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TRADE POLICY REFORM IN NEW ZEALAND

Trade Policy Reform in New Zealand

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Trade Policy reform in New Zealand

1 Introduction

The economic reforms in New Zealand from 1984 onwards rapidly became a benchmark for similar reforms in other countries to be judged against, but coming from a small and somewhat isolated part of the world one must place these in perspective and recognise that many other countries such as those of the former Soviet Union and China at one extreme and economies such as those also being studied as a part of this overall research project also have undergone reforms. However, what sets the New Zealand reforms apart from others was the comprehensive nature and speed of the reforms. While this paper examines the trade policy reforms, these cannot be viewed in isolation from the overall package, a package that covered the full stabilisation and liberalisation spectrum of reforms in:

- Finance markets;
- Trade policy;
- Agricultural and industry support;
- Research and development;
- The labour market;
- Taxation and taxation policies;
- Monetary policies;
- Fiscal policies;
- The welfare state itself;
- Corporatisation and eventually privatisation; and
- Government departments.

Many of these packages are inexorably linked (you cannot have a trade policy without an agricultural policy, for example), and even after a period of nearly a quarter of a century it is hard to clinically assess the overall effects of the package let alone the effects of an individual component of the package. Arguments continue over the sequencing versus comprehensiveness of the reforms and their associated human cost, but the New Zealand of today is a much different place from that of the early 1980s.

2 The Background

By the 1950s New Zealand had become one of the richest countries in the world on a per capita basis, with this prosperity based upon agricultural exports. The United Kingdom (UK) absorbed most of the produce New Zealand could supply; in 1960 the UK was the destination of 53.0 per cent of all New Zealand's merchandise exports, and such was the dominance of pastoral agriculture that wool (33%), meat (24.2%) and dairy (23.9%) comprised 81.1 percent of total global exports. New Zealand was regarded as a British farm. From there the dream started to end, and by the early 1980s New Zealand had become a highly regulated economy, with extensive government involvement in most areas of the economy. This was especially so in agriculture, where by 1984 assistance to the sector had doubled over a very short three to four year period to reach 30 –34 per cent of the final value of most pastoral farm output. Since then the economy in general has evolved to one of the most open in the world, and the agricultural sector is held up as the classical 'farming without subsidies'[1] example.

By the late 1960s, faced with growing balance of payment problems, successive governments sought to maintain New Zealand's high standard of living and full employment rate with increased levels of overseas borrowing and increasingly protective economic policies. The government introduced controls (quotas) for manufactured goods, increased tariffs, and undertook a huge capital works programme, building roads, houses, hospitals, power stations and telecommunications. The inevitable result was an inefficient manufacturing base, economic stagnation and increased government management of the economy. With export markets for agricultural produce guaranteed, increasing production became the name of the game. A turning point came around 1973 when the UK entered the European Common Market and the cosy agricultural market arrangements ceased[2] and the first international oil crisis hit, a crisis that New Zealand did not respond well towards, to its medium-term detriment.

By 1984 there was wide acceptance that a change in direction was required, and a number of acute problems had to be addressed:

- The fiscal deficit, which had reached nine per cent of GDP;
- A growing public debt problem, with borrowing often being used to support consumption. Government net debt as a proportion of GDP had risen from 9 per cent in 1976 to 41 per cent by the mid-1980s;
- A persistent current external deficit, which was complicating overseas debt management[3i] and putting pressure on the exchange rate;
- Persistent inflationary pressures, with the consumer price index (CPI) reaching almost 20 per cent before price controls were imposed in 1982;
- A lax monetary policy, which, because of the government's suppression of interest rates, had led to excessive monetary growth;
- A growing unemployment rate, which had reached 7 per cent by 1983; and
- A real GDP per capita growth between 1976 and 1984 that averaged only 1.15 per cent per annum.

A 'snap' election in 1984 brought to power the Labour Party, with a Finance Minister committed to a less interventionist approach and with strong support from his senior colleagues. For a traditionally left-wing democratic party, this approach was inconsistent with their general policy stances, and this contradiction demonstrated how far the previous government had drifted into intervention, the general disenchantment with intervention and the need for radical reform.

Looking back it is hard to see why New Zealand continued to rely upon border protection after the end of the Second World War and increasingly pursue an import-substitution policy in the manufacturing sector over this period. The general rational for such a policy is to ensure that

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[1] With reference to the seminal book (Sandrey and Reynolds, 1990) that describes in detail the background, the policy shifts and the consequences of New Zealand's agricultural reforms.

[2] The loss of unfettered access to the UK market was a dramatic blow to New Zealand given both its reliance on that market and the nature of the export basket in dairy in particular. Sheep meats were less effected as a special access deal was negotiated, while with wool the problem was not one of access but rather steadily declining prices from around that same time.

[3] The total public debt as a percentage of GDP gradually declined from nearly 70 percent in 1960 to a low of around 40 percent in 1974 before climbing dramatically again to around 70 percent in 1985 and 1986 before peaking at around 77 percent in 1987. Prior to 1974 most of the debt was domestic debt, but from that time through to 1984 overseas borrowings became much more important. From around 1984 a conscious decision was made to retire most of the overseas debt.

employment is kept up, but in New Zealand's case at one stage during the 1950s the official unemployment rate was around 0.1 percent[4]. The problem was perversely that these protectionist policies were generally considered to be the reason for the low unemployment, and this disguised the 'cost excess' burden[5] on protectionism upon the export sector for many years during and after the commodity boom of the 1950s. Right through to the around the early 1970s, a period of another commodity boom and the first oil crisis, New Zealand seemed to be 'I'm OK mate' with respect to economic policies. The economy continued to grow, and it was only when the relative growth was set against other rich countries that warning signs became apparent as New Zealanders were losing ground on this relative basis. From there until the 1984 crisis the economy deteriorated.

During the period leading up to 1984 steps were taken to address the fundamental problems, but these steps were often slow and faltering. For example, to free up the economy the first steps were taken towards the FTA agreement with Australia, with the original Closer Economic Partnership (CER) agreement signed in 1982, and protectionist measures such as the import licensing scheme were moved towards a tariff-only protection (albeit with these tariffs at a high level). On the other hand, from the late 1970s the infamous 'Think Big' import substitution programme for expanding domestic industries (car assembly and steel production) and energy production (petrol from natural gas) was launched and this was complemented with an ambitious export subsidy programme. The latter, by definition of the role of agriculture in the export mix of the time, concentrated upon agricultural products, products that were becoming increasingly protected in the global market. This accentuated New Zealand's problems, and the situation became more acute. Attempts by the government of the time resulted in what we referred to as 'hydraulic policies' whereby an attempt to patch one problem through intervention merely increased the pressure on another weak point thus causing yet another problem. This was the situation at 1984.

3 The reforms

The real feature of the reforms from that point was their dramatic nature; attention focused on stabilisation of the inflation rate, government deficit and overseas debt, and deregulation through reforms of commercial policies, the taxation system and the financial sector, and government trading policies. Trade policy reforms were an integral part of the overall package and New Zealand's trade reforms of the period must also be viewed as having a major export policy reform in that agriculture was such a major component of the total exports that reforms on the supply (export) side of trade must be viewed in parallel with reforms on the demand (import) side of trade. Furthermore, the trade reforms were but one element of a comprehensive package, and this comprehensiveness was and still is the main distinguishing feature of the New Zealand reforms. For example, the experience is often compared with 'Thatcherism' during a similar period in the United Kingdom, but one has to place these reforms in perspective. The UK has neither a trade nor an agricultural policy as these were are effectively handed over to and dictated by the European Commission.

Agriculture also became a central part of these reforms, partly because of its importance to the economy and partly because it was such a visible target. These agricultural reforms also enjoyed political support from the Labour Party's traditional rather 'anti-farmer' worker base. However,

[4] It is anecdotally told that at one stage the Minister of Labour knew the names of all the 27 registered unemployed persons in New Zealand.

[5] This 'cost excess' describes the situation whereby protection to the domestic (generally non-tradable) sectors increases the cost for the exporting sector. This is discussed in more detail later in the paper as the analytical contribution from Syntec and others provided an economic justification for the reduction/removal of these 'cost excesses' that were hindering the export sector.

reform of the agricultural sector also had many supporters within the sector itself. The situation was regarded as unsustainable and farmers expected compensation to the sector through reforms elsewhere in the economy. In particular, they expected that given agriculture's importance in the economy the newly-floated exchange rate would closely follow the agricultural terms of trade, This would then in turn provide a counter-cyclical compensation in the form of a lower New Zealand dollar and therefore higher farm gate returns during these periods of lower agricultural prices on the world markets. On the latter they were somewhat misled; the reforms to agriculture took place much faster than many reforms elsewhere, and, contrary to conventional wisdom, the nominal exchange rate (and consequently the real exchange rate) actually appreciated strongly. Both accentuated problems for the sector and delayed its eventual recovery.

The New Zealand dollar (the 'Kiwi') was immediately devalued, and then a few months later floated. Over a very short period of time export assistance was discontinued, import protection was lowered, the tax base was widened and made more indirect, government trading activities were privatised and the public sector was reformed.

In the agricultural sector, subsidies were withdrawn and by 1991 their value had reduced to around 2 per cent of output from the 1983 figure of 33 per cent, and from then until the present time that level has prevailed, with the remaining minimal support concentrated upon research and extension, animal health and quarantine, and assistance in times of adverse events; concessionary farm loans were progressively brought into line with market rates for the government-owned Rural Bank (although some debt write-off was introduced by way of compensation, the only real compensation provided to the sector); user fees were introduced for most government services; and farm input subsidies were terminated. In addition, the reform of domestic marketing regulations resulted in complete deregulation of the wheat and egg sectors and a partial deregulation of the town (domestic) milk sector (the export milk sector deregulation proved to be much more difficult). All of this happened over a short two to three-year period between 1986 and 1988, and a notable feature was that very limited compensation was paid.

The comprehensiveness of the reforms meant that reforms in several other areas impacted through to trade and trade related policies. One of these was in labour market reforms. Although the Labour Party upheld compulsory unionism during their 1984 to 1990 regime, the nature of wage bargaining changed in that the government refused to become involved as was previously the case. It was often claimed that it wasn't until advent of the 1991 Employment Contracts Act following the change of government in 1990 that real reform took place when labour contracts were placed on the same footing as other commercial contracts and employees were free to choose their own agents, agents that may or may not have been trade unions[6]. However, some analysts (including this author) considered that the preconditions for labour market reform were in fact set by the Labour Party's Labour Relations Act (LRA) of 1987, and that the full significance of the changes introduced in that Act had not been in place long enough to be widely appreciated. The LRA was enacted prior to the large jump in unemployment discussed in a footnote later in the paper, and its real significance became somewhat blurred until this unemployment made the impacts more visible.

Associated with the labour market reforms was the Corporatisation and Privatisation process whereby much of the government involvement in commercial activities was both initially corporatised to improve efficiency and then often later often privatised. This was generally dual process was designed to end the drain on the public purse that many operations had become. Examples of where this impacted upon trade included the railways and the ports, both of which saw

[6] Working days lost due to strikes declined sharply, and by 1995 only 17 percent of workers were in effect unionised.

massive labour shedding that contributed to unemployment initially but the resultant efficiencies later meant lower transaction costs to the productive sector[7]. Government departments were also the focus of many changes, both in their operational procedures and in their mandate. Departments such as Agriculture, for example, saw many of their previous operations in areas such as product inspection and research and development stripped out to State Owned Enterprises. Indeed, one entire Ministry, the Ministry of Works or the old Public Works department, was abolished entirely; partly because their functions in areas such as construction in major enterprises was reduced markedly and partly because during 1987 they remained critical of the reform process and its architect Roger Douglas!

3.1 The political economy of the period

There is much discussion in the economic reform issue about the concept of sequencing. While many commentators argued that this was not as optimal as it may have been in New Zealand's case I would argue that comprehensiveness and certainty of 'staying the distance' were more important from a political economy perspective. The speed of reforms certainly lessened opportunities for lobbyists as they became bewildered by the speed and comprehensiveness and were effectively unable to keep apace with policy changes let alone influence them. The NZIER (2006) the use the phrase 'crashing through the fog of war" to describe how Roger Douglas 'crashed through before opposition could organise itself'. In the desire to maintain momentum little consideration was given to adjustment costs and it became difficult for anyone (and especially opponents of the reforms) to keep track of individual reforms let alone the whole package.

The fascinating feature of the New Zealand reforms is that for the initial period leading up to the 1987 elections there was strong support from both major political parties. This support from the governing Labour party was however masked by the developments within the party itself; the reforms were effectively rammed through by a small cabal of perhaps ten to twelve senior Cabinet Ministers, with many of other Parliamentarians in the party (the traditionally left-wing group) left on the sidelines with no voice whatsoever. With respect to the National party opposition, a party that had mostly drifted towards the left itself, their 1987 election campaign was really 'we will do what they are doing but do it better'. There was a general sense of economic wellbeing leading through to the 1987 election, albeit one not reflected on the farms. The financial sector was booming along with a very bullish share market that was, along with the appreciating dollar, seen as a vindication of economic policies. Several of the other economic indicators were registering good news also.

The problem was that following the 1987 election the wheels started to fall off. Firstly came the major global share market crash of 1987, and the New Zealand market crashed much further than many others as the speculative bubble burst. This together with continuing unemployment caused confidence in the reforms to waver[8]. Reform architect Finance Minister Douglas and sometimes

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[7] For example, railways cut freight rates by 50 percent in real terms between 1983 and 1990, reduced staff by 60 percent and made its first operating profit in six years in 1989/90 (Brash, 1996). It does however remain a moot point as to how successful the later privatisation of the railways was. Several years later the government was effectively forced to retake a degree of control as the new ownerships 'asset stripped' the system and ran it down. A similar fate awaited Air New Zealand, the national airlines flag carrier, and enterprises such as New Zealand Steel that went spectacularly bust.

[8] The unemployment story is fascinating. Levels were minimal through to 1997 before they climbed to around 5.5 percent in 1983 before retreating again to around 4 percent until 1985. From that period they again increased to a peak of 11.1 percent at March of 1992 and they stayed in double figures until June 1993 before retreating again. A decade later that had declined to 4.3 percent. They have stayed below that level since. The levels post-reforms were somewhat lagged but they were definitely related to the economic efficiency drive as labour was shed in many

reluctant supporter Prime Minister Lange visibly fell out in early 1988, and this rift continued to place enormous pressures on the party and economic reform polices[9]. Despite this the economy actually started to do somewhat better, but the 1990 election saw a change of government to one that many voters considered were more capable of continuing the reforms. The National Party had fought the 1990 election saying that while they were generally in favour of the economic reforms there was a need for more thought to be given to the human consequences. The leader and new Prime Minister Jim Bolger spoke at 'the Decent Society' during the campaign, but after the election the incoming Finance Minster Ruth Richardson wished to expand and not retreat from the reforms. Once again electors felt betrayed.

3.2 Electoral reforms

An interesting feature of New Zealand politics of the time was the growing support for and eventual introduction of the "Mixed Member Proportional" (MMP) electoral system. Until the first MMP election in 1996 the vote was for members of parliament chosen on a 'winner takes all' basis, both at the electorate and national levels. This meant that a large element of the voters who did not vote for either of the main parties were disenfranchised. The first 'M' of MMP means that half of the members were elected as before, with the second half based upon the percentage share of the overall popular vote for each party (with a minimum five percent threshold) awarded from the party lists. The 1996 election eventually saw a victory for the governing National Party, which won around a third of the vote. The opposition Labour Party won slightly less. However, the smaller New Zealand First party, which won 17 seats, was placed in the position of "kingmaker", and able to provide the necessary majority to whichever side it chose. They eventually chose to form a coalition with the National party. The Alliance (left of centre) and the new ACT New Zealand (right of centre and led by a disgruntled Roger Douglas) also benefited. Parliament in New Zealand had become much more democratic, and now it is doubtful that a programme such as the 1984-87 reforms could be pushed through so effortlessly as was done at the time. It is also important to mention that New Zealand only has the one House, so there is no 'second level' such as there is in Australia to potentially block legislation.

The introduction of MMP was in a sizable part due to the way in which the left elements of the Labour party felt betrayed by the 1984 election that saw policies move sharply to the right and away from the traditional worker support base. While that base may have applauded several of the moves such as elimination of farm supports and the reductions of tariffs that brought lower prices to consumers, they resented the same suite of policies when unemployment continued at high levels, welfare policies were not addressed as they would have liked and the interest rates on their homes increased.

3.3 The intellectual basis of the reforms

It is difficult to say where the intellectual basis of the reforms came from. Certainly they were consistent with the so-called Washington consensus of the time and what can be thought of as the Chicago school of right wing economists, but they were just as much a case of 'kiwi' pragmatism in realising that something had to be changed and that something needed to be drastic. Standing

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government departments and related institutions. In the short term economic efficiency and productivity increases are almost defined by labour shedding.

[9] This was the period when the Prime Minister got 'cold feet' and suggested that the reform process pause 'for a cup of tea'.

behind the agricultural reforms was a fear that New Zealand may become vulnerable to countervailing duties on her agricultural exports from the US in particular, but whether this was a real threat or a red herring run out by proponents of the reforms to assist with their implementation is a moot point. The bottom line was that piecemeal changes were not working and something needed to be done.

For the narrower tariff reforms the intellectual concept of the true rates of assistance to specific sectors and the recognition of the cost-excess implied for the export sectors resulting from high tariffs was important. A report by the Australian consulting firm SYNTEC (1984) provided the base intellectual support for the first of the three or four tariff reviews conducted over the next 15 or so years from that time. This was augmented by some CGE modelling in the 2003 tariff review. This highlighted the high and often uneven nature of industry protection and clearly illustrated how much protection of the import substitution sector caused a ‘cost excess’ drag on the export sector by raising costs (Duncan et al, 1991). While this intellectual basis was not as powerful an influence as it was across the Tasman in Australia (and the astute reader will note that the dates here are largely after the initial reform thrust) it nonetheless was influential. This was especially so in the case of the tariff reforms, where the reductions were more measured and signaled in advance.

Using a broader base the concepts of public choice theory, agency or principle-agent theory and transactions cost theory were widely used to seek improvements in economic efficiency in the areas of deregulation, liberalisation, commercialisation and public service management (Bale and Dale, 1998). While the catch-phrases of the reformers, critics such as Tim Hazledine (2002) have argued that this foundation was not appropriate and indeed may have actually served to reduce economic efficiency as monitoring and enforcement costs were increased to counter increasing non-cooperation among the agents. As the New Zealand economy stagnated during much of the late 1980s to early 1990s he may have a valid argument.

Other critical commentators include Easton (1994), who discusses the intellectual foundations of the reforms and considered that while the New Zealand reforms were motivated partly by orthodox economics and the desire to apply its precepts to government they were also influenced by the political ‘New Right’. This latter approach sought, on philosophical grounds, a smaller role for the public sector than perhaps could be justified from conventional economic theory alone. The Treasury blue-print was the 1984 and 1987 post-election briefing papers that are prepared after each election as an economic vision for the immediate future, but these documents are based upon what the Treasury considers needs to be done rather than an intellectual framework. Later (Easton 1998), he argues that ‘the overt theory was essentially that which is known in Australia as “economic rationalism”, the consistent application of modern neo-classical market theory. At the practical microeconomic policy level this has been the withdrawal of government interventions which preferred one firm, industry, or sector (relative to others), in favour of market regulation of economic activity. Thus import licences have been abandoned, tariff levels steadily reduced, subsidies and tax incentives withdrawn, the tax regime made more uniform with exemptions, barriers to entry eradicated, corporatisation and privatisation of government trading activities, and greater reliance on competition law.’

Another interesting feature of the reforms is that an independent clinical analysis of them became difficult to find for an extended period. Those in support loudly proclaimed that any downside was caused not by the reforms but by the failure to pursue them far enough and fast enough, while those railing against them tended to do so in a more emotional than analytical manner. It is only relatively recently that there has emerged a more objective analysis. There are of course some exceptions to this, with Brian Easton for example being a balanced critic over an extended period of time who had the ability to support those reforms that he considered were needed. Indeed, Easton 1998 outlines the following general arguments put forward to justify the poor economic performance of New Zealand over the 1988 through to around 1993 period:

(1) The reforms are fundamentally flawed.

(2) The promise that the benefits of the reforms are yet to come has been a constant theme of the pro-reformers since 1985, with a constant shifting into the future of the date at which any benefits will become apparent.

(3) The economic record would have been even worse without the reforms[10].

(4) Any counterfactual scenario needs to take into account the international environment (terms of trade deterioration in the early 1980s, higher world interest rates and the third oil shock)

(5)The cost of disinflation was a loss of output.

(6) An overvalued exchange rate (linked to (5) above).

(7) The poor economic performance occurred because there were not the expected gains in productivity.

How many of these criticisms are valid? Certainly the time lags were much longer than proponents of the reforms forecast, and this possibly meant that adjustment costs were accentuated. The over-valued exchange rate was a major factor in accentuating the subsidy withdrawal impacts down on the farms, as was the agricultural terms of trade deterioration in (4) above. These factors are discussed in detail later in the paper. Similarly, the cost of disinflation (in (5) above) was costly in the short term, and as discussed earlier the unemployment costs as a result of labour shedding was large. With respect to (1) and (3) above, these two issues will always remain controversial, but I present a guarded and not emphatic 'no' and yes' respectively to the questions. To both of these questions the word 'TINA' was often used – not with respect to the celebrated Ms 'simply the best' Turner but rather 'there is no alternative'. These macroeconomic issues are revisited in the final Section 5.2 of the paper.

External factors influencing trade policies

Did external factors and pressures play a role in the reforms? The answer to that is probably no, although the role of the Australia New Zealand Closer Economic Relations Trade Agreement ANZCERTA (CER) was important in both providing a cushion for manufacturers as it enabled them to export to the still protected Australian market as their own tariff protection was reduced. CER was established between these two nations in 1983, and replaced an earlier but less comprehensive agreement and mandated that all tariff and non-tariff barriers be progressively liberalised and eliminated. In 1988 it was reviewed with the provision to accelerate the time frame for trade liberalisation to 1990, and importantly it was also expanded to include trade in services and investment as a result of this 1988 review.

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[10] There is a celebrated cartoon whereby the despairing Minister says along the lines of 'I have followed your advice and every action has led to disaster', with the official replying with 'just think how much worse it would have been had you not followed our advice'.

Following CER the economies came closer together. Both adopted free trade policies with each other and enjoyed relatively free trade with the rest of the world, and both capital and labour now move freely between the two countries. The concordance of the CER implementation and the border liberalisation adopted by both countries over a similar but slightly lagged time frame has been important for two reasons. The first is that the remaining high but reducing tariffs against third countries gave a “window of opportunity” for exporters on both sides of the Tasman to exploit by exporting behind this tariff wall. The second has been that because the tariff walls have been reducing the dangers of so-called trade diversion (or where goods are imported from a source just because they are cheaper through tariff preferences and not because they are benchmarked to best international prices) has been minimized. This lessens the overall cost to the importing economy from trade diversion. There is however a major difference between the importances of the CER in maintaining tariff reforms in New Zealand and Australia. In Australia, the influence of New Zealand duty-free imports is low, while in New Zealand the 20 percent of imports coming from Australia was high enough to put real pressure on the entire tariff structure and hasten wider liberalisation.

The GATT/WTO was not a factor in mandating changes to trade policies, and such was the religious zeal of New Zealand trade officials that (a) they used the GATT to lock in these reforms as much as possible by trying to bind tariff rates as low as possible for example, and (b) they used the review process of the CER and the newly formed Asia-pacific Economic Cooperation Process (APEC) and the global search for new FTA partners as opportunities to do the same. One the first point New Zealanders subsequently held several high positions in the WTO during the 1990s and 2000s, with Mike Moore as Director General and Crawford Falconer succeeding Tim Groser as Chairman of the WTO Agricultural negotiations in the early 2000s. Moore was a crucial Minister in the reform process, while Groser and Falconer were both influential Ministry of Foreign Affairs officers during the 1990s.

On the FTA front despite a lot of effort the harvest proved to be a general disappointment to date[11]. During the 1990s and through the early part of the 2000s FTAs were mooted and discussed with China, Chile, Korea, Hong Kong, Singapore, China, Malaysia, Thailand, the ASEAN block as a whole and more recently Egypt, Japan and the Gulf States. Agreements were signed firstly with Singapore (a duty-free county/zone and non agriculture producer) and this was extended to a so-called P4 (Pacific four) that extended the Singapore FTA to include Chile and Brunei. The P4 contained an extended phasing period (18 years) dairy exports from New Zealand to Chile becoming duty free to maintain the comprehensiveness of any FTA. The Hong Kong FTA negotiations came close to fruition but fell at the last hurdle, while the Thailand FTA is operational and comprehensive albeit with time lags for final phasing in of this comprehensiveness. The others, except Korea which never got off the ground at that time but has since re-emerged on the side-stage, remain in the negotiations stage.

In additional, New Zealand has vigorously pursued the possibility of an FTA with the US but has been given a decidedly cold shoulder by the US in response to the anti-nuclear policy of the late 1980s that refused entry to nuclear powered ships to New Zealand harbours. However, given the partial and rigid template nature of US ‘FTAs’ with other countries it remains a moot point as to whether New Zealand would accept an ‘FTA’ with the US under conditions the same as given to Australia, for example. On the regional front despite the much hyped ‘free trade by 2010’ of the Bogor Declaration APEC has become a political talkfest and photo opportunity as members blithely

[11] This statement would dramatically change with a break-through on the Chinese FTA negotiations, where New Zealand was ‘the first cab of the rank’.

disregard their earlier declaration. Unilateral concessions made by New Zealand such as the duty and quota free access to imports from least developed countries sounded impressive[12], but as the imports from these countries is minimal their trade policy impacts have mimicked these levels.

The salient point about the multilateral, regional and bilateral policies is that despite a lot of political activity there has only really been CER that has impacted on New Zealand import tariff policies and regimes. Literally the only change to New Zealand's tariff schedule mandated by the Uruguay Round of the GATT was to decrease the duty on light beer to zero (hence the 'small beer' jibe for the agreement). However, while New Zealand was not obliged to make any policy changes as a result of the GATT agreement, agriculture did benefit a lot from the liberalisation of many global food markets of direct interest to New Zealand farmers. This (and other more detailed aspects of the New Zealand agricultural reforms) is discussed in Sandrey and Vink (2006).

4 The consequences

4.1 Agriculture

The brief euphoria of a devalued currency lasted for a year or so from late 1984, and was followed by the pain of a sharply appreciating dollar for the next three or four years. To fully appreciate this nominal exchange rate picture it is necessary to analyse the real exchange rate (RER) over the period. The RER had been remarkably stable from 1976 to 1984 as the currency was managed, then improved in 1985 as the nominal dollar depreciated sharply, deteriorated (from the farmers' perspective) from 1986 to 1988, and then recovered again in 1989 as the inflation rate finally came under control and the New Zealand dollar stabilised. And of course the subsidies were rapidly being removed.

As world commodity prices were volatile immediately following the initial reforms, the lower farm prices placed stress on onshore processing industries. These processors were, in turn, forced to reduce their margins. Labour market reforms such as the abolition of compulsory union membership and greater flexibility in the labour negotiation process saw a transfer from the traditional large and inflexible agri-processing plants to newer more flexible ones that were able to adjust much faster to seasonality and other changes. Freedom of exit from the industry, which had not been a feature in the past in the regulated environment, took place concurrently with the new-found freedom of entry in the processing sector. However, the consequences for farmers as shareholders in some of these plants were rather mixed as the adjustment process worked its way through[13].

Sheep meat producers were the most protected sector, and the worst year for lamb producers was 1985/86 when all the contributions to farm gate returns were negative and the farm gate price fell to under half of that of the previous year. The next year farmers were partially rescued by increasing international prices of meat and skins, as well as the reprieve of the end of the subsidy withdrawals (but only in so far as withdrawal process had come to an end when there were no more subsidies left to take away from farmers). The patterns for mutton (older sheep meat) were somewhat similar, while dairy, not being as highly supported, did not suffer the same subsidy withdrawal symptoms. Both wool and beef were intermediate between the two extremes of sheep meat and dairy, although

[12] Since 1 July 2001 New Zealand has offered duty-free and quota-free access to all imports from LDCs. This was the first comprehensive such scheme in the world.

[13] This highlighted a major difference between dairy farmers who were and continued to be loyal to their own farmer-cooperatives and sheep farmers who tended more towards chasing short-term higher pricesthat may have been on offer from rivals to their own cooperatives.

wool was more heavily supported and that support was withdrawn more quickly.

There are three main areas where it is useful to track the consequences for agriculture. These are farm incomes, land prices and the composition of farm production, although all three have complex and often lagged interrelationships. By 1987 nominal farmland values had reduced to below 1981-82 boom prices, and in real terms were only about 40 percent of their peak values. Prices increased in subsequent years, and by 1995 the price of most categories of farmland had recovered to around 86 percent of their 1982 value in real terms. The price of most categories of farmland is now higher than the pre-reform peak.

These initial declines in farm values, coupled with higher interest rates and lower incomes, placed stress upon farmer equity and debt levels. Despite these adverse conditions few farmers were forced to exit the land, as most confounded expectations and stayed on by a combination of tightening spending, drawing on reserves and seeking outside employment (along with spousal support on all three, and especially the final one). Although accurate figures are not available, it is thought that perhaps only 1 percent of farmers were forced off the land rather than the predicted 10 percent. The data shows clearly the split emerging between the heavily supported sheep and beef farmers and the lightly supported dairy farmers as the subsidies were withdrawn.

Initially the reforms had little effect on farm size. However, subsequent to the implementation of the reforms some of the most fertile farmland was converted into horticulture and there has been a growth in the number of farms producing horticultural products, which typically are smaller in size than other land uses. Additionally, areas of marginal land were converted to forestry and the most marginal of land was withdrawn from agriculture production and retired into native bush. The distribution of farms has become more bimodal, with sheep and beef farms becoming fewer but larger and a number of smaller, diversified farms emerging. Perhaps the real story is in stock numbers. While a relative comparison between livestock numbers has become more complex as the productivity from a breeding ewe or diary cow thirty years ago has changed through technology, it does appear that rather than a major reduction in overall livestock equivalents over time there has been a movement around the composition of these units. The most striking feature was the reduction in sheep numbers as the move away from that highly subsidised sector took place. The deer sector is a fascinating case study[14], while the mohair goat industry came and largely went. Overall, total aggregate agricultural production did not decline that much following the reforms in the decade following 1984, as dairy, deer and fruit production replaced the traditional sheep and beef sectors. Part of this was due to production lags, and in particular the fruit sector that was stimulated by export incentives through the early 1980s. Production since the reforms has been driven by market prices, although the role of production lags and the inter-linkages between dairy and beef output that comes from around half of the beef output being cull dairy cows cannot be ignored.

[14] Deer were introduced into New Zealand by the white settlers, and by the early to middle part of the 20th century they had become both a recreational hunting facility but, more importantly, a pest in the bushlands. In the late 1960s commercial hunters started harvesting the feral animals for venison to supply the European market and velvet for the lucrative Asian market. In the 1970s this evolved into capturing the feral breeding stock for commercial farm production as the animals were domesticated, and by the early 1980s the industry was generating economic rents to owners of female animals, who were able to take advantage of disequilibrium prices that fuelled the industry as new entrants clamoured to get in. At this stage the by-product velvet was supplying returns to owners of stock, as few animals were being slaughtered for venison. Around the end of the 1980s the high prices for female animals collapsed and breeding was reverted to rather than speculative values as the herd began an orderly transition to a new domestic livestock industry. This saw the end of feral capture and the start of the marketing of venison globally as premium meat. Breeding numbers have stabilised at around 1.5 million head in recent years as the industry has matured. (Sandrey and Vink, 2006)

4.2 The role of agricultural marketing changes[15] as a component of trade policy reform

This is an important and usually overlooked component of New Zealand's trade reforms. Until the reforms, the essential link between farm gate and the final marketplace for the major agricultural products was largely controlled by producer marketing boards. For dairy products, apples and kiwifruit, these boards had exclusive export powers, while meat exporters were licensed and their activities regulated by the Meat Board (from October 1982 to December 1985 the Meat Producers Board took exclusive control of meat exporting). The only real exception was wool exports, as most of the product was auctioned. In addition, town milk (the domestic fresh milk market) and eggs were subject to supply controls under the umbrella of their respective boards. In most sectors the marketing boards either directly or indirectly operated price-smoothing mechanisms for farmer returns as well. The crucial question is the extent to which these marketing arrangements were reformed and their consequential impact upon the sector's performance.

Given the large percentage of agricultural produce that is exported, this relationship is pivotal, and arguments ranged freely on the extent that the marketing boards were able to enhance returns through single desk selling or market coordination on the one hand versus adding a burden through bureaucratic inefficiencies on the other. Interestingly, some members of the WTO have targeted the New Zealand Dairy Board (and its successor, Fonterra), as State Trading Enterprises (STEs) that must have their powers reduced under any WTO settlement. This suggests that at least in the eyes of many international observers that Fonterra is able to enhance market returns through powers vested in it by the government and therefore some market power does exist.

The dairy sector has faced the fewest adjustments; partly because fewer subsidies were directed to this sector and partly because the vexing question of the control of and economic rents associated with international quota markets has been difficult to resolve. The processing industry has been almost exclusively a cooperative-based one[16], with a steady process of mergers and amalgamations from the 168 dairy companies in 1961 through to 42 in 1981, 9 in 1998 and only 4 in 2001. At this latter date the two major companies and the Dairy Board merged into Fonterra, a cooperative company that processes around 95 per cent of New Zealand's milk supply and controls at least one-third of the world trade in dairy products. The statutory powers of export monopoly were removed, although a mechanism for domestically allocating New Zealand's butter and to a lesser extent cheese quota to the lucrative EU and other markets remains, and the almost-complete dominance of cooperatives in the New Zealand dairy sector remains a feature of the market, along with the strong international processing and marketing linkages of Fonterra.

The meat sector went through dramatic changes. At the time of the reforms the New Zealand Meat Board had complete control of the beef and sheep meat (but not venison) export market (but not processing), and the changing profitability of the sector that led to declining sheep numbers also led to a significant industry restructuring that had considerable animal and corporate 'blood on the floor' as this restructuring worked through in the face of considerable overcapacity and newer technologies. Cooperatives were relatively new to this sector, a sector traditionally dominated by overseas interests, but Evans and Meade (2005) report that cooperatives now account for around

[15] This section draws heavily from Sandrey and Reynolds (1990), Harrington (2005), and Evans and Meade (2005).

[16] Dairy processing plants are cooperative in the sense that farmers completely own the company through shares that both entitle them to present milk for processing and then partake in any profit distribution at the end of the season. Meat processing plants were generally closer to a normal commercial ownership in that complete farmer ownership was rarer.

half or more of the current processing. The once-mighty Meat Board now operates as two shells: one the Meat Industry Association to allocate and monitor the lamb supply for the EU quota, the other the combined Meat and Wool New Zealand body to coordinate the industry (but without any powers of enforcement) and collect and disburse the compulsory industry levies for functions that include research and development. Otherwise, the market where New Zealand holds a 50 per cent and 8 per cent global share of the sheep meat and beef trade respectively remains an open and competitive one. It must be reported also that around two-thirds of both New Zealand's lamb and beef are exported under quota to the EU and the US respectively. Since accounting for one-third of total exports in 1960, the importance of wool has steadily declined in tandem with its relative prices to become largely a by-product to the meat sector. Marketing has traditionally been through the auction floor, and this has remained important, as around 80 per cent of the clip is sent overseas with limited further processing.

Exports of apples and kiwifruit dominate the horticulture sector, with New Zealand holding a global trade share of around 5 and 25 per cent respectively, and around 55 and 95 per cent of the domestic production respectively being exported. Wine should also be included in this category, a horticultural product that is both riding and creating the so-called new world wine industry wave along with, inter alia, South Africa. The 'glamorous and high-flying' kiwifruit sector[17] benefited from marketing and input subsidies, and particularly taxation subsidies, during the 1978-82 period that fostered the growing boom and led to high returns to early entrants, while, except for a grape pull-out scheme in the mid 1980s, wine has 'gone it alone'. The marketing structures for these three sectors have varied, and the comment must be made that in the case of both wine and kiwifruit product differentiation and astute marketing in the face of increased global supplies has been a major factor in the success of these two sectors.

In summary, there is a large diversity in the marketing structures and their evolution in response to deregulation. The successful evolvers have been the dairy and kiwifruit sectors; the disasters have been the meat and apple sectors; the wool and wine sectors have really stood on the sidelines. Is it a coincidence that the dairy sector in particular has the successful industries following deregulation?[18] Perhaps, but then wine has been very successful as well, and, conversely, the sheep meat industry went through the largest structural changes at both the farm and off-farm levels.

4.3 The New Zealand agricultural experience: overall conclusions

New Zealand's export profile has changed since 1960. How much of this can be attributed to the reforms of the mid-1980s is of course a moot point, as many of the changes were already in movement at that time. Dairy has not regained ground since the 1960s, but of course this is partly due to the increase in non-traditional exports. Wool has been on a steady decline to obscurity as the world price has declined, but otherwise there has been little change from 1992 in the meat, fruit and vegetables, fish, forestry and aluminium export shares. This reaffirms that much of the response to the reforms had been competed by 1992, and more recent changes (not withstanding lag responses) have been from global market returns as agriculture has actually maintained its overall share in New

[17] A feature of New Zealand's agriculture around this period was that the domestication of red deer is perhaps the most successful domestication of a feral animal since at least biblical times, and the development of the kiwifruit industry is similarly the outstanding global example of the development and marketing of a fruit product from close to a new product.

[18] The dairy sector really benefited from several factors. The first was that as it had few if any direct production supports leading through to the reform process it consequently had fewer adjustment pains. The second is that new entrants into dairying were able to benefit from lower overall land prices on former sheep farmers that facilitated the conversion process to dairy farms, while the third is that dairy products benefited from better market access to global markets secured as a result of the GATT/WTO Uruguay Round Agreement on Agriculture outcome.

Zealand's exports.

We would agree with the New Zealand Institute of Economic Research (NZIER 2004) in that a number of lessons can be learnt from the New Zealand experience. Crucially, farmers have the scope and ability to make changes in reaction to the reduction in assistance, therefore raising business profitability above what it would have been had such a reaction not occurred. Importantly, they do not bear all the adjustment costs, as they do not face perfectly inelastic supply or demand curves with the result that the burden of adjustment is shared across the markets. Given time, profits recover from the initial shock as asset prices adjust to lower product prices, outputs change and demand grows: resources will be redirected towards those products with comparative advantage. Macroeconomic stability plays an important role in re-establishing agricultural profitability, but adoption and innovation in the sector are by far the most important factors in re-invigorating the sector post-reform.

In a speech to Federated Farmers, Alan Bollard, the Governor of the Reserve Bank of New Zealand[19], examined the new relationships between agriculture, monetary policy and the New Zealand economy. Against expectations, the role of the agricultural sector has increased in recent years, with much of this being due to the enhanced technological change that a market approach has brought to the sector and global 'shocks' in recent years that have been benign to New Zealand. These shocks have included the foot-and-mouth outbreak in Europe increasing sheep meat prices and North American mad cow outbreaks increasing demand for Australasian beef in Japan at a time when Australian droughts reduced beef exports from that country. In particular, farmers have learned to become more sophisticated in handling volatility, and this has in turn increased the demand for farmland to the extent that agricultural lending now represents around one-third of all registered bank lending to the corporate sector in New Zealand. In a true central banker fashion, the Governor warns against the downside of this exposure for both bankers and their clients, but he does temper this by concluding that the sector is in a much better position to handle the looming 'rebalancing' than it was 'in the turbulent 1980s'.

But perhaps we should give the final word to farmers themselves. Federated Farmers of New Zealand (2005) report on 'Life after Subsidies'[20] is a glowing testament to an agricultural sector operating in the absence of subsidies and urges international reform with a missionary zeal. They glorify the better life after subsidies, stress the productivity growth that exposure to market forces has dictated and relish being 'more in charge of their own destiny'.

4.4 Border trade policy

The basic economic principle underlying the reduction of border tariffs in New Zealand was to reduce the cost excess imposed by these tariffs on the exporting sector. It was generally considered that as the supports were removed from agriculture the reduction of this cost excess plus the conversion to a floating exchange rate would broadly act to compensate farmers given the overwhelming profile of agriculture in exports. On the second part this supposition was wrong, as the exchange rate appreciated rather than depreciated. On the first the issue become one of timing more than anything; the tariffs on inputs were removed but over a much more leisurely time path than agricultural subsidies were removed.

From 1990 most tariffs were gradually reduced following a series of tariff reviews, and in

[19] Bollard, 2006
[20] This short note is not to be confused with Sandrey and Reynolds, *Farming Without Subsidies*.

September 1998 the government announced a phasing plan to remove most tariffs by July 2001 and all tariffs by 2006. This was subsequently rescinded and replaced by a freeze by the labour-led government and instead the tariff became the subject of another review in 2003.

By 2003 95 percent of global imports by value enter New Zealand duty free, either because the Most Favoured Nation (MFN) tariff is set at zero, because of preferential tariff arrangements with Australia and other FTA partners, Pacific Island countries and Less Developed countries, or because they fall under the tariff concession system in Part II of the New Zealand Tariff[21]. The actual applied tariff rates on protected sectors in New Zealand are typically in the region of 5-7 percent. Certain sectors, however, receive higher protection; for example, most clothing, and footwear items at 2003 faced a 19 percent tariff (or more when "specific" tariffs, expressed in dollar terms per garment, are applied to low-cost clothing).

The outcome of the New Zealand Government's review of tariffs for post-2005 was announced on 30 September 2003. Under the review's decisions, New Zealand's few remaining applied tariff rates will reduce following the programme as set out in Table 1. Not shown in the table is that at 2003 around two-thirds of the entire tariff collection was from the sensitive textile-clothing-footwear (TCF) sectors, and around 75 percent of these TCF sector import were from China. Thus, over half of the entire tariff take was from Chinese TCF imports, and any FTA agreement with China on TCF will effectively dictate the future of the entire tariff policy as these concessions may be made available to a wider import source thus neutering the entire schedule and complete duty-free access is only a short step away from completing the long road to the post-2009 point..

Table 1; New Zealand's current tariff rate pathway.

2003 tariff	July 2006	July 2007	July 2008	July 2009
17-19%	17%	15%	12.5%	10%
10-12.5%	10%	7.5%	5%	5%
5-7.5%	5-7.5%	5-7.5%	5%	5%

Source: Ministry of Economic Development

5 The lessons and the future

New Zealand today is a different place from the early 1980s, but whether it is a better place is still argued by many. That something had to be done is generally accepted by most (but again not all). The adjustment costs cannot be ignored, although impossible to calculate. Did the means justify the ends? That is the question as Shakespeare would muse. There is no question that the recent improvements to the economy detailed below were achieved at a cost during the late 1980s and early 1990s period. But of course the counterfactual remains conjecture.

Export composition and destinations have changed. For destinations the reliance upon the United Kingdom has gone, but the EU is still the destination for 15.5 percent of the exports. Australia has been stable at around 20 percent, up from 12.6 percent during 1980, while the US has been

[21] Part Two of the New Zealand Tariff Schedule is a very thick and imposing document that lists at the extremely detailed level exemptions to the general tariff (Part One of the Schedule) whereby goods can be imported duty free. Initially it was a way of reducing import costs for export-oriented sectors but over time it moved increasingly into providing duty-free access for products not made in New Zealand and therefore accentuating the basic (Part One) schedule as a means of protecting domestic industries. Reformers saw it as a means of slowly gnawing away at tariff protection.

consistent at around 13 percent in 1980, 1990 and 2006. Asia remains important, although there have been some destination switches around the region with China in particular becoming more important (5.7% in 2006). By product agriculture still accounts for around 53 percent of the exports, but there have been product switches in the sector. Wool, at 18.1 percent in 1980 and a lower 8.7 percent in 1990 has continued this slide to 2.5 percent in 2006. Dairy has gained; from 15.9 percent in 1980 to 20.6 percent in 2006, while meat declined from its 1980 level of 23 percent to a more stable 15 percent for 1990 and 2006. Despite its early promise forestry has stabilised at a consistent 9 percent for the periods examined, and fisheries products has run into supply constraints at around 4 percent of the exports. When one considers the rise of tourism, if tourism exports or foreigners coming to New Zealand are exports of natural scenery, then the dependence upon the land-based natural resources for exports remains paramount.

Nearly a quarter of a century after New Zealand's trade reforms designed in part to shift dependence away from agricultural exports there is a certain irony in seeing the Secretary of the Treasury recently considering that[22] 'Meeting the challenges of globalisation will require a greater transformation of New Zealand's primary commodities to create new higher value-added goods and services that are branded and marketed in more complex and sophisticated ways. The primary sector is the only one in New Zealand that has all of the crucial attributes required to do this - including cost and quality competitiveness, international scale, an extensive science base and established channels to market.' Quite, and such a pity that dairy products, New Zealand's real competitively produced export, faces one of the most highly protected global markets. However, having said that, the aggregate export data on dairy above hides the significant diversification to over 1,000 products derived from milk and being exported to 26 countries that take at least 1 percent of the total and another 11 taking from 0.5 percent to 1 percent. This is a remarkable achievement and probably a diversification equalled by few from a single simple product.

5.1 **The Economy of New Zealand: an overview**[23]

After a period of weak growth during the late 1980s, New Zealand's economic performance improved significantly during the 1990s. From mid-1991, the economy grew strongly with particularly strong output from 1993 to 1996, with annual average growth in real GDP peaking at 6.8 percent in June 1994. Growth slowed during 1997 and 1998, performed strongly again post this period. Over 2002 to 2004 growth in GDP was generally in the 3.5 percent to 4.5 percent range, but recent rates have dropped below 2 percent.

The main sources of recent growth have been household spending and business investment as the demand for imports associated with a strong domestic economy, together with relatively weak export growth, has resulted in net exports subtracting from growth. Given the balance of domestically-oriented spending and export revenue, as well as strong profits by foreign-owned companies, the annual current account deficit is expected to increase from its September 2005 level of 8.5 percent of GDP. The combined influences of New Zealand's strong banking system, sound fiscal position and floating exchange rate, together with the role of foreign direct investment in building up external liabilities, mean that concerns about the size of the current account deficit need to be kept in perspective.

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[22] 26 July 2006, John Whitehead, Secretary to the Treasury, Simpson Grierson Policy Maker Seminar Series, Wellington. http://www.treasury.govt.nz/speeches/beyond2010/

[23] This section is drawn from the New Zealand Treasury website ate www.treasury.govt.nz

Following a prolonged period of fiscal deficits, New Zealand achieved surpluses in 1993/94 and has remained in surplus since. Net debt has fallen from 49 percent of GDP in 1992/93 to 7.1 percent in 2004/05.

New Zealand experienced a substantial improvement in inflation performance during the 1990s relative to previous decades. Annual inflation as measured by the CPI remained below 3 percent from the September 1991 quarter through to the June 2000 quarter, but declined to 1.5 percent on an annual basis in the year to June 2003 and remained close to that rate until June 2004 when it increased to 2.4%. It has been marginally over 3 percent for most of the period since then. The unemployment rate has also continued to decline, from around the 6 percent to 8 percent range in the late 1990s, to 3.4 percent in September 2005, the lowest level in 17 years.

End comment

In the introduction section to this paper a brief mention was made that the reform process included reforms to the welfare system itself. While the basic concept of a welfare state remained, many of these reforms were quite important and resulted from a fundamental first-principles look at what was required from a modern welfare system rather than adopting a piece-meal approach to reforms. The availability of a strong welfare 'safety net' did much to mitigate the financial pain for those suffering through features such as a job loss during the reforms, but of course other aspects such as the financial costs and social stigma of accepting a lower life-style remained.,

The fundamental point in raising this issue is not to get into discussing the reforms in detail but rather emphasis that this is very much a difference between New Zealand and South Africa. Those losing a job in New Zealand were largely able to get on with their lives, albeit a different and perhaps not as rewarding a life that may entail living on a social grant for an extended period. Conversely, in South Africa there is really no 'safety net' as is taken for grated in New Zealand and other western countries. Therefore the human cost can be much more severe. And while on this topic it is honest to acknowledge that possibly the reform process may have hurt the lower income persons disproportionately, and that in turn the indigenous Maori and Pacific Island persons are in turn disproportionately represented in this segment of New Zealand's society.

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