scrutiny if foreign equity is to be 15 per cent or more. In New Zealand, OIC approval

is required if a foreign party wishes to acquire a shareholding of 25 per cent or more.

Secondly: the FIRB gives relatively greater weight to the extent of foreign ownership and control of individual enterprises.

Thirdly: the FIRB makes a practice of imposing conditions on approved investments, often with respect to future allowable equity holdings.

Fourthly: the FIRB sometimes requires a company to advise the media that it has entered into a takeover agreement subject to the Board's approval. This is clearly to alert Australian interests to the proposal so that they also have an opportunity to make an offer. This practice is questionable from a commercial point of view, irrespective of the source of foreign capital.

Possible "intermediate positions" could include the following. First: the FIRB could formally or informally recognize CER as one of the relevant criteria for considering the national benefit derived from foreign investment proposals. This would not, however, serve as a guarantee that CER considerations would over-ride equity considerations.

Secondly: Australia's equity benchmark of 15 per cent could be altered to 25 per cent to be consistent with New Zealand practice. (At least this would allow New Zealand companies to adopt equity accounting, with respect to their interests in Australia, without having to go through the FIRB's formal procedures).

There remains the question as to why New Zealand firms regard significant part-ownership and control of investment in Australia as essential for achieving the rationalisation objective that is inherent in the Agreement, and for deriving national benefit from CER. Will increased ownership of itself facilitate the rationalisation process through a freer flow of information, technical and managerial skills?

I am hoping to research this area more closely in the next few months. It will be interesting to do case-studies of firms which, in the past, have made cross-investment decisions in the name of rationalisation, whether or not in anticipation of CER.

There seems little doubt that Australia's and New Zealand's foreign investment policies will be amongst the set of policies that will influence not only the magnitude of the benefits from CER but also their distribution as between the two member countries. But we need to know more about how different stances on foreign investment are likely to affect the size and distribution of the benefits.

Mr Burnett sees an important link between the distribution of benefits and the relative bargaining strength of the two countries in their future bilateral negotiations. (And he seemed to be giving notice from "big brother" that New Zealand has more to lose if it's naughty).

But there is also the wider question of the extent to which Australia and New Zealand can strengthen their collective bargaining position in respect of their trading and other relationships with the rest of the world. One of the major stepping stones is outwards: CER in the context of ASEAN and the Pacific Rim.