Research Monograph 68

NEW ZEALAND'S TRADE POLICY ODYSSEY

OTTAWA, VIA MARRAKECH, AND ON

BY CHRIS NIXON & JOHN YEABSLEY

n·z·i·e·r

The New Zealand Institute of Economic Research (NZIER), based in Wellington, was founded in 1958 as a non-profit making trust to provide economic research and consultancy services.

The Institute is best known for its long-established *Quarterly Survey of Business Opinion* and forecasting publications, including *Quarterly Predictions*.

The Institute undertakes a wide range of consultancy activities for government and private organisations. NZIER earns most of its income from research contracts obtained in a competitive market and trades on its reputation for delivering quality analysis in the right form, and at the right time, for its clients.

New Zealand's Trade Policy Odyssey

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Chris Nixon and John Yeabsley

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Preface

The New Zealand Institute of Economic Research (NZIER), based in Wellington, was founded in 1958 as a non-profit-making trust to carry out economic research and provide consultancy services. Best known for its long-established *Quarterly Survey of Business Opinion* and forecasting publication, *Quarterly Predictions*, the Institute also undertakes a wide range of consultancy activities for government and private organisations.

The original aim of producing a substantial quantity of 'public good' research about the New Zealand economy has become increasingly difficult over the years as sources of funds for such work have become scarcer. But the Foundation for Research, Science & Technology has been a useful sponsor for this type of work in recent times.

The work underpinning this monograph was supported over multiple years by the Foundation, and included a range of other contributions examining the broad sweep of issues associated with New Zealand's trading future. This work involved collaboration with a wide diversity of New Zealand economists, including people associated with the universities of Auckland, Massey, Victoria and Lincoln.

In addition, analysts with diverse affiliations have been involved in the whole project, and there has been regular consultation with users and potential in special seminars and general conference presentations. This open style reflects the way we see the Institute's commitment to public good work being carried through in the modern environment.

The authors of this study have been able to draw on this wider range of research where appropriate, and all of the earlier material is publicly available in a special working paper series published by NZIER—the Trade Policy Consortium Working Paper series.

The monograph itself has an intriguing topic. It investigates the circumstances surrounding one particular aspect of the nation's economic future: the possibility of a small country influencing the international trading environment to further its own interest.

There is a strong tradition of public (including political) comment, and even analysis, of the progress of international trade policy, in New Zealand. As New Zealanders, we consider ourselves well informed, and even knowledgeable about key aspects of the trading world. Past New Zealand successes—such as the Luxembourg protocol—are justly celebrated. But there is limited thoughtful discussion of the way the process actually works.

This study sets out to remedy that lack, at least in part. The authors have not only developed a simple model to consider how the process operates, they have also 'calibrated' their thinking by examining a series of important previous episodes. Where these are recent (as in four out of the five cases under discussion), the various written records used as sources have been supplemented by interviews with people who were involved with the episodes concerned.

The upshot is a combination of an analytical framework and practical knowledge and understanding of the realities of international negotiations (both the authors have worked in the New Zealand government for agencies concerned with aspects of international relations). This combination is applied to work through the selected episodes to produce a series of findings, that range from the expected to the more surprising.

But the world is never still. Developments such as the rise of non-government organisations (NGOs) as important international pressure groups are continually shifting the environment. Bringing the findings to bear on the 'new world' that New Zealand's negotiators and trade relations specialists now face is the final focus of this study.

The authors have been careful in developing a picture of the place of New Zealand in this new world, which is robust and sensible. This gives the results a real feel for the practical end of implementation.

Alex Sundakov

Director

NZIER, November 2002

Foreword

"Trade policy is the stuff of domestic politics"
Spero and Hart.[1]

The preparation involved in this study has vastly exceeded our early estimates. When we designed the original project, in 1998, we thought we would have the raw material for the study complete, and be well into the consolidation, analysis and writing by the turn of the millennium. But, like many pieces of original empirical research, the need to gather further material, and to understand carefully all aspects of the crucial episodes that lie at the heart of the work, took longer than initially anticipated.

Nonetheless, the subject of the study is as relevant now, as it seemed to be in 1998. New Zealand is a country whose high levels of prosperity over the last 140 years or so have been tightly connected with being part of an international trading community. Early on in that period the connection was with whomever would take our timber and gold at best prices, and strong and logical transport and migratory links with Australia, California and other parts of the Pacific Rim were established.

Then, when times became harder in the 1920s and 30s, the British Commonwealth (or Empire, as it was seen at the time) absorbed our exports of butter, cheese, meat and wool. Later the critical economic environment was an international agricultural trading system, supplemented by the rising importance of the special arrangement with Australia that goes beyond trade in physical products.

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[1] See JE Spero and JA Hart (1997) *The politics of international economic relations*, Routledge, London.

Today, we are poised to go, ..?

Whatever the critical characteristics of the new millennium's trading future for New Zealand, we will have to ensure we are getting the best results we can within this setting. This study tries to look at where we are, in terms of a clear-eyed stocktake of the episodes in the past that have represented our real challenges. This gives a picture of where we have come from. We need to understand the strengths and weaknesses of our systems in the past, as a short cut to thinking about how to employ our resources in the future.

The approach in this piece of analysis is to look closely at a series of historical episodes as a guide to the performance of the system, and so as to consider the underlying characteristics and capability of the New Zealand trade policy mechanisms. By applying a simple model and careful sifting of the elements of these episodes, we have come up with a series of vital factors that we think are important explanations of the results New Zealand has previously achieved. We then proceed to consider the extent to which these will serve us as well in the future—in the light of the likely evolution of the trading environment we face.

The prognosis is not as bright as some might expect; on the other hand, New Zealand has strong prospects if we are clear about our real national interests and are prepared to take them seriously and back them with commitment.

We are not professional historians, and this work is not intended to be a thorough history; nor is it a piece of new economic theory. It is focused on using the available technical methods to examine the question of the conduct of trade relations in a particular case—that of New Zealand. We will be particularly pleased if it brings to a wider audience some realistic flavour of the usually complex, and often arcane, world of international trade relations, as seen by the practitioners through the years.

THANKS

In preparing this volume we, like all those whose scholarship is informed by the efforts of those who preceded them, must pay tribute to the efforts of earlier writers and commentators. We also want to thank those 'old hands' who gave up their time to discuss their recollections and insights with us, and our informants, often over pretty frugal lunches. All of them were unfailingly helpful and contributed to our better understanding of the issues discussed here.

Second-hand information is not as fresh, nor as vivid as the immediate experience, but we were privileged to be allowed to share the recollections of some important moments with those who experienced them first-hand, and hope the richness and subtlety of their material is adequately reflected here.

In particular, we must thank: Alistair Bisley, Chris Carson, Tim Groser, Roger Kerr, Yvonne Lucas, John Martin, Richard Nottage, Merwyn Norrish, Terrence O'Brien, Alan Oxley, Mike Robson, Graham Scott, Malcolm Templeton, Gerard Thompson, Maarten Wevers, and Ted Woodfield.

We also need to thank several of our wider collaborators in the project who assisted us in coming to grips with the realities of the subject. These include, Allan Rae, and Stuart MacMillan (who carried out a number of fascinating interviews and made the results available to us), and in particular, our now colleague, Ralph Lattimore, who discussed the whole project extensively, and was always helpful, enthusiastic and rigorous.

None of those named, of course, can be held responsible for mistakes of fact analysis or presentation; such oversights remain the responsibility of the named authors.

Chris Nixon *John Yeabsley*

November 2002

CONTENTS

Preface iv

Foreword v

Future vi

Thanks vii

Part One 1

In brief—the approach and key thoughts 2

Trade policy—the role of consensus 2

Economic coherency and structure 7

Policy takers 10

Policy traders 13

Focus on a narrow range of issues 15

Capacity building 16

Trade policy—how it works 23

Approach used 23

The setting—world trade 27

The political economy of trade 27

Small state trade policy 32

Defining a small state 32

The impact and importance of trade 38

Significance of borders 40

New Zealand trade 41

Dynamic nature of trade and trade policy 47

Conclusion 70

Policy questions and implications 75

Part Two 79

Five case studies 80

Case I: The Ottawa connection 83
Introduction 83
Toward a solution—the Ottawa Conference 88
Conclusion 103

Case II: Britain and Europe 105
Introduction 105
The process of Britain joining the EEC 109
Conclusion 125

Case III: Trans-Tasman trade 127
Introduction 127
NAFTA 131
Closer Economic Relations 136
Conclusion 150

Case IV: GATT\WTO and the Cairns Group 153
Introduction 153
The trade liberalisation process 163
Summary of early GATT rounds 164
The Uruguay Round 170
Conclusion 188

Case V: APEC 192
Introduction 192
APEC: 1989–? 197
Conclusion 207

And lying ahead? 209
Critical factors 209
Key changes in the policy environment and their impact on New Zealand 214
Policy questions and challenges 226

References 229

Index 236

FIGURES

Figure 1 Stylised 'distribution' of trade policy research effort and New Zealand interests 18
Figure 2 Elements of successful capacity building 20
Figure 3 Proposed framework for the trade policy analysis 25
Figure 4 Stylised impact of deregulation: the political economy problem 28
Figure 5 Habeeb's framework for the balance of power in international negotiations 35
Figure 6 An illustration of commitment: "burning one's bridges" 36
Figure 7 Export prices 85
Figure 8 A comparison of exports from New Zealand and Argentina to Britain 98
Figure 9 A comparison of imports to New Zealand and Argentina of British goods 100
Figure 10 Trend in prices received by New Zealand farmers for milk solids since 1958 124
Figure 11 Total manufacturing hours worked 148
Figure 12 Why big countries find freer trade difficult 160

TABLES

Table 1 Trade policy events examined: the importance of consensus ... 8
Table 2 Composition of GDP ... 42
Table 3 Changing nature of exports ... 44
Table 4 Changing nature of imports ... 45
Table 5 Changing nature of export destinations ... 46
Table 6 Changing nature of import sources ... 47
Table 7 Global integration ... 55
Table 8 Cost of air transportation, telephone calls & computer price deflator ... 56
Table 9 Income and distance elasticities ... 62
Table 10 New Zealand's export distribution in different markets ... 64
Table 11 Openness ratio 1965 and 1990 ... 65
Table 12 Relationship between consumption of primary commodities and incomes, 1989–90 ... 66
Table 13 Composition of world trade, 1965-90 ... 67
Table 14 Trade export destinations ... 84
Table 15 Export prices ... 86
Table 16 Farming costs ... 87
Table 17 UK share of New Zealand exports of major products ... 108
Table 18 New Zealand exports and imports destination and origin ... 109
Table 19 New Zealand's relationship with the Six, the European Commission and Britain ... 116
Table 20 UK: New Zealand dairy and meat exports ... 123
Table 21 The New Zealand and Australian economies ... 127
Table 22 Trade with Australia: imports and exports ... 128
Table 23 NAFTA to CER: major destinations of New Zealand exports ... 149
Table 24: GATT/WTO rounds ... 165
Table 25 Average manufacturing tariff ... 167
Table 26 Cairns Group: selected statistics for 1986 ... 177
Tables 27/28 Strength through diversity: the Cairns Group ... 182/183
Table 29 Significance of APEC countries ... 194
Table 30 PGSF projects with trade policy, 1995–2001 ... 223

Part One

We recognise that the potential readership of this work is diverse. We have therefore organised the material in the following manner to allow people with different interests to focus on their own particular concerns.

Part One is a self-contained exposition of the ideas in the book, with an emphasis on the analytical side. The higher level results and implications of the examination of the episodes are also included, as appropriate.

Part Two contains a detailed exposition of the selected episodes with discussion of the implications of each within a common framework. It concludes with a careful discussion of the future implications of the findings, which draws on a simple picture of the likely evolution of the domestic and international scene, as they affect the trade negotiations process.

So this first section is aimed at providing both an analytical foundation and an overview of the empirical work. It could be seen as a 'quick read' for those who are less interested in the more expanded discussion.

In brief—the approach and key thoughts

Unless New Zealanders would prefer to have a vastly lower standard of living, international trade is a necessary part of their environment. If trade is a given, then the next question is, how does a small, open economy on the edge of the world conduct its trade, and particularly its trade policy, in an efficient and effective manner? This question is addressed in this study.

The method of the project has been to approach the question through the analysis of past New Zealand trade policy experience, in this case the five case studies, considered in significant detail in *Part Two*. From these we have drawn out the important findings with continuing relevance. We have then gone on to look at the way the trade policy world is changing, and how these changes might affect the future implications of the historical findings.

We hope that the consideration of the resulting conclusions, at a broad strategic level, will enable New Zealand policy makers to identify the elements required in the design of the most appropriate and efficient trade policy system for the future needs of New Zealand.

TRADE POLICY—THE ROLE OF CONSENSUS

All successful long-term trade policy must rest on some degree of consensus[2]—both domestically and internationally. A trade policy that does not have at least tacit support from a significant proportion of both domestic and international stakeholders, is unlikely to be sustainable. And, the impact of a lack of consensus, through the heat of debate and the costs of shifts in policy and implementation, can be disruptive of future policy options.

[2] We use the word consensus in a less traditional technical meaning—in particular we do not insist on complete absence of any dissenting voices. In our usage the word denotes the existence of a favourable climate of opinion, sufficiently widespread and broadly based to suppress any realistic prospect of meaningful political dissent.

Trade agreements that are prescriptive and do not take into account the need for domestic or international consensus are likely to be at best difficult, and at worst, disastrous. The content of such an international agreement is usually a balancing act. It must steer a path between the (possibly narrow) aspirations and understandings generated domestically, including specifically the costs of the policy (which may fall differentially on different groups over time), and the complex structure of international realities. What matters for the internal audience may have no relevance to the key international negotiators at all. And to the domestic interest groups, the more costly demands of foreigners are merely things to be dealt with by effective diplomacy.

In passing, it is ironic that the importance of domestic opinion—and the international treatment of the inevitable sectional domestic reactions to trans-national proposals—depends on the economic power of the country.[3]

Domestic consensus

As a small country New Zealand has an advantage, relative to many countries, because it has been relatively easy to form a consensus on trade policy, particularly agricultural trade policy. Between 1880 and 1994, for example, there was a largely unquestioned acceptance by New Zealanders, of the overall worth of achieving sufficient liberalisation of international agricultural trade to allow more local produce to enter lucrative markets, despite the likely 'price' we may have to pay to achieve it.

This made forming a consensus on trade strategy a relatively straightforward affair; both in deciding that agricultural products were to be the focus, and that access to selected foreign markets was the priority. In specific instances, we note that New Zealanders were prepared to wear the very real costs of achievement. So the country seems to have been solidly behind confirming

[3] Bigger international players are, by definition, more able to foist their views on others; thus, they can force other economies to bear the consequences of their own domestic political structure and associated problems of consensus. See the subsequent discussion on small country issues, following.

New Zealand's priority access to the British market in 1932 (the Ottawa Conference) and in 1973 (UK accession into Europe), and further agricultural trade liberalisation in 1994 (the signing of the Uruguay Round).

However, in areas where trade policy issues moved away from agricultural liberalisation (where New Zealand makes clear economic gains, and so can weather a measure of economic costs, if necessary), the New Zealand public seem to have been unprepared to accept the case without receiving additional information to be convinced about the real worth of liberalisation. In these situations, the government embarked on extensive media campaigns, with public meetings and a publishing programme to highlight why the proposals were worth doing for New Zealand.

The most important example examined here is the process by which CER was agreed to, and then signed. Despite strong opposition from certain groups, including the bulk of the manufacturers, the New Zealand public seem to have favoured signing the CER agreement. In fact, without overwhelming public support the then Prime Minister, RD Muldoon, would never have contemplated such an agreement. Similarly, the hosting of the Auckland APEC meeting was also preceded by a substantial government effort to explain the importance of APEC and its deliberations to New Zealand. Again, despite protests from some media and academic commentators, very little opposition emerged as the event unfolded.

But this position is changing.

Perceptions of what it is worth 'paying' to achieve some form of trade liberalisation seem to have been shifting over the last 20 years or so. At the height of the reforms of the 1980s, unilateral liberalisation (by abandoning import licensing and lowering tariffs, autonomously) was seen as part of the process. It was disassociated from any moves to encourage others to yield their markets to New Zealand produce, except by the saintly example we were setting. But as the optimistic mood of those days has receded, sharper questions about the costs of New Zealand liberalisation have been asked by pressure groups, who might suffer at least initial impacts from the process.

An emerging example is the way that the prospect of a free trade agreement with the US has been discussed. It is clear that New Zealand would prefer that it cover all sectors, including particularly the dairy industry. But some commentators have even wondered whether in that form it is a good idea at all. Others suggest we should be more realistic, and be ready to sign up for a (more achievable) truncated deal that excludes dairy (or even the whole of agriculture), and thus experience no substantial pressure from the Americans to change other aspects of our policy (such as dropping our nuclear free status, or moving away from permitting parallel imports) that they may demand as a *quid pro quo*. The issue of price is therefore on the table.

So, ironically, to become more successfully outwardly focused, New Zealand trade policy makers will have to become more inwardly aware. Most New Zealand trade resources have traditionally gone into building networks of like-minded countries, and into understanding the realities of relevant trade issues outside of New Zealand. As technology changes, through resources such as the internet, people have more access to information. Easy access to information has increased the range of opinions and opinion leaders. This is despite the fact that the quality of information used in the debates is often questionable, and at worst deliberate misinformation. In this, New Zealand is doing no more than reflect the changing shape of such debates around the world, of course.

The lessons of the past suggest that forming and shaping a domestic consensus is a resource intensive process. For example, the CER and APEC 'hearts and minds' public campaigns, were expensive processes—especially in terms of the scarce high quality public servant and politician resources dedicated to them—and will not likely be repeated for every major trade initiative. Responding to new challenges in tight fiscal times means New Zealand governments must be innovative in their domestic trade policy presentations.

To get across the continued relevance of trade policy effort, the New Zealand government will have to look increasingly to resources wider than those of the state sector. It will possibly have to facilitate opportunities for opinion leaders in the community (including perhaps academics, commentators, consultants, NGO representatives, and business people) to be sufficiently informed and eager to engage in public discussion about the potential costs and benefits of further trade reform.

Because there has previously been little need to engage those outside government to develop an ongoing domestic trade policy consensus, there has been little systematic attention paid to the process. Its dynamics have been particularly neglected. This has tended to point straight toward the traditional New Zealand coping strategy—if it's not broken, don't fix it.

The rare occasions when government effort has been engaged, have been one-off events with the actual process design being effectively ad hoc. Looking forward, it is likely that the government will have to engage consciously in the task of ensuring more continuous discussion of trade policy and involve a wider group, to create or discover the shape of the new consensus. This will not be an easy task, since the government has traditionally seen trade policy as its own domain—inhabited by 'insider' specialists—while others, who had an incentive and the ability to become engaged, have tended to 'free ride' on the benefits of freer trade.

Consensus outside New Zealand

The international consensus is dependent upon the particular trade policy issues being negotiated. In the five trade policy 'events' analysed in this piece, the international consensus varied depending on the situation.

For example:

- At the Ottawa Conference, New Zealand played on its loyalty to Britain to sustain its access to the UK market. Over the short and medium term, this strategy, and the accompanying tactics used, maintained New Zealand's position in the market in Britain, essentially at the expense of Latin American producers.

- In the CER negotiation, New Zealand had little choice but to go along with Australian requests to completely review the existing trading relationship, which was running out of steam. Despite this, the actual agreement secured was one that New Zealand played a vital role in shaping, particularly in regard to open regionalism.
- In the Uruguay Round, New Zealand gained 'traction' by joining a group of unsubsidised agricultural exporters to organise and maintain pressure on the EU and the US. By joining a single issue group (the Cairns Group), New Zealand was able to strengthen its influence on the agricultural negotiations.

Table 1, on the next page, shows the level of domestic and international consensus required for the various case studies.

ECONOMIC COHERENCY AND STRUCTURE

Despite the importance of these two types of consensus, they are only necessary conditions for a long-term sustainable agreement; they are not, in themselves, sufficient conditions. Trade policy history is littered with agreements that have been made, and are universally agreed upon, but do not endure because they are economically unsustainable.

So while consensus is important, over the long run any agreement has to be economically sound. This is particularly so for a small nation with limited resources and an inability to sustain protection over a long period of time.

For example, the Ottawa Conference gave preferential treatment to New Zealand meat, dairy and fruit in the British market. Preferential treatment came to an end because of the British desire to integrate its trade better with the rest of Europe—their most important market. Despite New Zealand's loyalty to Britain, over the long run New Zealand's position could not be maintained because it made economic sense for Britain to forge closer ties with Europe (by joining the then EEC).

Table 1 Trade policy events examined: the importance of consensus

	Domestic	International
The Ottawa Conference	A domestic consensus already existed. New Zealanders firmly believed in reciprocal preferential trade rights with the British market.	**Empire.** Loyalty to Britain and the development of a foreign and trade policy focused on the UK created an empire based view that gave New Zealand preferential treatment.
Britain's accession to Europe	A domestic consensus already existed. The narrowing market focus meant that all New Zealanders were aware of the importance of the UK market.	**Europe through the UK.** The UK parliament was the focus of New Zealand's effort followed by the British public and press. UK negotiators fought for New Zealand in Europe because they saw that a bad New Zealand result would risk the UK parliament not ratifying Britain's entry.
Closer Economic Relations	Public support was crucial in persuading New Zealand politicians to sign the CER agreement.	**Australia.** The Australians were already convinced that a new agreement had to be signed. The consensus reached agreed upon the structure of that agreement.
Uruguay Round. GATT/ WTO and the Cairns Group	Pre-Uruguay Round a domestic consensus for trade liberalisation was taken for granted. Post-Uruguay Round complexities suggest more resources are required.	**United States and European Union.** The formation of the Cairns Group (freer trading agricultural nations) influenced the final Uruguay Round outcome.
APEC	No ongoing consensus. Would stronger commitments improve chances of consensus? Substantial efforts will be needed to demonstrate to the public the value of trade liberalisation and how APEC will contribute to this process.	**APEC members.** The willingness of Pacific Rim nations to form a consensus on freer trade by 2010/2020 is unclear. Despite agreement in Indonesia, could some less ambitious (sustained) consensus have been possible?

Source: NZIER

While it took nearly 30 years for this to occur for New Zealand, for other Commonwealth nations, with broader, or at least differently aligned trading bases, such as Canada,[4] the economic

[4] Canada's natural trade partner, because of the geography of a long, thinly settled country, was the US. The international economic and trade relations history of the

inconsistencies of the Ottawa Conference unravelled their attachment to the agreement almost immediately.

Comparing the New Zealand Australia Free Trade Agreement (NAFTA[5]) with Closer Economic Relations (CER) highlights the importance of economic consistency within an agreement. NAFTA was a political fix between two nations that were not ready for an economic agreement. So the noble statements made in the preamble to the agreement, about moving towards freer trade, were not carried through in the implementation phase. This nullified the real intent of the agreement.

CER avoided these mistakes by:

- Getting clear agreement between the two Prime Ministers from the beginning about what the intent of the agreement was going to cover. In CER, all disagreements were referenced to the opening statement made by the two Prime Ministers, that is, since the statement clearly stated that everything was on the table for negotiation nothing could be left off—or taken off. NAFTA showed that sectors that were put into the too hard basket and set aside for later negotiations, never were dealt with. In fact, as time went on, opposition in these industries became intractable.
- Stipulating how the agreement was going to be implemented and making sure tariffs cuts were automatic. This protected politicians from the intense 'exceptions-based' lobbying from manufacturers (which occurred under NAFTA) and focused manufacturers on how they could best adapt to the new environment.

Canadian element of this partnership, compared with that of New Zealand, sheds some light on the different influences of the broader ties of empire and history and the power of economic forces.

[5] Note that both the New Zealand Australia Free Trade Agreement and the North American Free Trade Agreement share the same acronym—NAFTA. We use 'NAFTA' to refer to the New Zealand Australia agreement and have expressly stated in the text when we are referring to the North American agreement.

- Creating an open and outwardly focused agreement that could be easily expanded in a seamless fashion to include other nations. This avoided the customs union approach preferred by the Australians, which would have created a common border and tariff levels against products coming from third countries. Such a customs union approach would have made it much more difficult for New Zealand to embark upon its own trade liberalisation policies independent of Australia.

Similarly, comparing the structure of the agricultural agreement in the Uruguay Round to the clothing and textiles agreement highlights the importance of implementation details. While the agricultural agreement is widely regarded as a modest success by reducing tariffs automatically over five years, the clothing and textiles agreement has caused much resentment in developing countries. Most of the tariff reductions in the clothing and textiles sector have been 'back-loaded' to occur in 2004, and there is uncertainty whether these cuts will actually eventuate.

POLICY TAKERS

A small country like New Zealand is effectively an international *policy taker*. One of the misconceptions that New Zealand commentators have is that New Zealand's voice is listened to on the international trade stage because of its recent policy moves which have brought about a deregulated economy. It is thought that New Zealand is able to use the 'moral high ground' thus gained to somehow persuade, browbeat, or otherwise obtain concessions from larger, more powerful nations.

This could not be further from the truth. New Zealand has no real power to set the framework for the international consensus. As a small nation, it has to operate in a trade policy environment set by others.[6] Where New Zealand has excelled is in the focus and

[6] While New Zealand's efforts to deregulate its own economy carry little weight in trade policy negotiations, there are some spin-offs:

commitment that it has applied to the negotiations. Examples of this are provided briefly above. We have earned 'brownie points' for good behaviour on occasion, and notably where New Zealand has helped create conditions for an otherwise unlikely international consensus to occur.

Maintenance of flexibility

Given that New Zealand is a policy taker, how has New Zealand been able to successfully leverage its rather meagre trade policy resources and thereby play a significant role in selected trade policy debates, vital to New Zealand's interests?

Certainly our trade negotiators as a group are not necessarily more able today than those they face across the table.[7] So, is it then one of the alternative explanations:

- the structure they operate in,
- the way things are managed, or
- the resourcing they have available?

In fact, the resources at the disposal of New Zealand diplomats are a lot less than most larger countries. And the structure we have, together with the management exercised, seems sound and purposeful rather than super-competitive. A key negotiating

- A degree of 'credit' is given in some international organisations for efforts to deregulate. The delegates to these organisations are friendly towards New Zealand.
- Playing a straightforward game pays off over the long run, as consistency (and its associated predictability) is useful to counterparties.
- A deregulated economy also helps with strategy and tactics—since the economic and political aims line up in a coherent fashion.

[7] There probably was a time when the relative scarcity of travel opportunities for New Zealanders and the somewhat unfriendly atmosphere non-commerce graduates found in the private sector, meant that the foreign service had its pick of the graduate crop. That is definitely a belief of some substance. But those times have gone. New Zealand graduates, like those of the rest of the developed world, can find their way to the international 'glittering prizes' if they so choose. The Ministry of Foreign Affairs and Trade (MFAT) today provides an interesting career, but not one that crowds out the other options quite so obviously as in the past.

strength, however, for small open economies is the ability to remain flexible and nimble in the negotiation process. The New Zealand history of a strong and maintained domestic consensus about the aims of trade policy allowed our representatives to be opportunistically active during the process. The lack of real threat that our representatives pose to the larger players, allows them to be more provocative and innovative.

The positions of larger countries are typically more complex, with a series of careful balancing acts to achieve relatively unstable domestic consensus. Thus their delegations are inherently less flexible—as the positions are the result of finely crafted and complicated (domestic) compromises. And that weakness is reinforced through the well-resourced 'watching' briefs of the significant domestic lobby groups that actively monitor the process. These lobby groups depend, in part, on the domestic political process for their power and will resist efforts to erode that power via internationalisation of the rules, including through freer trading arrangements.[8]

As a negotiation progresses, negotiators from small countries need to be given flexibility by their home authorities to take advantage of the 'shifting sands' of the negotiation so that they can be effective. This is their natural counter to the genuine economic weight of the bigger international traders.

In this regard, the role for countries such as New Zealand[9] is to:

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[8] For large countries, entering into a trade negotiation is fraught with difficulty. The actual formal negotiations with international colleagues are to an extent a side-show, as the real negotiation is domestic and involves obtaining a workable mandate for trade liberalisation. The US case is an extreme example. To ensure that the results will be able to be implemented the President seeks 'fast track' authority. The rest of Congress play their own games and frequently deny him that power.

[9] New Zealand's economic structure is notable too. As a relatively wealthy agricultural products trader, we have long shared characteristics—and interests—with both developed and developing countries. Being associated with representatives of both groups in the Cairns Group was a natural follow-on from our role as a founder and prime mover of the Group of 77 (originally commodity

- Come up with constructive, innovative ways of breaking the deadlock in any particular negotiation. This includes ways of selling the resulting deal to domestic actors in large countries. New Zealand's role as an 'honest broker' can have useful payoffs as negotiations progress—being useful to the process puts New Zealand negotiators in an influential position.
- Not take unrealistic negotiating positions, or hard line stances to delay final conclusions and their results.
- Target issues that do not directly concern New Zealand and devise possible economically coherent solutions that take into account the wider negotiating constraints. In this way New Zealand negotiators can demonstrate their willingness to be impartial and useful to the process.
- Allow negotiators to learn by their mistakes. To be innovative in negotiations, just as in any other field, requires novel ideas. Sometimes, those ideas do not always produce the results intended. Making mistakes is all part of the innovative process.
- Allow negotiators to 'fly kites' in a negotiation and be useful to the process is of great importance to New Zealand.

POLICY TRADERS

All markets are potentially important

One of the most important design features of the trade policy pursued by New Zealand is the 'open regionalism' approach adopted under the CER agreement. At the heart of the process of open regionalism is the ability to tailor trade relationships with all countries with whom appropriate reciprocal agreements can be reached. Just as trading with many countries can mitigate the risk associated with concentration of markets, New Zealand needs to have trade policy links, however informal, with all countries where gains from trade can be achieved.

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traders, but today an umbrella body for developing countries) in UNCTAD in the 1960s.

This means that open regionalism involves:

- Not participating in exclusive trade deals that give preference to one particular trading regime over another.
- Being willing to do deals with other trading nations—if the structure of the agreement is 'right'.
- Not attaching New Zealand to any particular block of nations—we should not be picking trade policy winners. For example, while trade growth is significant and substantial among the Pacific Rim countries, New Zealand should not overlook opportunities in the rest of the world—we are essentially interested in being traders with the world. Long term there is a risk of neglecting other markets. The supposed 'success' of the 1932 Ottawa Conference, as it was hailed at the time, for example, meant that New Zealand continued to focus its foreign and trade policy virtually exclusively on Britain. By attaching itself more firmly to that single market New Zealand was always in danger of concentrating risk. In fact, we were caught twice. First, when demand growth in that market slowed and our export income thus contracted too, and then subsequently when barriers to entry were applied against us in the post-war era.
- While New Zealand should use every avenue to advance freer trade, the main prize is further liberalisation through the multilateral system. This is where New Zealand can achieve most lasting gains. Aside from the institutional structure issues, which are particularly important to small players, lowering barriers to trade globally increases (real) incomes around the globe, and allows resources to flow to the efficient players: a 'raising all boats' effect.[10]

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[10] This is a salute to US President JF Kennedy's description of the GATT achievements as "a high tide raises all boats".

FOCUS ON A NARROW RANGE OF ISSUES

Small countries have few resources and typically face issues which are 'lumpy'[11] in their demands. Therefore, in search of the best returns, government's international relations resources are usually, but not exclusively, focused on trade and economic matters. This has certainly been the case in New Zealand where trade policy issues have tended to dominate the relationship with other regions. It means that issues within the general trade policy arena have to be prioritised. This is no easy matter.

Some of the questions that need to be asked include:

- Does the outcome directly impact on New Zealand? Those issues that will have a substantial first round effect on New Zealand must take precedence.
- Over what time period will the impact occur? Some trade policy goals and objectives take years to achieve and at differing times require different amounts of resources.
- What is the degree of uncertainty associated with the process? The resource budget needs to be flexible to accommodate unexpected developments.
- Is the issue being approached in a multilateral, plurilateral or bilateral way? All are potentially important and could lead to improved welfare in New Zealand. While the main benefits will come from a multilateral round, bilaterals (that is, involving New Zealand's relationship with Australia, Singapore, and Hong Kong) and plurilaterals (APEC) can be seen as both reinforcing or complementing the multilateral process.
- Can New Zealand realistically expect to influence the outcome of the decision process (usually a negotiation)? If not, then the resources should be directed elsewhere.

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[11] The point is that many international efforts demand a certain minimum commitment of resource to make it worth being associated with the process at all.

CAPACITY BUILDING

The gains from trade policy successes up until the end of the Uruguay Round have been relatively easy to see. The straightforward analysis was: if the high income industrialised nations reduce their agricultural protection in some measurable way (on New Zealand's products) then the New Zealand economy gains.

The stance taken by the government on developing analytical tools to demonstrate the size and distribution of the potential gains was ambivalent. Such an ability was regarded as nice to have rather than central to the execution of the negotiating strategy. It was likely to be expensive and thus there was no emphasis on building up, and maintaining a sophisticated modelling capability.

The government knew—without it having to be proved in theory—that any drop in agricultural support would be good enough for New Zealand to be worth a degree of domestic sacrifice if necessary. If work needed to be done, we could piggyback on work done overseas. For example, arguably the most significant piece of work done to further agricultural liberalisation was started by Tim Josling at the FAO in the 1970s but carried forward through a New Zealand intervention of Prime Minister Muldoon (crafted by seconded Treasury official, Richard Carey). This drove the Multilateral Trade Mandate project (MTM) at the OECD to reach fruition in the late 1980s. The creation of the practical and empirically measurable concept of *producer subsidy equivalent* (PSE) finally allowed practical and meaningful comparisons of the myriad of methods used for agricultural support across various protectionist nations.

This analytical device (in effect a new part of the trade policy 'language') meant that virtually all of the full array of agricultural protective measures could be brought into a common metric. And it was one that was (roughly) comparable with the sort of measures that GATT was used to handling. Once this occurred, traditional trade negotiating and agreement implementing techniques (essentially those built out from the treatment of tariff liberalisation in GATT from the beginning) could be brought to bear[12] on the array of non-tariff devices deployed within the world of agricultural trade barriers.

So agricultural trade was finally able to be 'brought into the system',[13] thereby fulfilling one of New Zealand's long-held ambitions in trade policy. But New Zealand had not initially created the device, and, though we (via Muldoon and Carey) played a critical role in kicking it along, we were effectively an innovation 'follower', in terms of having to absorb and become fluent with the new technical issues and jargon associated with this innovation.

In the post-Uruguay Round world, the questions that policy makers (including those in New Zealand) are now asking have become more issue (and country) specific and less generic or widely applicable. The stylised diagram in Figure 1 (where the vertical axis represents some measure of the effective research effort looking at the issue worldwide, with the horizontal axis being a categorisation of trade issues) is a picture of our increasing isolation from the research and problem-solving mainstream.[14]

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[12] From its earliest days the GATT had been remarkably practical about the degree of technical informality and innovation it was prepared to accept. This might have reflected the pragmatism of its founders and the rather intimate group of nations involved in the initial days. Thus, the whole system of British preferential tariffs, was not only allowed to continue—over the strongly resisting bodies of US negotiators—but was entrenched in the GATT binding lists, or schedules. Similarly, rather weird bindings were accepted, such as a New Zealand one that tied the tariff on a type of lumber to a similar one in the Canadian tariff!

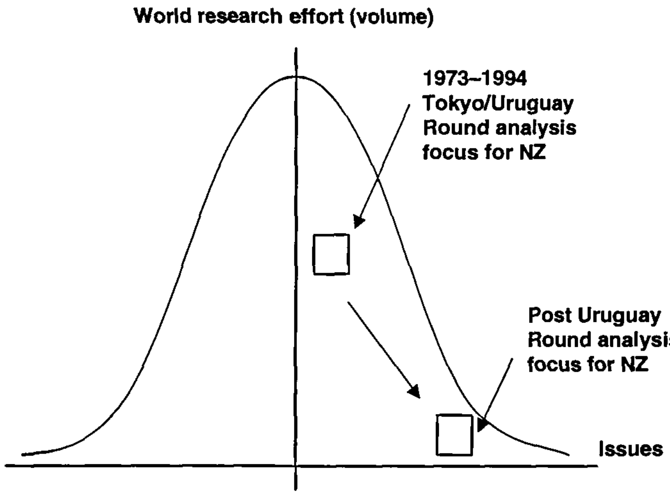
[13] Note that agricultural trade was brought into the system in two ways:

- It was agreed that it would be treated alongside all other products, rather than in a special category, with exceptions to the most important GATT rules (such as the broad ban on quotas), where it had languished since the earliest days of the GATT; and
- Its regulation was to be accomplished in relatively GATT-familiar ways, so the absorption into the existing system would be reasonably complete and 'natural'.

[14] An example is New Zealand's unique position in addressing the Kyoto agreement. No other country has to untangle the combination of issues involved in the situation that we face.

So, in the past, New Zealand policy analysts could often free ride on relevant theoretical/empirical trade research carried out overseas (if any research at all was needed). The questions being asked in New Zealand were either basically the same questions being asked by all countries (represented as the peak in the form of a normal distribution in Figure 1), or were ones where the answers were within the capacity of New Zealand policy researchers to answer.

Figure I Stylised 'distribution' of trade policy research effort and New Zealand interests



Source: NZIER

As we absorb the implications of the Uruguay Round and move on to the next set of liberalisation issues, more complex practical and technical questions arise from the consideration of the policy possibilities now in front of New Zealand. For instance, in the trading world which treated agricultural products in a less than integrated way (with various exceptions to the rest of the rules), New Zealand worked for many years to achieve some validation of its position. An example was the institution of special (New Zealand-specific) tariff quotas to cement in place the results of earlier negotiations.[15] These are technically 'distortions' of the type that the WTO is seeking, in general, to eliminate. But they do offer the supplier country high returns[16] on aspects of its export trade by allowing access to markets with higher than world prices, which are otherwise closed. As universal access for agricultural products at lowering tariffs becomes more widespread, New Zealand may experience some diminution in returns as the quota rents reduce. Analysing the costs and benefits of the total effect is therefore less than straightforward, and is likely to reveal that some possible types or pathways of liberalisation are significantly better for New Zealand than others. So the differentiated potential outcomes associated with the variety of distortions that have emerged over time, means we need the domestic capacity to analyse them, as the results are important to the New Zealand position.

Additionally, as we head towards a new round of world trade talks—following the successful meeting at Doha—the (domestic and international) negotiating trade-offs for New Zealand will be more and more complicated. An obvious result is that the strategic choices should be increasingly strongly influenced by what sophisticated trade models tell us will be the likely results of any particular negotiating stance.

For instance, of particular interest to New Zealand are the detailed dynamics of the various quota arrangements referred to previously. Apart from the importing nation, few other nations are interested in this question. Hence, the rise of more of this type of issue being addressed is a movement away from the generic widely interesting problem base, towards the sort of less generally interesting and particular questions as illustrated in Figure 1. Information about the foreign market implications of the various potential outcomes, as well as the New Zealand results, possibly in terms of economic, environmental and social impacts, may well be

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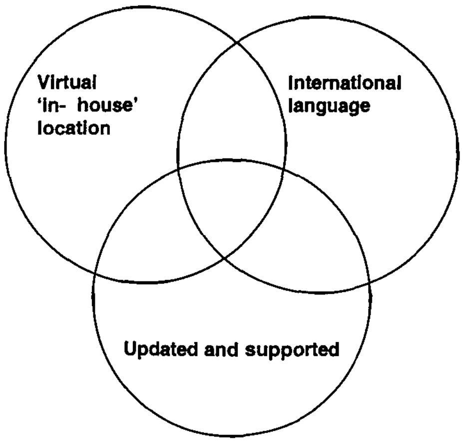
[15] For example, in dairy products to the European market.

[16] These are technically known as 'rents', being the result of trading at above normal prices.

required to properly evaluate the various possible negotiating positions that could be adopted.

So to answer fully the 'what if' questions posed by the pending removal of these quotas requires the use of complicated empirical trade models, since there are a number of different effects potentially arising simultaneously, and these need to be netted out. In order to handle such issues, the models are of necessity complex, and require specialised skills to operate and equally to analyse the results successfully.

Figure 2 Elements of successful capacity building



Source: NZIER

As policy support mechanisms, these models are like the scientific knowledge of a forensic scientist; and as such need to be well maintained, with the researchers continually updating their knowledge of the modelling techniques being applied and the policies being discussed, so that the results can be seen as relevant and defensible. This 'model maintenance' (including staying in touch with international developments to ensure that New Zealand's modelling techniques are not marooned by new advances) requires the ability to build and hold sufficient policy related capacity in order to produce sensible answers in a timely fashion.

What are the elements of successful capacity building?

Figure 2 illustrates the elements of the type of capacity required. These can be discussed on an individual basis.

The model(s) used must:

- Be effectively 'in-house', so that the process of using and understanding the modelling tool itself is as efficient and secure as normal policy development. What this means in practice is that the relationship between the trade policy production process and the modelling resource is sufficiently close that there are no more than the normal bureaucratic risks of misunderstandings or other errors.

  An extremely tight integration between the modellers and the policy developers is required, at a working and responsibility level, to allow them to be comfortable with the results (as well as the detailed structure and technical methods), and so that there can be a clear assessment of the model's supporting grounds for any result. This suggests either a modelling team within the trade policy agency, or a close ongoing working relationship with a respected external contractor.

- Additionally, because trade relationships are inherently national, with the interests of the country at stake, there are often issues of (national) security involved, (and, of course, beyond these realities there are perception issues relating to political credibility). It is likely, for both these reasons, that the national interest requirement will be difficult to satisfy by any modelling contribution that is not on-shore.

- The model(s) used must have credibility internationally, so that the New Zealand trade diplomat/negotiators and their advisors abroad accept that the basic structure, style and operation of the model(s) used is/are sound, or at least difficult to challenge. Thus, in any negotiation, the validity of the methods used to arrive at various results does not become part of the negotiation. It means that (except in those circumstances when no real progress is possible for other reasons) the discussions focus on the issues and inevitably then, on the necessary political trade-offs to reach an agreement. The model(s) must be almost a type of international 'language' where both sides accept the methods used to achieve the results.[17]

- The model(s) used must be updated and supported regularly. This is needed to keep the model(s) real, credible and producing believable results. In practice, the model(s) need to be regularly 're-based', new sectors of interest added, and more sophisticated techniques incorporated to improve the output, efficiency and, critically, the relevance of the model(s).

[17] This was the strength of Josling's work on *PSEs*, cited earlier, so that once given the necessary development effort by the OECD, nudged by New Zealand, it became the de facto international framework for debate.

Trade policy—how it works

APPROACH USED

We have seen that trade policy is an element of the way governments function to improve their economies. But we also noted that small countries have relatively limited ability to influence the way the rest of the world treats them.

So, how does a small country conduct its trade policy?[18] Does it throw in the towel and blame overwhelming political forces from bigger countries for all of its social, political and economic ills?

As a way of thinking about the issues, we have constructed a simple model to demonstrate the relationship between the various stages of the process. This is portrayed in Figure 3, following.

To put some reality onto the bare outline of influences shown in this diagram we have further chosen to look closely at five trade policy 'episodes' which illustrate the development of trade and trade policy in New Zealand over the past eighty years. These events have had a major impact on the lives of ordinary New Zealanders, either directly on incomes (mainly farming incomes) or indirectly through the risk premiums built into interest payments, the reduction in prices on imports or the increased economic activity generated from increased trade. The events considered can be seen as pivotal in our trade policy history. They signal changes in New Zealand's trading environment that have had dramatic impacts on the domestic economy and the well-being of New Zealanders.

The events are:

1. The Ottawa Conference of 1932. It established imperial preference and marked the end of unlimited expansion of unrestricted agricultural exports to Britain.

[18] Some thoughtful discussion of this appears in Duncan, Lattimore and Bollard (1992) pp 23-28.

2. Britain joining the EEC in 1973. In the period between 1961 and 1971 New Zealand negotiated special access to the British market in the post-ECC accession period.
3. The New Zealand Australia Free Trade Agreement (NAFTA) signed in 1965 and the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA and referred to as CER) signed in 1982. These two important trade agreements reflected the maturing of the New Zealand and Australian trade relationship.
4. The Cairns Group and the Uruguay Round (1986–1994). The Uruguay Round was the first serious liberalisation of the agricultural trade rules under the international trading rules initiated through the GATT system in 1948.
5. APEC (1988–). This was the first attempt to bring nations of the Pacific Rim together on a regular basis to discuss liberalisation of trade and associated issues.

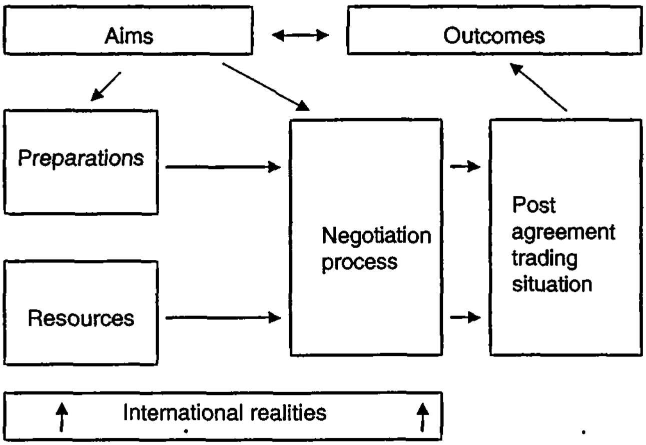
By applying the model to the five trading episodes we hope to capture the essence of the actual negotiations that determined the outcomes. We look at the factors that contributed to the success or otherwise of these negotiations. We look for common themes running through each episode, and more importantly, for portable successful strategies. Can they be practically applied to trade policy situations that we find ourselves in now or in the future?

The design of this analysis has deliberately been kept simple. To do this we have abstracted from the full detail of the trade policy. This analysis should contain just sufficient complexity and reality to allow us to capture and illustrate the advantages and disadvantages of the strategies adopted in each trade policy episode.

Why have we chosen a model framework?

A model portrays a system of relationships which, although abstract, seeks to capture the salient elements of the real world. Any real world problem will have a large number of variables with a large set of, often complex, relationships between them. We wish to draw out the main points of interest without the complications of all the issues. In this way, we hope to gain insight into the problem at hand and advance the solutions for it. The potential cost of this approach, of course, is that the process of abstraction has eliminated characteristics that are vital to the full understanding of the question under discussion.

Figure 3 Proposed framework for the trade policy analysis



Source: NZIER

Figure 3 shows the model used. It concentrates on the interaction between the various elements of the trade policy process. The aims, preparations, and resources are decided on domestically to produce what is planned to be a favourable post negotiation outcome. These initial positions in turn, through reactions by other countries in the negotiation process, produce outcomes over the short and long term. International realities associated with the selected negotiation condition this process, for example, through changes in technology, differing regional growth rates, and the changing composition of world demand.

One of the key elements in the model design is the interaction between aims and preparations and the negotiating process. For example, in the past it has been a straightforward proposition for New Zealand trade policy makers to see the shape of broad domestic agreement on a national negotiating stance. However, the onset of technology has increased the ease by which groups opposed to further trade liberalisation can communicate internationally.

This has, to some extent, broken down part of the broad consensus for trade liberalisation in New Zealand. Therefore, the development of the aims and objectives associated with a negotiating position within New Zealand will take longer to achieve. The partial breaking down of the consensus in New Zealand towards further liberalisation increases the complexity associated with negotiating a trade agreement. This has major ramifications for the interaction between the various parties and is an important part of analysing the success or failure for various trade policy initiatives.

The setting—world trade

THE POLITICAL ECONOMY OF TRADE

The good news

Enormous changes in world trade have occurred since the end of World War II in late 1945. It is often unacknowledged, however, by those focused on the current state of the world that many of these changes were already well developed in the nineteenth century. In particular, the steady growth of technological advances had already had numerous effects, of which we highlight two.

One was the relentless lowering of transport costs which lowered the natural barriers between countries, created by the sheer cost of movement. The other was the increasing emphasis on the importance of economies of scale, which especially provides huge opportunities for those who can harness trans-national markets. It has only been the interruption of two world wars and the Depression of the 1930s that has stunted steady progress towards further world integration as one of the fundamental forces acting throughout the whole of the twentieth century.[19]

Two important points can be made:

- Trade barriers, in general, have been falling since World War II.
- There is a strong connection between trade and economic growth. Furthermore, there is a strong connection between growth and the growth of the poorest section of society (Dollar, 2000).

The bad news

There are various theories that discuss the political economy of trade reform. The formulation of the modern normative framework is usually credited to thoughtful US economist Mancur Olson.[20] He focused on the way high levels of protection facilitate domestic

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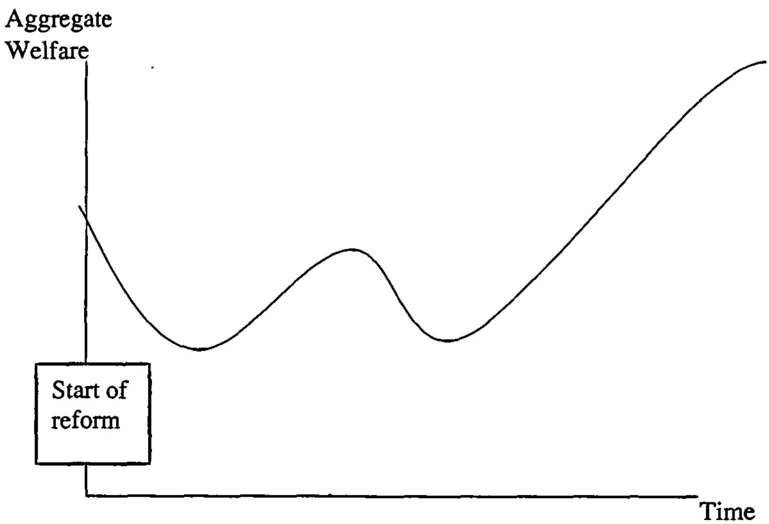
[19] See Williamson (1999).

[20] See Olson (1987).

collective action to distort the sheltered markets and thus enhance inefficiency. The recent focus of the analysis in this area of economics has normally been on 'rent-seeking' behaviour by commercial and non-commercial interests.[21] Despite their rough-hewn assumptions, the predictions of the stylised models have a degree of correlation with real world outcomes.[22]

In this spirit, in Figure 4, we illustrate a simple but profound issue associated with the problems of 'selling' trade liberalisation in a democracy.

Figure 4 Stylised impact of deregulation: the political economy problem



Source: NZIER

[21] Alternative approaches tend to stress more overtly 'political' or 'social' aspects such as 'control' or expectations. Recent international contributions include Went (2000) and James (2000). In New Zealand, various commentators have expressed their doubts, most notably Jane Kelsey in a string of books, such as Kelsey (1993).

[22] Some helpful discussion of the way this school of analysis fits features of the New Zealand setting is contained in Evans and Richardson (1998).

This stylised picture is intended to illustrate that in order to move toward a higher level of welfare it is often necessary for the whole economy to pay a price. In the diagram, while eventually, aggregate welfare increases, there are longish periods when it is decreasing, and for a sustained time the total is below the value achieved before the start of the process. Inevitably, the upshot will be that some members of the society must suffer welfare losses (they may lose their jobs as assembly plants are closed, though the replacement imported products are cheaper). There are many ways this could arise and work its way through. Perhaps, in reality, this occurs through the fall of costs of the necessary changes, or of some investments that are needed to reach the new situation. Frequently too, however, this new situation will not result in a Pareto improvement.[23]

While aggregate welfare may eventually be vastly improved, certain individuals may be worse off, either permanently, or at least for sustained periods. Or it may be that the improvements are just delayed, with resulting uncertainty as well as delay costs. Or, as is frequently the case—and often debated in the literature—the benefits are thinly spread across many citizens while the detriments are more concentrated, falling heavily on a few.

Whatever the cause, or the precise time profile, the argument is a general one: that any policies that cause or are even feared to cause lower level of aggregate welfare for significant groups, will be sternly resisted. And that this resistance will be stronger the more the falls are concentrated, particularly by those who doubt that they will see the positive results of the changes.

Short-term losses in employment make the headlines, but incremental growth in employment numbers do not. Furthermore, the price reductions on consumer items and jobs created are not naturally linked in the public mind with the process of liberalisation. But the results of the reductions in protection in

[23] Named after Italian economist Pareto, this is a high level of test: it requires that no member of society be made worse off as the result of the policy, while at least one is made better off.

New Zealand have been widespread, and have contributed to the standard of living enjoyed today.[24]

Despite these long-term effects, two aspects of the inevitable impacts of liberalisation are likely to persist into the future. These are the distributional effects, and the responsiveness.

The *distributional* effects come about because, as sketched above, a likely impact of liberalisation is that different groups are going to be affected differently within the liberalising country. To the extent that these effects are significant, these groups will experience changes in income. From an aggregate perspective, these can be see as shifts in the distribution of income, from the losers to the gainers. Unless this effect is very transitory it will be discussed politically in such terms. There are signs that this sort of debate is coming to dominate the technical discussions about efficiency and overall welfare gains. As it does, it makes the task of selling liberalisation more difficult.

Moreover, *responsiveness* can be seen as a reflection of the inherent flexibility of modern economies. The structure allows for shifts in the use of resources in reaction to changes in the incentives expected. So a responsive economy can cope effectively and speedily with major shocks because the facilities required to develop new strategies, and the managerial and entrepreneurial nous to assemble the skills and resources to carry them through, are at hand. All economies have a degree of responsiveness that shows up as economies recover from serious shocks. But in terms of political economy, such positive reactions are in the future, and they can be strongly discounted by those who have limited horizons, and by the significantly affected sectional interests. Thus this aspect of trade liberalisation is likely to reinforce the general political economic picture, as discussed above.

There are many reasons why liberalisation is not clearly seen for what it is and what it could do. An important one is that the very concept of liberalisation has become inextricably political. And as

[24] One local discussion of some of these effects is NZIER (1998).

such, it is lumbered with its own version of history. Exaggeration is seemingly inevitable in the political market place,[25] so it is not surprising that the possible gains from liberalisation have been oversold. This has created an atmosphere of sustained disbelief in future claims and driven recent Nobel Prize winner, Joe Stiglitz, to offer a general criticism of the process.[26]

The weakness seems to be a reluctance to trust the public to understand the process, even if it is explained to them in order to overcome their reluctance to give up welfare in the medium term. To achieve this change of view, in the light of the foregoing, would seem to be difficult—the mark of a statesman or stateswoman, perhaps—but it is not impossible. Strong political stands recently have been able to convince the New Zealand electorate—once thought to be the classic example of the weakness of democracy in being thoroughly locked into deficit spending—that surpluses were the defining characteristic of good fiscal management. This has caused many stresses in the body politic, but not overt explicit reaction. In this light, 'reinventing' the liberalisation cause may be a reasonable prospect.[27]

In the long run, countries that wish to remain relatively rich need to move with the changes in their environment. They need to be able to adjust their mix of activities to keep ahead of the shifts in tastes and technologies and management to justify their incomes. This implies constant dynamic change.

[25] This is a version of Gresham's law: in the political market place, bad analysis drives out good.

[26] See Stiglitz (1999).

[27] As these words were being written (early 2002) a group (the Trade Liberalisation Network) has emerged in New Zealand to undertake the task.

Small state trade policy

DEFINING A SMALL STATE

Definitions of a small state abound in the literature. Fauriol (1984), East (1973) and Henderson (1991) are some of the many authors giving reasonable explanations of how to classify a small state.

Each author acknowledges the somewhat arbitrary nature of the process of defining a small state. For example, Fauriol (1984) stresses two important aspects that are significant. Firstly, the resources and power base of states (population, territorial power, military resources) and, secondly, national development issues (GNP per capita, industrialisation, and energy use). Henderson (1991) suggests that any nation under ten million people should be classified as a small state.

East (1973) lists six characteristics of a small state, which we repeat with our own interpretation in places:

- *Low levels of participation in world affairs, as a result of limited material and human resources.* Small states are interested in where they can obtain the 'most bang for their limited bucks'. The question continually asked by their trade policy makers is: if I had one more dollar to spend on trade policy, where would I spend it?[28] Resources (money, material and skilled personnel) are notably scarce. This has a major impact on the ability of a small state to formulate and implement successful foreign policy tactics and strategies.
- *A narrow scope of foreign policy, focusing on regional issues, and matters of direct concern to the small state.* The limited resources of the small state restrict the scope of its realised foreign policy concerns. However, this does not restrict the potential for a small state to have a significant impact on specific issues or particular regional concerns.

[28] Personal communication with a New Zealand trade policy official.

- *An economic focus in foreign policy execution, in order to gain maximum benefit from the limited resources.* The international trading environment is of importance to small states; second only to their survival. Within the bounds of their security concerns, small states recognise that the level of activity in the domestic market of a small state is limited, which means that it is dependent on overseas trade for its economic well-being. Vulnerability of national income to the vagaries of international markets concentrates the minds of foreign policy makers in a small state on economic matters.
- *An emphasis on internationalism, involving participation in regional and international organisations as a means of compensating for the state's limited resources.* This is all about leverage. By grouping together with other states, a small state can seek to make up for its lack of power in the international arena. The use of international institutions, international law, the larger internationally committed resources of other states, and any other international activities are integral parts of a small state's strategy and tactics in achieving its key objectives. In multilateral for a, the enforcement of agreed upon trade 'rules' and the implementation of trade agreements are thus crucially important to small states. Strengthening these rules (while maintaining the adhesion of the larger countries), usually through getting 'agreement' between all parties, is a way of partially negating the inherent power of large countries in the world trading environment.
- *A moral emphasis and a high level of support for international legal norms.* In international diplomacy it is not unusual for a small state to take a high moral stance on any particular issue.[29] Small states are not seen as threatening to larger states, therefore they can be useful to the international process by:

[29] Despite this, it also important to distinguish the rhetoric from the reality. Rothstein (1979) has noted that: "If power corrupts, so too does the lack of it".

- Taking a stance that other countries are unable to do (because of their internal politics), and thereby giving moral leadership to a negotiating process.
- Being 'useful' to the negotiation process means a small state can assist in bringing larger states to an agreement. By so doing it can advance its own issues and aims and thus benefit indirectly. Gresham (1973, p109) notes that while small states often take a high moral stand on a variety of issues, sometimes this behaviour can appear "...pathetic to the large state onlooker".

- *Hawks or doves?* Opinions differ on the degree to which small states pursue an assertive or a compliant foreign policy. The attitudes expressed by small states to particular issues seem situational and dominated by a powerful elite inside the small state.

Conventional approach

How do small states negotiate, particularly with large states? In this section we explore some of the relevant literature on the subject. Central to our interest is: how can a small state achieve its aims and objectives when dealing with other states whose resources exceed its own?

Habeeb (1988) starts with the classic premise that there are 'weak' states and 'strong' states. In any encounter between such states, the 'stronger' state should prevail because of its greater resources and capabilities. Yet this does not seem to occur in practice. International relations are full of occasions when so-called 'weaker' states have extracted advantageous concessions out of 'stronger' states.

Baldwin (1988) suggests that international relations must be seen in terms of a 'policy contingency framework'. This requires knowing who is getting what and how in the context of a negotiation. This allows for the situation where a nation is weak in one issue and strong in another.

Habeeb (1988, p17) draws a distinction between:

- *Aggregate structural power.* Aggregate power refers to a state's resources, capabilities and its position relative to the rest of the world. Aggregate power at any point in time is fixed.
- *Issue-specific structural power.* Issue-specific power examines a state's ability to position itself relative to another state in the context of a specific mutual issue. The focus is on the power structure of a specific relationship in a specific situation.

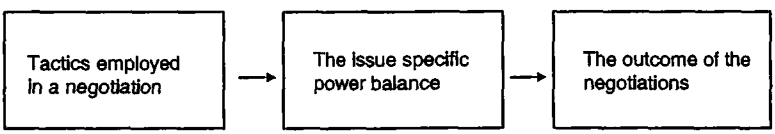
It follows from the specific structural power definition, that the characteristics giving power in one situation may be totally irrelevant in another. Therefore, a large economic power may well find that it cannot impose its will on a smaller and economically weaker state.

Lasswell and Kaplan (1950) first suggest that power is relative and situational, as opposed to aggregate and absolute. Habeeb (1988, p14) has pushed the idea further when he comments that:

> *"The most important component of power is resources (both aggregate and issue specific). Power is the result of having resources. But resources alone do not cause outcomes, they are merely used to create outcomes. Power... lies between its source (resources) and its result (outcomes). It is that which creates outcomes".*

A tactic in Habeeb's (1988) framework is the use of a particular resource in a specific negotiation situation.

Figure 5 Habeeb's framework for the balance of power in international negotiations



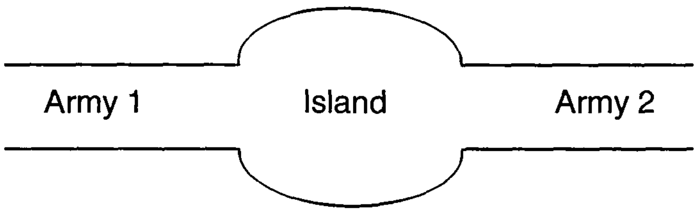
Source: Adapted from Habeeb (1988)

Figure 5 illustrates Habeeb's view of a negotiation process between two states. Of major importance are the links between the tactics used, the specific issue of the power that one state has relative to another, and the actual outcome of the negotiations. In this manner, the individual case studies can be analysed in a consistent way.

Habeeb (1988, p21-22) further suggests that the issue-specific power balance in the negotiation process depends on three factors:

- *Commitment.* How badly does one state want a particular outcome? The amount of commitment reflects a state's desire to achieve a particular outcome. Tirole (1995, p316) illustrates this concept. Two armies wish to occupy an island between their two countries and each state is connected by a bridge to the island. We assume that each state prefers the other state to have the island instead of fighting. If Army 1, with superior knowledge of strategies and tactics, occupies the island and then burns the bridge behind it, it signals its commitment to fight—it has nowhere to retreat. Army 2 then knows that if it attacks, Army 1 will have no option but to fight. The demonstrated reduction in the set of choices open to Army 1 (commitment) improves their chances of success.

Figure 6 An illustration of commitment: "burning one's bridges"



Source: Tirole (1995, p316)

Similarly, in business, a firm can signal its commitment by signing irreversible contracts for investment goods necessary for a particular course of action. In this way a business can 'see off' rival firms, without there even being any open hostility. Habeeb (1988, p16) draws a further distinction between aspirations and need:

> *"Generally, commitment based on aspirations—a self-generated motivation—is a source of issue-power strength, whereas commitment based on need—a form of dependency—is a source of issue-power weakness".*

- *Alternatives.* Having alternative options can strengthen the hand of one state and enhance the chances of a favourable outcome for a small state. This runs counter to the idea of commitment as Habeeb (1988, p21) explains:

  "The availability of alternatives may thus increase an actor's issue power by decreasing its dependence on the other actor. Conversely, a lack of alternatives may weaken an actor's position by increasing its dependence on the opponent. It is possible, however, that a lack of alternatives may increase an actor's motivation and therefore commitment".

- *Control* refers to the ability of a state to be able to achieve an outcome outside the negotiating framework. If this is the case, it will have a direct bearing, according to Habeeb, on the outcome of the negotiation.

These three ingredients: commitment, alternatives and control, are important elements in a negotiating framework. However, not all are required in equal amounts for one state to succeed in its desired outcome in a particular situation. Since each negotiating situation is different, different tactics and varying amounts of the three variables are required to achieve a favourable outcome. Therefore, the framework put forward does not give an insight into the optimal mix of variables that determine success. The lesson from Habeeb is that no one negotiating position will best fit all negotiations. A careful case-by-case assessment of the trade-offs is required in each negotiating situation to determine the relative efficacy of the tactics to be used.

There are two important points to make about the framework developed by Habeeb, which are:

- A state, which is large relative to the state it is negotiating with, might not always achieve its preferred outcome in a negotiation. Mere size is no guarantee of success; and
- A small state can enhance its negotiating position by utilising, to varying degrees, the tactics of: commitment, alternatives, and control. It should also be recognised that it is the "balance of *issue based power*" that is important. The tactics employed can

work either on increasing the power of a small state in a particular negotiation, or on decreasing the power of the large state.

THE IMPACT AND IMPORTANCE OF TRADE

The spatial dimension of trade

Economists have long recognised the role of space and incorporated it in their models of trade. Takayama and Judge (1971), Martin (1981), Nixon (1991), Rae, Nixon & Gardiner (1998) all use transport costs in price determination calculations which are then used to determine the volume allocation of selected goods to various markets. In the cases mentioned above, the process can involve sophisticated techniques in complex models. While modelling trade in this way is useful in showing patterns in trade and irregularities in the trading system, like all techniques of trade analysis it does not tell the full trade story.

One of the most important questions for the development of the world economy (and its impact on New Zealand) is where will economic activity occur? As factors of production become increasingly mobile it has become significantly less problematic to supply distant markets at competitive prices. But this revolution has been a general one. Many more countries now are engaged in the international rivalry to supply than were part of the international trade scene in, say, 1960.

In what Krugman (1991, p1) describes as 'economic geography' or the 'location of production in space', there are attempts to shed light on other aspects of the trading environment that are important in the dynamic trading environment. While the new economic geography theory complements traditional trade theory, the point of departure is the Heckscher-Ohlin model. Essentially, Krugman (1991) states that international trade literature often involves making assumptions that are 'too restrictive'. Central to these assumptions are perfect competition and constant returns to scale.

Krugman (1991) remarks that one casual observation about the economics of geography is the frequency of concentration, suggesting that there are benefits associated with increasing returns to scale. This is backed up by Chandler's (1990) major study of the US, British and German economies:

> *"The critical entrepreneurial act was not the invention—or even the commercialization—of a new or greatly improved product or process. Instead it was the construction of a plant of the optimal size required to exploit fully the economies of scale or those of scope, or both".* In Teece (1993, p201).

As well as increasing returns associated with scale and scope internal to the firm, Krugman (1991) argues that externalities (such as transport infrastructure) are also important to the firm, but very difficult to model.

Krugman (1991, p15) suggests that the main geographic 'story' relies on the interaction between increasing returns, transportation costs and demand.

> *"Given sufficiently strong economies of scale, each manufacturer wants to serve the national market from a single location. To minimize transportation costs, she chooses a location with large local demand. But local demand will be large precisely where the majority of manufactures choose to locate. Thus there is a circularity that tends to keep a manufacturing belt in existence once it is established".*

This is not a new theme: Porter and his adherents (Porter, 1990; Crocombe, Enright, & Porter, 1991; and Porter et al, 1991) discussed the effects of 'clustering' of industries and suggested using their analytical 'diamonds' as a framework for the development of industry. Porter has attempted to transport these ideas and apply the use of 'clusters' and 'diamonds' to the New Zealand[30] and Canadian economies.

However, a number of authors have found that the approach applied by Porter and others to be less than satisfying. Yetton,

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[30] For a serious assessment of the 'Porter approach' applied to New Zealand, and some commentary, together with a contribution from Porter himself, see Yeabsley (2001).

Craig, Davis and Hilmer (1992), Grant (1991), Hannah and Williamson (1990), Ruggman (1991, 1992) and Scobie (1991) have all criticised Porter's work for having limited application, not being supported by the evidence, and for being simplistic in its approach.

SIGNIFICANCE OF BORDERS

Krugman (1991, p71) has suggested parts of the Canadian market were linked directly to the US market and could be considered one market. However, work by McCallum (1995), and more recently Helliwell (1996, 1998, 1999) and Anderson and Smith (1999) point to national borders as being major obstacles to trade that are, at the very least, more important than it was presumed previously.

All of these authors investigate the impact of national borders on trade, in particular, trade between US states and Canadian provinces. The research suggests a more complex interaction occurring in inter-country, relative to intra-country trade. The main finding is that the removal of formal trade-related barriers between nations alone may not produce the desired effect of full economic integration.

Using gravity models, McCallum, Helliwell, and Anderson and Smith demonstrate that inter-country trade is far less likely to occur than intra-country trade, even over the US/Canadian border, which is one of the freest in the world.[31] What is rather startling is the magnitude of results reported in McCallum's (1995) pioneering work: he estimated that, on average, Canadian provinces are 22 times more likely to trade between themselves than they are with US states that are a similar distance away.

Helliwell (1996) extended the original analysis to include trade occurring between 1989 and 1990 and found a similar border effect. Further dis-aggregation and cleaning of the data has produced more robust sets of inter-provincial trade. Helliwell (1998) has extended the number of years (from 1988 through to 1996) and re-

[31] The United States and Canada share a common language, and border tariffs were low at the time of the test.

estimated the equations. The re-estimated gravity models produce inter-provincial trade (relative inter-country trade) multiples of 17 for 1988 and reducing to 12 in 1996.

Work by Anderson and Smith (1999) further refined the data for 1990. This reduces the original McCallum (1995) and Helliwell (1996) estimates significantly—by approximately 50 percent. However, the border impact is still large. Analysis of the relationship between geography and trade is yet in its infancy, as Anderson and Smith (1999, p225) remark:

> *"It has been widely observed that economics has well-developed theories regarding the commodity composition of trade, but relatively little to say about predicting the volume of trade. In ruling out standard kinds of official trade protection as the source of the border effect, the unanswered question remains: why does the border matter so much?"*

Other questions are equally interesting. Is the US/Canadian experience universal?[32] How does this apply to the New Zealand historical situation, and is it still relevant now? Given that we have these insights, what are some of the policy implications?

The methods used by the authors cited are rather data demanding because of the specific needs of the models. The difficulty in replicating this work for other countries is substantial. If, however, researchers are able to have access to appropriate data sets that give a unique insight into the New Zealand intra-regional trade relative to inter-country trade then it would contribute to our knowledge of the nature of New Zealand international trade.

NEW ZEALAND TRADE

> *"Imagine that we had a magic black box that we turned things that we produce: sheepmeat, logs, milk products, wool, beef, fruit etc into things that we want: cars, computers, electronic equipment etc. Well we have: it's called international trade"*. Local economist, drawing on Krugman (1991).

[32] Since we know that Canadian provinces react differently to trade than US states.

What is important for growth in an economy is economic activity. With a small population base, the domestic drivers of economic activity in New Zealand are limited, making trade important.

Table 2 Composition of GDP

Proportions (%)

	Agriculture	Primary	Goods	Services	Business activity	GDP
1978	4	6	28	40	74	100
1979	4	6	27	41	74	100
1980	5	6	27	40	74	100
1981	5	7	27	40	74	100
1982	5	6	28	40	74	100
1983	5	7	28	39	74	100
1984	5	6	28	40	75	100
1985	4	6	29	40	75	100
1986	5	8	28	40	76	100
1987	5	8	28	41	77	100
1988	6	8	27	42	77	100
1989	6	8	26	43	77	100
1990	5	8	26	43	77	100
1991	6	9	25	43	77	100
1992	6	9	24	43	76	100
1993	5	8	24	44	77	100
1994	6	9	24	44	77	100
1995	6	8	25	45	78	100
1996	6	8	25	45	78	100
1997	6	9	24	46	79	100
1998	6	9	24	46	79	100
1999	6	8	23	47	79	100
2000	6	8	23	48	79	100

Source: Statistics New Zealand

Pattern of trade

Composition of GDP

While agricultural trade dominates New Zealand's ability to trade internationally to support a relatively high standard of living, Table 2 shows the growth in relative size in the service sector in New Zealand since 1978. This can reflect underlying movements in the economy, so, for instance, according to Findlay,[33] there is a

[33] See Findlay (1995, p118).

strong correlation between female participation rates and the growth of service sector employment. In the New Zealand context, recent work has shown that the exportable sector is relatively rich in its use of unskilled labour, women and Mäori.[34]

While the growth in services, and to a lesser extent manufacturing output (the difference, in Table 2, between primary and total good sector proportions) has been dramatic, it has been the export of basically processed bulk agricultural commodities which has been the main stay of New Zealand's exports, and the source of New Zealand's wealth and standard of living.

The products

As a relatively lightly populated, temperate zone country, New Zealand is richly endowed with potentially productive[35] and accessible land. Land and the efficient use of it has been a key determinant in New Zealand's growth and prosperity. It is not surprising, therefore, that New Zealand's exports have been mainly agriculturally-based primary products. Apart from the earliest days of European settlement, and during the period of an early gold rush, such primary product exports have accounted for most of New Zealand's export receipts since they have been recorded.

But the product make-up has not stood still. Table 3 illustrates the way in which exports have changed over the last 75 years. There have been dramatic changes in our major exports in value terms. Meat, wool and dairy exports have fallen from their position of dominance, although dairy has rebounded dramatically, mainly due to the Uruguay Round agreement.

To illustrate the rise of services and the complete international setting, comparisons of the make-up of the current account over the years would have been preferable. But such an official series is not available. Within the figures displayed, of note are the rises in

[34] See Deardorff and Lattimore (1999).

[35] Note that the New Zealand soils have some 'chemical' weaknesses, and the development of sustainable pastoral farming methods was not possible without considerable practical and scientific innovation tailored to the particulars of the local setting.

manufactured exports, wood and wood products, other food products and seafood. Reasons for the increases over the last 25 years are a mixture of supply and demand effects. On the supply side, the amount of wood coming on-stream from mass plantation forests planted in phases from the 1930s on, and the imposition of a 200 mile Exclusive Economic Zone (EEZ) fishing zone, with its spur to research and the adoption of fish management controls, have greatly increased the supply of raw product.

Table 3 Changing nature of exports

Share of exports, value terms

	1925	1950	1975	2000[1]
Dairy products	29	29	18	21
Meat	20	16	27	12
Wool	32	41	16	
Other food & beverages	5	1	5	11
Seafoods			1	5
Wood and wood products	2		7	10
Crude materials[2]	8	9	8	16
Machinery & equipment			3	9
Manufactured goods			8	15
Miscellaneous	4	4	7	

Notes: (1) Estimates and forecasts, NZIER *Quarterly Predictions*, September 1999.
(2) Wool is now recorded under crude materials.

Source: Statistics NZ, Yearbooks, various years.

On the demand side, northern industrialised countries have increased their consumption of horticultural products (particularly kiwifruit and apples), vegetables, niche crops, seeds, and grapes for wine making. The growth in trade in manufacturing goods is primarily due to a more outward orientation of manufacturing companies (spurred by deliberate government policies) and the opening up of access to the Australian market under CER.

Table 4 shows a high consistency in the classification of products imported into New Zealand over the past 75 years. New Zealand's comparative advantage in land and sea-based products, limited number of consumers, and policies designed to protect domestic manufacturing over most of this time, have meant that the dominant form of imports has been manufactures.[36] One interesting statistic is the large share, in value terms, of mineral fuels in 1975 following the first oil shock, which dramatically, but transitionally, increased the real price of oil.

Table 4 Changing nature of imports

Share of imports, value terms

	1925	1950	1975	2000
Food	16[1]	12[1]	6	7
Manufactures	77	70	65	67
Mineral fuels		7	13	6
Chemicals		4	12	15
Crude materials	6	6	4	5
Other	1	1		

Notes: (1) Includes drink and tobacco.
Source: Statisitics NZ, Yearbooks, various years.

Trade partners

The dominance of the United Kingdom as a source for both imports and exports is the main trade feature of the first half of the twentieth century. The second half of the century was characterised by a marked diversification away from the United Kingdom for both imports and exports.

Up until the 1960s, Britain was New Zealand's major trading partner. For New Zealand's leading exports (agriculturally produced protein and fats) the 'world market' was effectively a portion of Britain. Imports, mainly of manufactured goods that

[36] Rather than increase the size of New Zealand's internationally efficient manufacturing capacity, which would have meant exporting on a competitive basis, the 'infant industries' created were typically content to focus on supplying domestic consumers. This meant they largely remained internationally overpriced or lacking in quality because of the combination of their style, scale or technology. But they could take advantage of the rents available from the 'quota protected' local market. As well as resulting in high prices for consumers, this approach to protection also—through creating a high cost environment—stunted the growth of a competitive manufacturing base in New Zealand, and made the inevitable eventual adjustment difficult and costly.

New Zealand did not produce, were also sourced from British producers.

This nexus was the product of a series of forces acting over time. And, as might be expected, when these changed (like the concept of the 'sterling area') or fell in intensity (such as the UK ability to take all New Zealand's meat and dairy produce at the world's best prices), the resulting shifts in New Zealand's trading pattern were rather complex.

So, as the 1960s proceeded, economic growth rates continued to languish in the United Kingdom, the ties of empire waned, UK focused on joining the EEC, and the importance of UK to the world economy shrank. New Zealand reluctantly took on the challenging task of diversifying its export base, and also looked to diversify the number of trading partners. This has had a major impact on how New Zealand has had to think about the conduct of trade policy.

In value terms, New Zealand trade diversification has been relatively successful. Table 5 shows the diversification of export destinations. The most important contribution to market diversification has been from the Australian economy.

Table 5 Changing nature of export destinations

Percent share, value

	1925	1950	1975	1999
United Kingdom	80	66	21	6
Australia	5	3	12	21
Canada	1	2	3	1
Pacific Island	1	1	3	3
United States	8	6	11	13
European Union (non-UK)	3	13	12	12
Japan	0	1	12	13
Other[1]	3	10	26	30

Note: (1) The increased growth is mainly due to increased consumption of New Zealand goods in Pacific Rim regions.

Source: Statistics NZ, Yearbooks, various years.

For many years Australia was seen as a competitor, and barriers to entry into each other's markets were relatively high. The advent of NAFTA and then CER radically changed this approach, making

Australia New Zealand's most important export destination. Growth in the trade with the US, other destinations (mainly Pacific Rim nations) and Japan, and the decline and static nature of the United Kingdom and European Union markets, are the other main features of Table 5.

Table 6 shows a similar pattern to Table 5. As the UK-sourced imports have become less important, Australian, US and others (mainly Pacific Rim countries) have become more important. This reflects less discrimination in terms of treatment based on import source (doing away with tariffs based on imperial preference) by New Zealand, and the growth of competitiveness among Pacific Rim nations.

Table 6 Changing nature of import sources

Percent share, value

	1925	1950	1975	1999
United Kingdom	52	60	19	4
Australia	11	12	20	22
Canada	7	2	2	1
Pacific Island	3	1		
United States	16	7	13	18
European Union	2	3	11	15
Japan	1		14	12
Other	8	14	21	26

Note: Pacific Island (1975, 1999) and Japanese (1950) import values were very small relative to other countries in those years.

Source: Statistics NZ, Yearbooks, various years.

DYNAMIC NATURE OF TRADE AND TRADE POLICY

Not only is world trade changing in nature and composition, but so also is New Zealand trade and trade policy changing. Below we have documented the development of trade policy in New Zealand alongside the key trends in world trade that partly shape New Zealand's trade policy settings.

Development of trade policy

It is not our intention here to enter into the debate about whether New Zealand's foreign policy *is* trade policy; however, the views expressed by Lattimore and Hawke[37] do have a certain resonance:

> *"We have become accustomed to half-truths such as: 'For New Zealand, foreign policy is trade'. It was never the entire truth, since New Zealand's international diplomacy always had many concerns, but it served to undermine any sense that mere trade was less important than matters of high politics. It even understated the case to some extent since for many of the post-Second World War years foreign policy was concentrated not only on trade but specifically on market access".*

According to Hawke and Lattimore, the early concerns of our trade policy centred on communications and the accompanying required infrastructure for the relationship with the United Kingdom. The mail service from New Zealand to Britain, for example, was subsidised. Trade spats with Australia were also a feature of early trade policy. Australia and New Zealand, both fledging colonies, were desperate to keep free trade with the United Kingdom and also equally desperate to keep 'selected' products out of each other's market.

In the post-World War I era, the world changed markedly after the commodity boom associated with the wartime Bareme purchasing system. No longer were prices in the United Kingdom market guaranteed. As the British economy declined and wild fluctuations occurred in commodity prices, preferential trading blocks started to emerge. For New Zealand, the achievement of the Ottawa agreement of 1932 was of major significance. It excluded competing products from South America and gave preference to New Zealand, Canadian and Australian producers.

> *"...a principal objective of the Government in the 1930s was to get Britain to exclude Danish butter to make more room for New Zealand, and to get Britain to exclude Argentine beef to*

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[37] See Lattimore and Hawke (1999).

make more room for New Zealand meat".
Lattimore and Hawke (1999).

Market access negotiations, particularly into the UK market, thereby assumed great importance for New Zealand and continued to do so, until the end of the Uruguay Round in 1994. This meant that discussions of volumes and prices of dairy and meat products became a key part of any negotiations. The process consumed a large part of the scarce skilled human resources devoted to managing the economy, and may have led to some neglect of domestic economic policy, as well as of alternative trading strategies.

The relationship between the state, producer boards and trade policy was incredibly tight over this period:

> *"...there was rhetoric about a return to free marketing in the 1950s, there was never any intention of relaxing the grip of the producer boards and they were a (if not the) key element of the 'corporate' state whereby politics was a matter of mediating among interest groups and trade policy was a matter of assisting the producer boards with their external marketing".*
> Lattimore and Hawke (1999).

With the United Kingdom joining the European Common Market (which was soon to be the European Economic Community, later the European Community, and then the European Union), the entry of New Zealand products into the EEC was strictly controlled. Britain's accession into Europe had done to Commonwealth commodity producers what the Ottawa agreement had done to South American producers 40 years earlier—it restricted, or in some cases banned, access for commodities from the Commonwealth.

New Zealand trade negotiators sought to advance New Zealand's access case by playing a 'behind the scenes' low-key role, keeping communication channels open with all parties associated with the accession talks.[38] To a large degree this was successful, and acceptable deals were struck in 1973, and then renewed virtually every year (an ongoing feat that in itself took considerable resources). The tribute to their success was that these access commitments were finally enshrined in the Uruguay Round agreement.

The question does remain however, could New Zealand have got a better deal?

As noted by Lattimore and Hawke, the major disaster was not the restricted entry for New Zealand goods, but the growth of subsidised competition in third markets by the EEC. It is difficult to see what kind of binding arrangement New Zealand could have constructed then to deal with burgeoning European surpluses in a non distorting way, as the key driver was out of their hands.[39] European farmers literally 'farmed the subsidies' provided for under the Common Agricultural Policy. The result was that their excess production tended to gradually increase. And the 'cheapest' solution, at least for the Europeans, was to provide community funds to support the process of dumping the resulting surpluses on third markets, depressing world agricultural prices.[40]

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[38] This contrasted sharply with the Australian approach, which was more confrontational.

[39] The main broad instrument pursued by New Zealand negotiators at the time, to counter this recognised threat, was the increasingly complicated arrangements to set minimum prices for internationally traded dairy produce. These arrangements, which started with skim milk powder and included the somewhat ironically titled 'gentlemen's agreement on whole milk powder' implemented in Paris, were wrapped into a single GATT code (the International Dairy Agreement) in the Tokyo Round. The logic was to try and appeal to exporter financial interests by looking to set a minimum world price, to safeguard the market against wild subsidies from the protected markets of Europe and North America. It was hoped that this sort of international pressure might combine with other forces to restrain the unlimited spending through more basic policy approaches, such as direct support to farmers.

[40] Lest it be thought that such behaviour was unique to the EEC, it should be noted that many other relatively wealthy countries, which have adopted internal agricultural intervention regimes that generate surplus production, for whatever reasons, have looked to exporting (with public subsidies) as a solution. This

As New Zealand's trade interests widened, New Zealand became more seriously interested in the multilateral rounds of negotiations.[41] At the cornerstone of the General Agreement on Trade and Tariffs (GATT), is the concept of 'most favoured nation' (MFN)—what is enjoyed by one trading partner should be enjoyed by all club members.

Trade barriers can be utilised to protect domestic industries but they should apply to all (GATT members, at least). To facilitate the reduction of barriers to trade, GATT developed the institution of negotiating 'rounds' in which sets of bilateral agreements on reduced tariffs were negotiated. New Zealand's approach to GATT was haphazard, to say the least.

For openers, New Zealand was a significant beneficiary from, and stout supporter of, the British preferential tariff system, which was always seen by the US as inimical to the whole (MFN) construct. And then, on the one hand, New Zealand promoted freer trade in agricultural products (rather unpopular among the predominant Europeans with memories of their scarcities in the late 1940s), while on the other, it had erected a set of comprehensive (quota) barriers for industrial products under a system of import licensing.

The CER agreement in 1983 instituted a change to this policy split. It was instrumental in starting the reform of the considerable set of trade barriers put in place in New Zealand since 1938. The previous bilateral trade agreement in 1965, NAFTA, failed to advance freer trade across the Tasman significantly. After some rather painless 'swaps' of freer access for products that were already basically rationalised between the partners, NAFTA

includes Canada, US, and even New Zealand, where in pre-deregulation days the process of stabilising the egg market domestically led to periodic exports of highly subsidised dried powder to Pacific countries.

[41] New Zealand had been one of the original GATT members taking part in all the negotiating rounds—indeed, a New Zealand delegation led by Deputy Prime Minister Nash was at the Havana meeting that drafted the charter of GATT's forerunner, the ITO, in 1947.

ground to a halt in a mesh of lobbying by local producers in both countries. Much serious political and bureaucratic time was spent on 'major' trade items like corn brooms, carpet fixing tape and the notorious frozen peas and beans.

But from the start—as Australia intended, and in fact demanded—CER was a far more potent and comprehensive agreement. The sweep of its rules forced New Zealand to think through the consequences. As a result, it set up the more integrated principles that modern New Zealand trade policy is founded on. The coverage of CER is complete and the agreement is founded on open regionalism.

The Uruguay Round has also been a significant landmark in New Zealand trade policy progress. Up until the start of the Uruguay Round, the real emphasis of New Zealand trade policy effort had been on bilateral negotiations with the European Union, Australia, the US, and Japan. New Zealand had been rather ambivalent about the multilateral process because the structure of New Zealand protection was out of step with the rest of the (GATT) world. The system of quota protection—at high levels—of its industrial sector, coupled with advocacy of free trade for agricultural products, made it a mirror image of the typical OECD member.

But by the start of the Uruguay Round, the deregulation of the New Zealand economy signalled a shift to a more consistent position. This allowed the advocacy for freer trade in (agricultural) export markets to be matched by some impressive dismantling of the whole import quota system and a significant reduction in applied tariffs on the mainly industrial products and raw materials coming into New Zealand.

One of the difficult conundrums facing a small country is how to have influence in the multilateral trade setting. By definition, a small country, on its own, can carry only a small amount of weight in international trade negotiations. New Zealand and other relatively unsubsidised agricultural exporters have banded together to form what has been a highly effective lobby force in the World Trade Organisation (WTO), the Cairns Group.[42] The Cairns Group was able to keep agriculture firmly on the Uruguay Round agenda, highlighting the inconsistencies of the approach taken by both the United States and the European Union.

Another point of leverage was the constructive role played by New Zealand in the sometimes bitter and acrimonious negotiation process that characterised the Uruguay Round. Since small nations have fewer 'axes to grind', they are often seen as more objective and usually have more flexibility to make decisions 'inside the negotiating room'. Small countries can also play a constructive role in brokering (and writing) compromise agreements between major powers. Freedom to actually negotiate can allow negotiators to get the best possible deal, within the constraints of the circumstances of the negotiations taken into account.[43]

While flexibility in negotiations has been a key asset for New Zealand negotiators in the past, the internal consensus that small countries have traditionally had domestically on trade issues (in New Zealand, this meant efforts to advance agricultural liberalisation) is breaking down. To the extent this occurs, it will restrict the ability of negotiators to make decisions 'on the spot' in a trade negotiation process.

Another important negotiating tactic has been to have an alternative negotiating arena to the multilateral forum in which to advance New Zealand's trade policy goals. In another Australian initiative, the Asia Pacific Economic Co-operation (APEC) forum, brought together the Pacific Rim nations regularly, to agree upon ways to reduce trade barriers.

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[42] The Cairns Group of nations was put together by Australia and Uruguay to pressure the EU and the US in the last round of multilateral talks.

[43] At the other end of the scale are negotiators from large countries, who can, with a degree of justification, view the formal negotiation process as a sideshow. The main negotiating game for them is how do they 'sell' any deal they achieve with international counterparts, to groups in their own countries who have considerable influence on their future prospects.

In Habeeb's (1988) terms, by having an alternative negotiating forum in APEC, where credible trade agreements can be made, New Zealand and other APEC members can put pressure on the multilateral process (at WTO) to liberalise further. The creation and successful continuation of the APEC forum sent a clear message to the EU—naturally excluded from a Pacific-based grouping: trade liberalisation would happen with or without Europe. And this put extra pressure on that group of nations to keep discussing the possible further liberalisation of trade.

In a further twist to using alternative fora to pressure trading partners to liberalise further, trade officials have identified a group of 'core' APEC members who may wish to liberalise faster than the others. These countries in the core will be able to pressure other APEC nations (and themselves) to liberalise faster, by signing up to free trade agreements between the five nations taking part.

This in turn will put pressure on the multilateral process to aim for further liberalisation over the longer run.

Trends in world trade

The trends now seen to globalisation and closer integration are not new.

World trade was expanding from the late eighteenth century up until the start of World War I (see Table 7). According to Krugman (1995), the opening of the Suez Canal, the completion of the Union Pacific railroad (opening up not just the continental USA, but also the Pacific Rim to European traders), and improved communications amongst major economies, generated impressive world trade growth figures.[44]

One of the most striking features of Table 7 is the stunting of world growth between 1913 and 1973. Two world wars and a major depression have had a major impact on world trade growth. Another important feature is the relatively slow integration of the United States economy with the rest of the world, that is, up until the 1980s and 1990s.

[44] The first submarine telegraph cable under the Atlantic was laid in 1858.

There are a number of other 'drivers' currently associated with world growth, and these are briefly canvassed individually below.

Table 7 Global integration

Percent

World merchandise exports as percentage of GDP[1]

1850	1880	1913	1950	1973	1985	1993
5.1[2]	9.8[2]	11.9[2]	7.1	11.7	14.5	17.1

Trade shares in the United Kingdom, the United States, and Germany[3,4]

Country	1913	1950	1970	1987
United Kingdom	27.7	13.1	16.6	21.1
United States	3.9	2.9	4.4	7.4
Germany	19.9	9.8	17.4	23.3

Notes: (1) World Bank (1995)
(2) OECD nations only
(3) Liesner (1989)
(4) Merchandise trade, measured as the average of exports and imports, as a share of GDP.

Source: Krugman (1995)

Lowered trade and transaction costs

One of the most striking features of the late twentieth century has been the sustained onslaught of advances in technology. This process has relentlessly driven down the most basic economic side of international barriers to commerce by steadily reducing costs associated with moving products and services (including importantly, people and information) around the world. At no time in human history has this change been so far reaching, and so influential. Indeed, it has left political and economic institutions scrambling to adapt and keep up. Table 8 illustrates this point, and shows how a selection of communication costs have been reduced through the latter part of the twentieth century.

The widespread adoption of such cheap technologies has enabled those businesses with the foresight (and nerve) to do so, to use technology in order to mass produce (the inherently cheaper) products and then utilise transport on a global scale to market to the world. This drive for the benefits of scale and scope is a key theme of Chandler's, and is captured in his (1990, p607) comments on the post-World War II era:

> *"The impact of the new technologies was almost as profound as the impact of those which had led to the creation of modern industrial enterprises in the last decades of the nineteenth century. Of particular importance were the innovations in compiling, collating, and communicating information, which required the application of the science of electronics".*

Table 8 Cost of air transportation, telephone calls & computer price deflator

(In 1990 US$)

Year	Average air transportation revenue per passenger mile	Cost of a three minute call, New York to London	US Department of Commerce computer price deflator (1000 = 1990)
1930	0.68	244.65	
1940	0.48	188.51	
1950	0.30	53.20	
1960	0.24	45.86	125,000
1970	0.16	31.58	19,474
1980	0.10	4.80	3,620
1990	0.11	3.32	1,000

Source: RJ Herring and RE Litan (1995) *Financial regulation in the global economy* Washington, Brookings Institute, p14.

Regionalism

Regionalism refers to the growing number of countries, usually but not always in neighbouring geographic regions, banding together in free trade areas, or customs unions. The best known examples are the European Union (EU), North American Free Trade Agreement (NAFTA) and Asia Pacific Economic Co-operation (APEC). Some of these agreements are more open, in terms of possible liberalisation of trade with third countries, than others. One of the best examples of an open agreement, in terms of trade liberalisation both inside and outside the agreement, has been CER between New Zealand and Australia.

Regionalism has caused much dissension among trade commentators and analysts, as it is seldom possible to determine before or even after entering a regional trade agreement, whether or not an agreement enhances or contracts world trade. This is because different approaches to analysing regional trade agreements emphasise different aspects of the agreements, and thus yield different results. The argument for regional agreements has not been helped by one of the earliest examples, the EU, which, in practice, has turned out to be strongly protectionist in character.

Analysts are united on one point however, and that is, that a small relatively closed economy would gain more, in economic growth terms, by liberalising on a multilateral basis than entering into a regional trade agreement. The option of joining a closed regional agreement is, at best, a second best solution. But in a less than perfectly competitive world, second best may be the best alternative.[45]

With slow progress expected in the multilateral negotiations and obstacles to freer trade remaining in APEC, the next best alternative is to develop a free trade zone with likeminded APEC members. By having a free trade zone between a group of 'core' APEC members, pressure can be brought to bear on other APEC members to consider liberalisation seriously. This is why the Ministry of Foreign Affairs and Trade has seen it as highly advantageous, and consistent with New Zealand's trading objectives, to pursue every avenue of trade liberalisation with all countries willing to engage in lowering trade barriers on a bilateral, plurilateral or multilateral basis.

There are other reasons for countries wanting to join regional trading groups. They can be used as a vehicle to 'glue' regional geo-political identities. In the 1960s, NAFTA reflected the protectionist nature of the New Zealand economy and the more mildly protectionist nature of the Australian economy. Any critic could have legitimately questioned the real economic value of such an agreement.

[45] One way of harmonising the bilateral and multilateral processes is to offer similar concessions in a bilateral negotiation to third countries. This will make any agreement signed between two nations more consistent with the multilateral process.

As the trade relationship progressed however, there came a point of decision: whether to have a significantly closer trade relationship or none at all. Given the protectionist nature of both economies, the rethink of the 'deeply flawed' NAFTA committed both countries to a course of action that produced, over the long run, a commitment to a more comprehensive trade agreement (CER) and more importantly, a more open New Zealand economy.

The Australian view of CER appeared to be that it would provide stability in the South Pacific region and growth opportunities for both countries.[46] The attitude of the Australians was, if we cannot get an agreement between New Zealand and Australia, how would it be possible to achieve a multilateral agreement in GATT. The mounting frustration and dissatisfaction with their trading relationships was a very significant catalyst in initiating the fundamental approach that led to CER negotiations.

According to Nash and Takacs (1998, p23), in a wider context regionalism represents an important pathway to democracy and the market economy for Eastern European nations. They note that:

> *"Romania placed such a high value on these principles that it was willing to accept a rather asymmetrical design of concessions in its association agreement with the EU. For the same reason Russia has been pushing hard to create a common economic space with the other republics of the former Soviet Union, and some of them have been resisting".*

Most small countries have much to gain from participating in trading regional alliances, particularly if they are integrating with larger countries. According to Nash and Takacs (1998, p23) again, most trade modelling exercises point to gains by smaller nations when they integrate with larger countries, although the reasons for doing so are not always apparent.[47] One of the qualitative reasons for this may be that members of a customs union are less likely to

[46] Interviews with a number of trade policy specialists.

[47] This is because of the complicated structure of these models, which means that tracing through paths of cause and effect can be difficult.

be affected by non-transparent protectionist instruments. Chile, for example, is very keen to join NAFTA because it will become an 'insider', and while still facing some non tariff barriers, it believes it will be in a better position than those countries remaining outside NAFTA.

Harmonisation of trading standards and institutions is also an important part of the benefit of regional trade agreements. It can be used internally to upgrade and standardise regulations in a way that can increase trade with those in the custom union or free trade agreement, and also with countries outside the agreement. The standardisation of rules and regulations allows for the possibility of increased foreign investment, because of the increased surety of the investment environment.

Should countries, therefore, encourage and promote regional agreements without first quantifying the extent of the costs and benefits associated with entry?

The answer is a definite no, since there are a great many uncertainties associated with any regional trade agreement. Economic analysis (Panagariya, 1998) suggests that the most important advice for those countries seeking to join a regional trade agreement is to offer similar concessions, in terms of reducing tariffs and other barriers, to other regions outside the arrangement at the same time; that is, to seek to follow the general principles of open regionalism.

Globalisation and localisation

> *"...globalisation has made national identity more important. If everybody can make the same thing anywhere, a firm's distinguishing mark is often its geography, be it the Californianness of a software maker or the Germanness of a machine-tools firm". Economist* (1999b, p2).

Since World War II, the changes to the international trading environment have been dramatic. The phenomenon of *globalisation* and its natural reaction, *localisation,* has been driven by technology, and associated with the unprecedented attempts by governments to deregulate their economies.

Globalisation in this context essentially means the growing economic interconnectedness of the world's economies. However, this is only part of the story, since technology has reduced the costs of communications allowing for regional identification and differences to be more cheaply articulated. While technology has helped in the process of globalisation it has also been used to promote the distinctiveness of localisation. It is, therefore, not surprising that part of the success of some governments and businesses, has been the ability to welcome globalisation and promote a distinctive local flavour in the services they offer or the goods and services they sell.

In the past, governments have been able to protect the domestic and agricultural and industrial sectors through a series of political short- and long-term fixes. Globalisation has changed governments' ability to interfere, particularly on trade issues and to a lesser extent domestically. Policy makers have struggled to come to terms with these changes that have combined with relentless technological advances to have a dramatic impact on trade. With world trade growing, the spotlight is firmly fixed on domestic policies that impact on competitiveness and a region's comparative advantage.

In respect of the world economy, there is little doubt that the opening up of markets has benefited some lower income regions, particularly in Asia, and in turn boosted world growth. Furthermore, the growth associated with lower income economies has benefited unskilled labour, as these economies have moved away from natural resources and concentrated on labour intensive manufacturing activities.

Gravity models

One way of looking at the expected impact of a more global trading world, is to consider what might happen in the absence of special linkages (which are often historical in nature). The so-called gravity models, which assume that trade between countries is likely to be strongly influenced by their populations and the distance between them, give a method of estimating this counterfactual.[48]

Some recent local work has calculated such models for New Zealand.[49]

We can use these gravity models to analyse trade flows in several ways:

- We can look at the derived values of the gravity equation's coefficients to see what they tell us.
- We can use the model to calculate forecasts or estimates of exports for a recent year, and compare these estimates with actual values. For some countries we will find that actual values are below estimated values. This suggests that, for these countries, factors other than those included in the equation may be inhibiting trade. If the effects of these inhibiting factors could be reduced, exports could be expected to rise.

Looking at the coefficients

The coefficients in the equations estimated tell us about the 'elasticity' of the variable; that is, the coefficient on income gives the expected size of the change in exports as a result of trading partner income growth.

What Table 9 below shows is the huge effect of distance on New Zealand's exports. The distance elasticity is a large negative for every category of exports—that is, distance really matters.

This distance coefficient is considerably larger than that which has been found in other similar studies to date. However, other research has looked at bilateral trade flows for the world economy, rather than just export flows, and this work looks at New Zealand alone. Given the structure of New Zealand's trade and the type of products involved, we would expect that focusing on the effect of

[48] The basic idea is that in the long run these effects—demand and supply being related to population spending power (income), and transport costs, (roughly) depending on distance—will be important.

[49] See various NZIER reports including, Fan et al (2001) and Smith (2001).

New Zealand's considerable distance from its trading partners would produce a high value for the distance coefficient.

Table 9 Income and distance elasticities

Export category	Income elasticity	Distance elasticity
Chemicals and related products	2.41	-7.34
Dairy products	1.50	-8.80
Fish and fish preparations	1.74	-4.74
Forestry products	2.52	-9.75
Fruit and vegetables	2.31	-6.30
Machinery and transport equipment	1.51	-5.36
Non-fuel crude materials	2.40	-6.31

Source: NZIER

We can also see the effect of breaking exports down into components: the distance coefficient is largest for forestry products, and we would expect that distance would have a proportionally larger impact on large bulky items such as logs.

Note though, that because distance doesn't change over time, it doesn't affect the *growth* of New Zealand's exports. It simply affects the level—a one-off effect. In contrast, growth in exports is affected by GDP growth in destination countries.

The application of the gravity modelling framework is intended to provide a numerical estimate of the levels of trade that could be expected in the absence of the historical, cultural and political peculiarities that exist between New Zealand and our trading partners. This gives us a point of comparison against which the effects of history, culture and politics on the actual pattern of economic relations can be evaluated. The analysis can serve as a framework for interpreting the changes that are taking place.

Comparisons—what's driving New Zealand trade?

The gravity model derived for overall exports can be used to estimate the expected value of exports to each country for 2000. This estimated value represents an estimated average value of exports purely determined by the GDP of trading partners and the distance between New Zealand and their capitals. It can be understood as a value of exports that is free from the influence of cultural, historical, political, and other factors. More speculatively, it can be seen as the 'globalised' version of the potential trade flows.

It is possible to compare the gravity level to the actual level, in order to measure how far from or close to this gravity estimation actual export values were. If exports to a country are above gravity value, it suggests New Zealand has good access to the market. This may be due to factors such as historical ties, common language and cultural similarities, and often, commercial relationships.

Where New Zealand is below the gravity value in exports, this suggests the presence of barriers to trade, such as cultural differences, different languages, or administrative difficulties. Protectionist measures such as tariffs may also be relevant. And for some commodity groups, local tastes may also be affecting export levels.

Considering overall export trade over the 1990 to 2000 period the conclusions were that:

- Flows in total goods exports to Australia, APEC countries and the UK were largely explained by gravity factors (that is, real GDP and distance) and did not show significantly different characteristics to trade flows to other countries.
- The coefficients of the equation have not changed significantly over time. However, an examination of the equation's errors showed that these errors have been reducing over time. That is, trade is moving closer to gravity values.

To look at spatial patterns of trade destination, countries (or markets) were grouped based on their distance from New Zealand. Forecasts were prepared for 2010. These results are shown in Table 10.

The estimated shares for 2000 in the table are based on the model's gravity values. Note that, compared to gravity values, New Zealand exports are underweight in group 4 and overweight in group 6.

The group 4 result arises from trade with the US. Despite the huge size of the US economy, and its relative closeness, New Zealand under-exports in the US. The group 6 result indicates that New Zealand generally exports more to Europe than one would expect. This may reflect cultural and historical ties.

Table 10 New Zealand's export distribution in different markets

Group no	No of countries	Distance km	Actual shares in 2000(1)	Estimated shares for 2000(1)	Forecast shares for 2010(1)
1	2	d<7,000	23.7	20.5	23.2
2	18	7,000<d<11,000	35.3	32.1	39.6
3	20	11,000<d<13,000	3.2	5.6	3.4
4	18	13,000<d<15,000	18.4	29.1	17.2
5	14	15,000<d<17,000	1.4	0.5	1.5
6	27	17,000<d<20,000	17.9	12.3	15.0

Note: (1) Percent of total NZ exports.

Source: NZIER, Statistics New Zealand

There are also some interesting differences within groups. New Zealand generally over-exports to group 2, which includes East Asian and South American countries. But there is a generally overweighting of exports to East Asia, and (corresponding?) underweighting of exports to South America. This may reflect factors such as transport links and language barriers. (One notably underweight East Asian country is China.)

Looking at the next ten years, the model produced marked differences in growth rates across countries. For example, exports to China were forecast to show average growth of 9.8 percent per annum, while export growth to the UK was 2.4 percent per annum. Summing over all countries, it was found that growth in the real value of total goods exports out to 2010 was 4.4 percent per annum.

Table 10 shows that the proportion of exports to countries in group 2 will increase substantially over the next ten years. However, most of the gains, in real dollar values, will be in East Asia. While the growth rates in exports to South American countries are reasonably strong, these exports are coming off a low base. Still, the gravity values suggest there is scope for growth into this area to be even stronger, provided some of the present impediments to trade are removed or reduced. This provides a guide as to the areas that trade policy may be effective, as any improvements in access provisions may be followed by an expansion of trade.

Trade patterns

Wider impacts of globalisation can be seen in terms of the prevailing trade patterns. Table 11 illustrates the process of globalisation based on an indicator ratio of goods exports and services to GDP (openness ratio).

Table 11 Openness ratio 1965 and 1990

Exports of goods and non-factor services to GDP multiplied by 100

By income level and country	1965	1990
Low-income economies	8	18
Middle-income economies	17	25
High-income economies	12	20
China	4	18
Indonesia	5	26
Philippines	17	28
Thailand	16	38
Malaysia	42	79
Korea, Rep	9	32
Singapore	123	190
Hong Kong	71	137
New Zealand	21	28
Australia	14	17
Japan	11	11
Canada	19	25
United States	5	10

Source: World Bank (1992) table 9, pp234-235.

Composition of world trade

Since World War II the composition of world trade has changed. Freer trade in industrial products has been achieved through the GATT process.

Table 13 shows that trade in agricultural products has declined, not only in terms of total share of world trade, but as a total share of imports. While protection in industrialised nations has helped reduce (at least potential) world agricultural trade, other factors also contribute to a declining share of world trade in agricultural products.[50]

The two main reasons for this are:

- One side of Engel's law: that as countries increase their wealth they tend to spend smaller proportions of their total income on food products. The empirical support for this is shown in Table 12; and
- The declining intensity in overall economic activity of raw materials used. The OECD (1997, p13), puts this down to a number of reasons: the development of synthetic substitutes, the evolution in the structure of economic activity in key consuming countries towards products and services that require less material inputs and the decline in the material intensity of industrial output generally.

Table 12 Relationship between consumption of primary commodities[(1)] and incomes, 1989–90

Country	Total personal expenditures spent on food (%)
United States	10
Canada, Japan, France, Australia, New Zealand, Italy, Hong Kong and Singapore	10-20
Mexico	37
India	50

Note: (1) Mainly food commodities.

Source: OECD (1997, p13)

The difference between agricultural trade and trade in other goods and services is also important. Essentially, because of the protected nature of world agricultural trade, the trade is 'managed'. Thus, tariffs on industrial products average approximately 5 percent in the developed world, while tariffs on agricultural products average close to 40 percent.

[50] In OECD nations, the trade share for primary commodities slipped from 17% in 1960 to 9% in 1990.

This suits bigger players, since to earn profits based on above world prices, a business entity needs to have critical mass in the market place. Smaller players, more often than not, are forced to accept volatile world prices. This makes it more difficult for smaller commodity exporters to gain traction in the market place.

Commoditisation

Trade in industrial products has grown substantially in the post-World War II era. The politics of global warfare, isolationism, and overpowering nationalism are in abeyance. The failures of the first half of the century set the platform for the resurgence of unprecedented trade growth. This has been aided by the establishment of GATT (now the WTO) which has promoted multilateralism, albeit in a slightly skewed fashion. As a result, trading routes have become more secure, attitudes to imports have softened and the linkages between prosperity, growth and trade have become more widely recognised.

Table 13 Composition of world trade, 1965-90

GATT breakdown (shares of total world trade)	1970	1980	1990	1997
Merchandise				
Agriculture	16.5	12.5	10.0	9.0
Mining	12.0	22.0	11.5	9.0
Manufactures	50.0	45.5	57.0	61.0
(not specified)	2.5	3.0	2.5	1.0
Capital goods	29.5	26.5	37.0	
Commercial services	19.0	17.0	19.0	20.0
World Bank breakdown (shares of world merchandise imports)	**1965**	**1979**	**1985**	**1990**
Food	18	12	10	9
Fuels	10	20	19	11
Other primary commodities	17	9	8	8
Manufactures	55	58	62	73
Machinery, transport	23	25	29	34

Source: RJ Grant, MC Papadakis and DJ Richardson (1993)

This has provided a framework for trade to flourish, in particular the trade in industrial products (see Table 13). The success of trade in industrial manufactures has led to increased competition in world manufacturing trade. As a result, increased commoditisation and standardisation of manufactured products around the globe has occurred.

Multinational companies compete head to head in markets around the world in manufactured products. Cost has become a major factor in determining success in these markets. This has changed patterns of world trade dramatically. For example, components that are necessary for particular manufactured goods are made in a variety of different countries and then exported to a third country for assembly, and even 'domestic' over-the-phone services offered by companies can be (and are) located in different countries.

The increased global reach of multinationals has allowed for increases in scale and scope of production. The increased market size available through the relaxation of trade barriers has allowed operations to be carried out on a larger scale, further reducing the costs of products.

Market barrier building

The relentless drive towards commoditisation of agricultural and industrial products has pushed companies to search for new markets to look to 'crop the rents'. Rents here are profits above normal levels. One of the classic business strategies is to develop, maintain and exploit barriers to entry in any particular market, so as to be able to profit from the consumers without high risks of competitors entering.

One way of achieving this goal is to establish an overpowering presence in any particular market before rivals can react. By exploiting the rents thereby available, business entities can earn higher than normal profits. Falling trade barriers, transport costs and improved communication have aided this process. This phenomenon has been enhanced by the ability of firms to utilise more sophisticated logistics to explore and try to isolate all available market niches.

Of course, the ability of rival firms to counter this process has also increased, therefore the time that a company has to uniquely exploit individual markets has shortened. Hence the continued search for new markets and ways of extending the 'cropping of rents technique' in more mature markets.

Most business-consulting firms portray this in two ways:

- Being the first large-scale mover into a market. This translates into dominating the changes in the market through being the largest player and is the chosen goal of many firms. So, being number one or two in the market is the favoured strategy of General Electric, supposedly the world's most admired company.
- Being able to introduce a product or service as fast as possible during the introductory period and being able to maintain profitability into the maturity phase of the product life cycle. One way of doing this is to make the product or service indispensable to the customer.

Intra- and inter-company trade

Technology, commoditisation, market barrier creation, globalisation and localisation, and the managed nature of agricultural trade have driven another emerging trend in world trade: inter- and intra-company trade. According to the Forrester research,[51] inter-company trade of goods and services will double every year for the next five years surging from US$43 billion to US$1.3 trillion in 2003. Most of the current growth in internet trading is on a commercial or business to business basis.

In the highly competitive manufacturing market, similar increases in business to business trade have occurred. With the high value of the yen relative to the US dollar, Japanese auto-makers have found it more difficult to compete in the US market. One way of remaining competitive for them was to develop links or start subsidiaries in the fast-growing Asian 'tiger' countries. By manufacturing and sometimes assembling cars in countries other than Japan, their auto-makers have been able maintain competitiveness.

[51] See *Economist* (1999a).

Similar types of operation in vastly different types of businesses are mushrooming as technology and intense competition allow for, and necessitate more complex interactions between businesses and subsidiaries. Key to these technologies is the ability to track and co-ordinate the just-in-time systems required to make these businesses competitive. The ability of this type of trade to deliver significant competitive advantages will mean that business to business trade remains a fast growing component of world trade.

CONCLUSION

The discussion and analysis of the various critical trade policy episodes sketched above, and developed in more detail in *Part Two,* suggest a number of basic thoughts about the way New Zealand has conducted its trade policy. Provided the nature of the situations and their respective similarities and differences are carefully accounted for, these can be used to draw implications for the future conduct of trade policy in the type of world New Zealand now faces.

Key trade policy parameters

The critical factors that are going to cause shifts in the trade policy environment are discussed here too. We integrate these into the following summary discussion. More detail and analysis is developed in the final section, *And lying ahead?*

The general framework we have used here is the model put forward by Habeeb (1988). It provides insights into the way a small player such as New Zealand can think about the approach it adopts in trade negotiations.

The Habeeb framework distinguishes between *absolute power* and *situational power*. New Zealand has virtually no absolute power; we are usually a policy taker. With careful craft and the use of situational power, small countries can make international gains.

An important road to this is to seek to become an intermediary who is useful to the negotiation process.

This role involves being opportunistic and innovative. It demands: focus and commitment; quality staff resources; high levels of intelligence about the situation of other players; and real flexibility on the ground.

The necessary conditions for negotiation-level flexibility in a small country like New Zealand include:

- *A domestic 'consensus'.* This must approve and underpin the direction in which domestic citizens (New Zealanders) wish to proceed on trade policy.
- *A focused approach.* Resource constraints (including the economies of scale involved in international relations) mean that small countries—which in theory face all the same possible issues as larger countries—need to focus on a limited number of objectives.
- *The right relationship between the authorities and the negotiators.* Being flexible requires a high degree of contact between the negotiators and the capital; balanced by a significant amount of trust of the judgement of the 'on-the-ground' operators. The ability to be entrepreneurial and opportunistic in any negotiation depends on the discretion that the negotiators have been given in any particular situation.
- *Having a long-term commitment to the process.* The back-up (or backroom work) must tie into and support the 'front-up' (the 'on-the-ground' negotiating strategy and tactics, including shrewd deployment of Ministerial resources).

  This means:

  - *Understanding the specific circumstances.* It includes knowing the detailed *conditions* surrounding the issue being negotiated, and ensuring the ability to influence outcomes.
  - *Knowing what will lose or gain (domestic) advantage in the negotiation.* To understand the gains and losses for one's own side is often not trivial and requires a unified approach to quantifying the benefits and working on the 'sensitivity analysis' of alternatives.
  - *Choosing and using the right tools and language.* To be effective the tools used must be acceptable (or at least credible) to those counterparts faced around the negotiating table.

- *An experienced team.* The training of negotiators requires on-the-job systematic experience. Negotiating skills are more a craft than a science. They are acquired through long and varied experience. There is useful theory, but to be effective requires a combination of individual flair, judgement and personal traits, alongside the ability to select the right tactics for the right situation.

- *Economic soundness for sustainability.* The above are all necessary conditions for the long-run success of a negotiation. The fundamental sufficient condition is that it is an economically sustainable and fundamentally sound approach.

Key shifts in the trade policy environment

The changing nature and composition of world trade is reflected in the changing role and shape of trade policy issues confronting New Zealand. The nature of the international institutional setting and the domestic political environment have altered too. We quickly traverse the issues here—they are dealt with at more length later in the final section.

The rise and rise of services

International trade has included a growing services component over the years since World War II. This changes the nature of negotiations and increases the importance of newer trade areas, relative to issues such as agricultural trade, and there is a strong likelihood that it will be given a prominent role in any future multilateral round.

From New Zealand's perspective, this both complicates matters and makes the actual management and servicing of the round harder.

Commercial integration

International companies have increased the amount of trade they do with their subsidiaries. Modern firms see long-running relationships (including ownership) as the key to building and maintaining competitiveness.

This is another complication for New Zealand in the negotiation story, and will make the New Zealand task harder by adding to the issues on the table.

Partners and products

New Zealand now has a completely different trading profile than in times past. We are serious traders with many more countries, have more export and import products, and are virtually unattached to any substantial block or particular trading partner (aside from Australia).

As a result, it is impossible to envisage the form of sustained and focused all-round single country pressure, that was a feature of both the Ottawa and the UK accession negotiations, being applied today. This evolving status changes the strategies we can draw upon, and means that we have to be more innovative and develop 'new tricks' for the new environment.

International institutions and players

The GATT/WTO 'club' has changed in numbers and make-up. Since the Tokyo Round and the growing politicisation of the world economic institutions, what was GATT has now become a new organisation with new powers (WTO) and includes over 140 countries as members. New countries bring new priorities and problems, complicating the process of discussion and final conclusion. The challenge for the organisation in seeking to move freer trade forward has become more complex. Each country has a new set of priorities; all are wanting to be heard; all their representatives are wanting to prove to their domestic masters that they are 'making a difference'. This growth tends to clog the agenda prioritisation process and make the design of workable deals more difficult.

The issues that WTO is having to deal with are less system-wide and increasingly fragmented. The splintering pressures the WTO process which is trying to 'stitch' together a deal that will satisfy all. Increasing membership numbers complicate the necessary make-up of any final 'deal'. The round and other negotiations are increasingly complex to generate appropriate political 'wins' for each of the participants.

In the past WTO has only had to deal with governments. Increasingly, NGOs are seeking a prominent part in shaping the actual negotiation process, and they pose a potential competitive challenge for small countries.

Domestic political structures

Also contributing to the more complicated trade policy formulation process is the New Zealand MMP environment. The (accompanying?) loosening of party discipline has added to this significant enhancement of the diversity of views as well. There are more visible 'anti' views now on offer.

Despite the continuing support (via their party vote) of most voters for parties that generally support freer trade, any New Zealand government has to be mindful of those people and parties who hold opposing or different views. Overall, the evolution of this situation has made the task of assembling a reasonable domestic 'consensus' on important trade policy issues harder than previously.

Domestic resource management

Within New Zealand's own dedicated resource base for trade policy there have been significant challenges and changes. We now have representation in many countries, only some of which can be seen as relevant to trade policy developments. Some of the newer posts reflect the increasingly diverse nature of the political interest groups.

Tighter attention to the requirements of fiscal accountability mean that short-term objectives are tending to prevail over long-term matters, such as research in the foreign relations area. It means that effort redeployment is increasingly political, formal, difficult and resource-intensive. The natural informal response to the volatility of operational needs (keeping some resources as uncommitted 'reserves') discourages the establishment of long-term relationships between researchers and negotiators. Those projects that are commissioned, are largely organised on a one-off, ad hoc basis, have limited budgets, and tend to be focused on issues that have a relatively quick political payoff.

It seems that the resources available are not being exploited to the full and thus the 'buy' option does not seem to be used to the extent it could be. This situation means New Zealand is in danger of not matching aspects of the capacity development model discussed earlier, which stressed the need to build a common language. The requirement for that is to have sound research material advancing independently of operational fluctuations. This can, when appropriate, then be quickly hooked into established frameworks that are accepted by authorities round the world.

International communication

The use of new technology has transformed information flows around the globe. This has two relevant effects. First, no longer can governments straightforwardly control the type of information transmitted out of their domestic domains into the international arena. 'Sifting the wheat from the chaff', due to volume increases in information, is easier with independent cross-sightings. This could come from better quality information, or from high calibre understanding of the issues, usually associated with specialisation of topics. All of this suggests, effectively, that the degree of importance attached to 'economies of scale' and specialisation in the representation game are likely to have increased.

Secondly, the quantity of information entering a country has exploded—and the cost of access has effectively disappeared. The domestic audience is now potentially widely exposed to the full range of different possible opinions about all international developments. Thus the nature of the challenge of forging a domestic consensus has changed. The task suggests the need for increased focus and greater resource commitment.

POLICY QUESTIONS AND IMPLICATIONS

New Zealand trade policy has been relatively successful (and cost effective) in the past.

In the future, its main challenge will be to adjust the habits of a successful experience base to the requirements of what seems to be a rapidly shifting environment. The dominant feature of this review of the setting is the growth of *complexity*, both internationally and within this country.

So beyond the useful lessons that have been drawn out above, there are a series of challenges that need to be faced and decided in the years ahead.

We discuss these at length in the *Part Two*, but first present them here in summary form.

Domestic demands and debates

More effective trade policy requires more resources put into the process of domestic debate and understanding as consensus-building contributions. How will the 'opening out' to engage with external commentators and analysts be handled? Where will those resources come from? If an element of the private sector is to become involved, how will impartiality and security of information and advice be preserved?

Public-private co-operation

The role of the trade bureaucracy and private sector, and the nature of the interaction between the two will possibly also have to change. How does New Zealand develop a working 'system' and regular processes that will promote long-term relationship building between the private sector, informed researchers, political decision makers, and trade policy negotiators?

Binding up the views

The effect of MMP and the heightened flows of electronically available information mean that domestic consensus has become more difficult to achieve. Is there a role for a solely trade-focused ministry to co-ordinate a more complex domestic trade environment, without the complications of international political and strategic matters?

Focus and resources

To achieve the sort of access and professionalism we seek, will demand both focus and additional resource use. Better use of technology and innovation could produce productivity gains which will contribute to effective trade policy management.

Will our system be robust enough to make the hard decisions and generate the resource commitment required?

Part Two

As foreshadowed earlier, the contents of this section are effectively an examination of the historical episodes covered more briefly in *Part One*. The treatment here, however, is more expansive and deals with each of the separate episodes individually and as separate case studies.

The implications of these experiences are then drawn out and put carefully into a suggested context for the emerging pattern of future trade relations challenges facing New Zealand.

Five case studies

The second section of this study deals with an examination of the five illustrative, individual episodes of New Zealand's trade policy history. These particular episodes have been picked because they represent the major trade policy events in New Zealand's recent trading history, and also because under careful analysis they give vital clues about the detailed workings of trade policy.

The episodes chosen and their aspects of particular interest are:

- *Post-World War I trade policy concerns.* The most important trade policy 'episode' in this period was the Ottawa Conference where the concept of Commonwealth Preference was agreed upon. In effect, this gave preference to New Zealand and other Commonwealth products into the British market. The main issues associated with the inter-war period are:
  - The post-World War I difficulties associated with the British economy, which had a tight connection with the value of the pound sterling.
  - Commonwealth preference and the Ottawa Conference.
  - The narrowness of the New Zealand export range and markets relative to pre-World War I.
  - New Zealand views of other nations and attitudes to trading relationships.
- *Post-World War II period culminating in the accession of the UK into the European Economic Community (EEC) in 1973.* After World War II, the lack of growth in the British market and finally, the UK accession into the EEC, saw New Zealand agricultural goods gradually facing more restrictive trading conditions, even in terms of volumes able to be sold on the UK market. This spurred the attempts to achieve a diversification of products and markets and to loosen the dependence on the UK market. We are interested in:
  - What drove trade relationships in this period?

- How did the changing trading relationship impact on the products and the range of countries that New Zealand traded with?
- What were the mechanics of the UK/EEC negotiations and what influence did New Zealand have on the various parties?
- Did New Zealand get a good deal when the UK joined the EEC? Relative to which countries—for example, Australia, Canada or Israel?

- *ANZCERTA (usually referred to as Closer Economic Relations, or CER) negotiations.* CER replaced the previous NAFTA to produce a comprehensive trade agreement with our closest significant trading partner, Australia. The main issues and questions include:
  - Why was an entirely new trade agreement between Australia and New Zealand necessary?
  - How did the negotiations develop? What were the aspirations of both parties for a new agreement?
  - How did the negotiations proceed?
  - What was the end result?
- *Cairns Group and the Uruguay Round.* The Cairns Group was set up to further the cause of agricultural exporters in the Uruguay Round of GATT. It acts as a lobby group within the multilateral process, promoting the aims and objectives of agricultural liberalisation. Questions for discussion include:
  - What were the aims for the group and how have they panned out?
  - How did we deal with issues other than agriculture in the group?
  - Are we basically a one-issue negotiating country?
  - What was our approach to services and parallel importing?
  - Were resources spread too thinly in the Uruguay Round?
- *Asia Pacific Economic Co-operation (APEC).* The 21 members of APEC are a loose grouping of Pacific Rim economies that have

come together to promote economic co-operation and freer trade. Issues and questions include:

- What has been New Zealand's role?
- What drives the APEC process and how can we influence it?
- Is APEC an alternative to WTO, or something more subtle?
- Is the way we have influenced competition policy a good way to illustrate how to influence the debate?

Case 1: The Ottawa connection

INTRODUCTION

Dependence on Britain

Refrigeration, first used in the 1880s, was the key to sustained international economic success for New Zealand. It brought new technology, with upside, to bear on the search for a staple export for New Zealand. In effect, by enabling (efficiently produced) meat and dairy produce to be transported to the UK in reasonable condition, this new technology allowed for a form of product arbitrage between temperate zone countries. Such transport of 'like products' is often the basis of trade.

The technical trick was to directly connect the fast-growing British market for protein and fats to a ready source of (relatively) cheap meat and dairy produce in New Zealand. However, this created a real dependency on the British market to the virtual exclusion of all other markets. Lattimore and Hawke (1999) describe it as a type of 'Dutch disease', whereby agricultural products came to dominate production, trade and resource allocation to the exclusion of other economic activities.

This was true right up until Britain's entry into the European Economic Community in 1973. The economic dependence on farming gave that sector a powerful voice in the politics of New Zealand. Table 14 illustrates this point, showing not only the dependence on Britain, but also on other Dominions. Trade with other 'foreign' countries was just that—largely foreign to New Zealand experience.

Exports from New Zealand to Britain increased dramatically through the growth phase between 1880 and 1914. This was sustained because of very strong British economic growth rates, particularly between 1900 and 1910. In this rapid growth phase, new technology boosted agricultural production in New Zealand and the quality and consistency of the final product improved markedly.

Table 14 Trade export destinations

Percent 1927-1936

	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936
UK	76.04	72.90	73.58	80.14	87.96	88.02	86.03	81.59	83.63	80.16
Canada	3.44	4.45	6.11	5.65	0.74	0.69	1.37	1.46	1.41	1.95
India	0.30	0.68	0.70	0.91	0.17	0.15	0.08	0.14	0.13	0.22
Ceylon	0.00	0.01	0.01	0.02	0.01	0.01	0.01	0.00	0.00	0.00
S. Africa	0.06	0.12	0.09	0.04	0.02	0.03	0.03	0.06	0.06	0.04
Australia	7.56	5.22	4.26	3.48	3.34	4.06	3.40	3.98	3.83	3.25
Fiji	0.25	0.23	0.23	0.24	0.25	0.25	0.21	0.18	0.19	0.18
Other	0.52	0.50	0.42	0.48	0.43	0.44	0.37	0.42	0.52	0.48
Total British countries	88.17	84.11	85.40	90.96	92.92	93.65	91.50	87.83	89.77	86.28
Germany	2.35	2.32	2.22	0.89	0.89	0.82	0.92	2.00	0.36	0.48
France	2.08	3.24	3.22	1.15	1.20	1.43	1.80	2.60	1.04	2.90
Belgium	0.34	0.55	0.45	0.44	0.42	0.47	0.81	1.29	1.39	1.09
Japan	0.52	1.18	0.78	0.34	0.76	0.67	0.86	1.81	0.93	2.74
US	5.53	7.51	6.51	4.71	2.66	1.94	2.91	2.64	5.30	5.07
Other	1.01	1.09	1.42	1.51	1.15	1.02	1.20	1.83	1.21	1.44
Total foreign countries	11.83	15.89	14.60	9.04	7.08	6.35	8.50	12.17	10.23	13.72

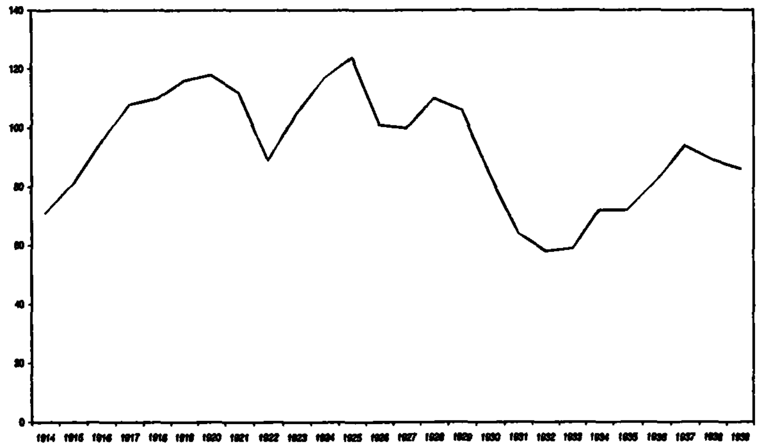
Source: Statistics New Zealand (1938) Yearbook, p232.

During World War I, a purchasing agreement (the 'Bareme') with the UK government, meant that produce prices were guaranteed, and farmers responded (in a profit maximising way) by producing as much volume as they could. This supply response from New Zealand farmers meant that at the end of the war there was a glut of agricultural product on the British market, in an economy exhausted by the war.

As wartime guaranteed prices ended, New Zealand farmer returns dropped dramatically. Gross export receipts for New Zealand products are shown in Figure 7, and sector by sector index export prices in Table 15. Figure 7 illustrates the turbulence of the period, through export receipts: these grew strongly until the end of World War I, remained volatile during the 1920s, and then dropped dramatically as the world depression in the early 1930s took hold in our target market.

Figure 7 Export prices

Gross value of farm products, 1928–29 to 1932–33, millions of pounds



Source: JB Condliffe (1959, p16)

In the 1920s, the British economy faltered as it attempted to come to terms with the changes in the structure of the world economy and its own financial plight, having disposed of many assets to pay for the war. Therefore, the ability to sustain increased amounts of agricultural imports from New Zealand, maintain other 'foreign' (non-empire) agricultural imports, and satisfy domestic demands by British farmers for fair prices, reached a limit. Furthermore, the booms and slumps experienced by the British economy were reflected in the volatile prices received by New Zealand exporters (see Table 15).

The British market became more difficult as successive governments tried to recreate the world that had been, with the vital ingredient, pre-war prosperity. As Mowat (1955, p259) suggests: "...the idea persisted [in Britain] that there could be a return to 1914, to 'normalcy' ".

Returning to the gold standard (that is, a convertible currency) and to sterling at the pre-war parity level with the dollar (US$4.80 to £Stl) was seen as a critical part of that drive. This had the impact of effectively overvaluing the pound, given the changes in UK competitiveness, and thereby exacerbating Britain's economic situation. Furthermore, Mowat suggests: "[that it only gradually] ... became clear that Britain had been in a state of depression ever since the war".

Table 15 Export prices

Index numbers, base year 1929

Year	Dairy produce (1)	Meat (2)	Wool (3)	Other pastoral (4)	All (1-4)	Agricultural exports	All exports
1929	100	100	100	100	100	100	100
1930	83	94	59	73	78	89	79
1931	68	71	40	45	59	81	61
1932	64	60	37	37	53	78	55
1933	57	64	39	44	53	81	55
1934	53	83	74	74	67	85	68

Notes: (1) Non-farming exports included products such as: timber and minerals, which comprised 5.2% of the total value of exports in 1933.

Source: Belshaw et al (1936, p787)

The volatile nature of the British economy had important implications for New Zealand exports. As the 1920s progressed the British economy slumped, then recovered slightly, then slumped again before 1929. Britain's economic toils during this period and beyond into the 1930s resulted in rather uneven impacts on consumers' incomes.[52] But it turned out that the impact on selected suppliers, such as New Zealand, was dramatic. Britain was virtually New Zealand's only market. Therefore, economic

[52] The slump in the UK (see, for instance, Stevenson and Cook, 1979) had severe effects which resulted from the difficult adjustment away from traditional industries that were no longer competitive (such as ship building). But the impacts on families seem, in the thirties at least, to be defined by whether they were afflicted by unemployment, which had fierce local concentrations in industry-based affected areas.

problems in Britain which had an effect on the particular consumers of New Zealand produce, meant major economic problems for New Zealand export income.

Thus, as the British economy faltered in the 1920s with an overvalued exchange rate, so too did its ability to import goods. Pressure began to mount there to exclude products from foreign nations, that is, nations other than those of the British Commonwealth/empire.

Table 16 Farming costs

Index numbers, base year 1914=1000

	1928	1931	% fall
Export prices	1,553	881	43
Farm expenditure	1,642	1,490	9
Wholesale prices, all groups	1,417	1,278	10
Retail prices	1,602	1,447	10
Nominal wages	1,656	1,542	7

Source: Belshaw et al (1936, p788)

New Zealand saw itself as one of the most British of nations.[53] But this feeling was backed up by less noble motivations. So there were more economically-driven calls for preferential treatment in the British market, particularly from the politically strong farming lobby. As the depression struck, the cost-price squeeze on farmers intensified. The grim reality of the situation is highlighted in Table 15 and Table 16. Export prices of major commodities dropped alarmingly and only recovered slowly. Most affected were dairy products that dropped to nearly half of their 1929 prices (Table 15). While product prices dropped sharply, farm costs reduced only moderately (Table 16). This squeezed farm revenue even further, pushing farmers closer to the edge of bankruptcy.

While domestic support for preferential treatment in the British market grew from the time of refrigeration in New Zealand, it is easy to see how pressure on New Zealand politicians mounted still

[53] This is one of the themes of the second volume of Bellich's history of New Zealand, see Bellich (2001).

further as product prices slumped with the development of the world depression.

TOWARD A SOLUTION—THE OTTAWA CONFERENCE

Introduction

> *"In July 1932 on board the Aorangi, which was carrying the Australian and New Zealand delegations to Ottawa, a hot tip at the ship's 'race meeting' was a horse called 'Recovery' by 'Quotas' out of 'Quantitative Restrictions'. The name of the winner is not recorded: it might well have been 'Disillusionment' by 'False Hopes' out of 'Imperial Unity'".*
> Sinclair (1988, p260).

The Ottawa Conference was essentially a battle between freer traders and protectionist forces in each of the Dominions and in Britain itself. These battles had traditionally been rehearsed in each Dominion's parliament, and then replayed at the periodic Commonwealth conferences. The history of imperial preference stems from the 1887 British Commonwealth of Nations Conference. It was here that preferential trading systems were first discussed. At the time, while most Dominions were in favour of such a system, the British were still firmly opposed. British attachment to free trade remained dominant.

Some movement was made towards implementing an imperial preference scheme at the 1894 Ottawa Conference. Agreement was reached on a trading system designed to introduce differential duties within different parts of the British Empire. However, very few such bilateral agreements got off the ground. Britain, with its eye on the European market, did not want to jeopardise its existing trade treaties with Belgium and Germany.

By 1897 however, Dominions were granting preferences to Britain in their domestic markets. This increased the pressure on Britain to do the same at 'home'. It was only in the 1930s, with the onset of the depression, that Britain finally succumbed to that pressure.

Britain's advocacy for free trade collapsed with the election of a National government in 1931. By March 1932, the British government had imposed a ten percent *ad valorem* tariff on most foreign goods. The tariff was not imposed on Dominion produce, pending the outcome of the Ottawa Conference to be held in June/July of that year.

Aims

Officially the aim of the Ottawa Conference was to exclude some nations and somehow increase world welfare. The mechanics apparently would be achieved:

> *"... by the lowering and removal of barriers among themselves ... the flow of trade between the various countries of the Empire will be facilitated, and that by the consequent increase of purchasing power of their peoples the trade of the world will also be stimulated and increased".*
> Australian Hansard, 13.10.32 in Reitsma (1960, p56).

While this may have been the flawed theoretical underpinnings of the Ottawa Conference, it certainly was not the reality of the agreement. The clear intention of the British government was to keep the foreigners out of British and Dominion markets, to juggle the needs of domestic sectors such as farmers and Dominion primary producers, and to maintain markets for British manufactured products around the world. The British negotiating team, made up of Conservative ministers (who dominated the new coalition), hoped to use the tariffs imposed against foreign imports as a bargaining tool.

Tracy (1989, p151) puts it more directly:

> *"The principle underlying the [British] Government's policy was that home producers should have first claim on the Market, Empire producers second and foreigners last".*

This was an impossible task and it was just a matter of time before the package began to unravel.

New Zealand had few alternatives but to support British attempts to implement these policies. The powerful agricultural lobby in New Zealand and public opinion fully supported excluding 'foreign' agricultural commodities from the British market. According to Belshaw et al (1936, p800), New Zealand sought:

- A guaranteed market for agricultural exports, especially dairy, meat and fresh fruit, to alleviate pre-1932 price fluctuations.
- To severely limit other countries' access to the British market.
- Preferential treatment from Britain over other Commonwealth producers.

Other Commonwealth countries, particularly Australia and Canada, needed access to the large British domestic market for their agricultural products. But they were wary of conceding unlimited access of British manufactured exports in return, as this move would have an impact on their own infant factory industries.

Preparations

The preparations focused on the 'problem' and the possible solutions. The main problem facing New Zealand was oversupply of the British agricultural produce market. The situation was made even worse by increased New Zealand production, and exports of agricultural products, particularly dairy produce. The volume amount of butter sent from New Zealand to the British market had tripled in 14 years. Also, as the depression intensified, farmers around the world searched for markets to take their output, as barriers to trade were erected more and more widely. Britain was the last great open market—as a result of the early nineteenth century policy shift to free trade that started with the abolition of the corn laws. The result was that the British market was being flooded with agricultural produce.

The immediate answer to this was to organise exclusive access to the British market. The general consensus of both the public and the agricultural lobby in New Zealand was that the British market was *rightly* New Zealand's market. If that meant the exclusion of others, then so be it.

If possible, New Zealand negotiators, to improve the position further, favoured an exclusive arrangement on agricultural products, even at the expense of other Dominions. Most Dominions saw the relationship with Britain in their own terms. Relationships between different Dominions were seen as if there was a giant mirror placed in Britain which reflected back on each Dominion. New Zealand saw Australia, for example, not directly across the Tasman Sea, but through its relationship with Britain: effectively a 'hub and spokes' relationship.

The practical impact of this type of relationship was the vicious competition among the Dominions for British markets. Commonwealth trade policies were characterised by bitter rows (for example the disputes between New Zealand and Australia over access to each others markets in the 1920s and 1930s) and the use of 'sharp elbows' as they competed for market share in Britain. One of stated aims of the New Zealand delegation was to obtain, not only preferential treatment in Britain over 'foreign' produce, but also, as far as possible, over that from other Dominions.

Resources

Most of the available resources within New Zealand were used in an attempt to influence the make-up of the delegation to Ottawa. In essence, the issues to be discussed at Ottawa were straightforward, so the brief was simple and the domestic focus was on who would represent New Zealand. In particular, the powerful Farmers' Union (precursor of Federated Farmers), the Sheepowners' Association, and representatives of meat, dairy and fruit producers' boards exercised their political muscle to ensure they obtained the representation they wanted at Ottawa.

The importance of the Ottawa Conference to New Zealand was illustrated by the political difficulties in even choosing the delegation. In the early part of 1932 it had almost been decided that the Premier (Forbes) and the Minister of Finance (Stewart) would attend the conference. However, the powerful farming lobby objected to the influence of Stewart, since he was not seen as 'farmer friendly'. Stewart was also seen as a powerful (negative) influence on Forbes.

Farmer organisations agitated for Coates (head of the Reform Party, then part of the United/Reform Coalition Government) to replace Forbes as head of the delegation and voiced their disapproval of Stewart. After Stewart had threatened to resign, it was decided in May that Forbes, Stewart and Coates would all attend the conference. However, this meant that New Zealand would have been sending its three top-ranked ministers overseas for nearly two months, given travel time. This caused alarm in the press and put further pressure on Forbes. Two weeks before the group was to sail it was finally announced that Coates would lead the New Zealand delegation, and Premier Forbes would remain in New Zealand.

The tussle over the make-up of the delegation illustrated the perceived importance of the Ottawa Conference, and the influence of farmer-politicians in New Zealand.[54] Coates, the Northland popularist, who depended on farmer support, ended up leading the New Zealand delegation to Ottawa.

Negotiating process

"it was not a love-feast for which Conservative imperialists and protectionists had hoped". Mowat (1955, p417).

The Ottawa Conference was convened on 21 July and ran till 20 August 1932. It could not be said to reflect of the spirit of the Empire at its finest. Rather than a principled and possibly high-minded discussion about what was best for the whole, it was closer in tone to the kind of family squabble that might result from an intestate death.

From the beginning, the stark economic realities of the situation meant that the different domestic pressures in each country imposed themselves on the negotiations. And this was essentially a conference of politicians—that was who the delegates fundamentally were. The British, who had just introduced their general tariff, were hoping to offer preferential treatment on

[54] Brooking judges Coates to be one of the great New Zealand farmer politicians, while assessing Forbes, in passing, as unsuccessful (Brooking, 1997). The vital nature of farmer influence was also shown by the fact that senior farming leaders were also included among the others in New Zealand's delegation.

products imported from the Dominions in return for access into Dominion markets. They were constrained by the desire to protect the British farmers from the 'ravages' of world markets and the very real need for the 'workshop of the world' to trade with 'foreign' nations.

On the other hand, the Dominions wanted access to the British market, but were not prepared to expose their protected infant industries to competition from mainly British manufactures. The Dominions wanted trade, but only in areas that did not impact on carefully built up domestic economic developments.

Such an economically irrational agreement could not hope to succeed or be sustained. All sides had adopted positions that were inherently contradictory, and attempts by all to get their own way caused much bitterness at the conference.

The flavour of the proceeding is captured by Loch (1955, pp417-18):

> *"The British ministers found themselves amateurs at the game of bargaining over tariffs. The fighting, haggling and snubbing to which they were subjected even threatened their own unity. They were exposed to sharp attacks in the Canadian press. Even civil servants such as Sir Horace Wilson, adept at the production of mollifying 'formulas', were not spared from criticism. At the end, the conference almost broke down at an all-night session which Chamberlain left in disgust".*

The boisterous approach taken by the Australian and Canadian ministers put paid to any ending that would have been a showcase for Empire solidarity. They were playing to their own domestic constituencies and keen to blame Britain for the domestic difficulties. This placed the British in a no-win situation. The UK delegation was exposed to persistent and almost belligerent attacks by Australian and Canadian ministers, who were very keen to open British markets, while equally adamant that their own nascent industries—and the employment they represented—should be protected from fierce international competition.

While Canadian and Australian positions were entrenched, New Zealand had very little bargaining power. With a small home market and high dependence on trade with Britain, New Zealand had little choice but to acquiesce to British demands. In this situation, New Zealand negotiators took a more low-key conciliatory approach than their Empire colleagues. Even before the conference, for example, New Zealand already had a preferential tariff system in operation for British goods.

The conference did nothing for relations between the Dominions and the United Kingdom, and set the prevailing tone for the next 40 years. As the Australian and Canadian economies became more diversified in terms of products and markets, and Britain thereby became less important to them, their trading relationship deteriorated further. For New Zealand however, the British market was, and remained, vital. This focused New Zealand trade policy solely on the British political 'market', with all the risks that that entailed.

Outcomes

Deals at the conference

The main agreements reached at Ottawa between the United Kingdom and the Dominions, according to Belshaw et al (1936, p799), were:

- Those products imported by the United Kingdom from the Dominions that were exempt from duties under the Import Duties Act 1932 would remain free of duty.
- The United Kingdom applied tariffs on foreign goods entering their markets. These included wheat, butter, and cheese, all of which received a 15 percent *ad valorem* tariff. Apples and pears, dried fruit, eggs, milk products and honey were also taxed at the border.
- After three years the United Kingdom reserved the right to put tariffs on dairy products and eggs from Dominion nations, while maintaining preferential margins over foreign products.
- The Dominions agreed to reduce tariffs on imported British goods and maintain preferential margins. In New Zealand's case

the preferential margins would be no less than 20 percent, unless otherwise agreed to by the British government.

- The British Government secured, as part of the agreement, a commitment from Dominion nations to conduct inquiries into their own protected industries and guarantee that:

  "protection by tariffs should be afforded against United Kingdom products only to those industries which are reasonably assured of sound opportunities for success"; and,

  "... where necessary, to reduce protective duties as speedily as possible to such a level as will place the United Kingdom producer in the position of the domestic competitor, that is, that the protection afforded to the (Dominion) producer shall be on a level which will give the United Kingdom producer full opportunity of reasonable competition on the basis of the relative cost of economical and efficient production".
  See Belshaw et al (1936).

- Quantitative restrictions were brought in for meat in the United Kingdom market. South American mutton, lamb and frozen beef were reduced, by progressive quarterly cuts, to 35 percent of the volume for the year ending 30 June 1932. The same applied to foreign chilled product. Australia and New Zealand agreed to hold volumes at the same level as that shipped in the year ending July 1932. Furthermore, this agreement was to hold until 1934 when it would be renegotiated. The policy was designed to increase the share of the market for Australian and New Zealand producers and increase the price to 'remunerative levels'.

- Canadian pork producers were given free entry into the United Kingdom market up to a maximum of 2,500,000 hundred-weight per annum.

- Dominion countries also asked that tariffs and quantitative regulation be applied on foreign produce such as dairy products, meat, and fresh fruit. The agreement stated that:
  - ❑ Quantitative regulation of imports of meat would apply to all import sources.

- Preferential tariffs, rather than quantitative restrictions would apply to dairy products.

Trading arrangements after Ottawa

The change to a 'managed system' of trade within the Empire, had its inevitable cost. The necessary engagement of the political dimension to produce the regulatory environment required for tariffs opened up the structure to further 'political influence'. Thus there was constant 'tinkering with the system' as various groups in Britain lobbied to gain a favourable position. Politicians in the United Kingdom became more reactive to demand and supply conditions for domestic goods traded, rather than trying to develop a coherent and efficient trade policy.

For example:

- In 1933 the British government made agreements with Argentina, Denmark and Sweden: in return for entry of British goods into these countries, price-unrestricted entry of butter, meat and bacon into the UK was allowed. However, quantitative restrictions remained in place and were the dominant influence on the market.
- The United Kingdom in 1934 and 1935 increased subsidies paid to British farmers for manufactured milk (mainly for cheese production) and meat. This enhanced the supply response from British farmers, and made their product more competitive in the domestic market.
- In a subsequent meat agreement in 1935, the United Kingdom agreed to allow 1932 levels of mutton and lamb into Britain with no duty or levy from the Dominions.

These continual (and demanding, because they were potentially economically critical) access talks and negotiations would typify the ongoing relationship between Britain and the old Empire (at least for New Zealand) up until the end of the Uruguay Round in 1994. They also, due to the situation of the UK as the sole large high income country with a net import demand for temperate agricultural products, came to be increasingly important for the Europeans.

Post-agreement trading situation

World trade in the 1930s was in total disarray.[55] The depression finally triggered by the Wall Street crash in late 1929 struck hard at virtually every country in the world. And its severity was prolonged by the economic policies adopted by large and small nations alike. The Ottawa agreement, like the US adoption of the 1930 Smoot-Hawley tariff package, might have given advantages to some (the Empire countries), but helped reinforce the acceptability of the general *sauvre qui peur* attitude, which was encompassed in preferential exclusiveness. It thereby could be seen as contributing to the vicious spiral of 'beggar thy neighbour' policies adopted in the 1930s, which set a restrictive framework around the world trade system.

The Ottawa agreement ushered in a new era of managed agricultural trade between an important world market sub-system, Britain, the Dominions and the surviving 'foreign' suppliers. For the UK, it broke 90 years of free trade policies that extended back to the hard-fought decisions of the corn laws and, as they had done, ushered in a new shape to the international trading scene. The predominant factor was the great trading uncertainty.

Conditions were bad already. The incomes of countries had declined, and most were really suffering economically. There followed a series of body blows to the prevailing style of open international trade, which had offered a potential way out of the position they found themselves, by exporting the surplus production domestic consumers could not—hopefully temporarily—afford. The sudden conversion of the UK economy from the 'swing market' of world agricultural trade to a politically managed closed shop undermined the whole system.

The introduction of preferential tariffs and quotas produced a structure that was designed to maintain agricultural trade for the Dominions at the exclusion of other, so-called 'foreign' nations and,

[55] See, for instance, Yeagar (1966).

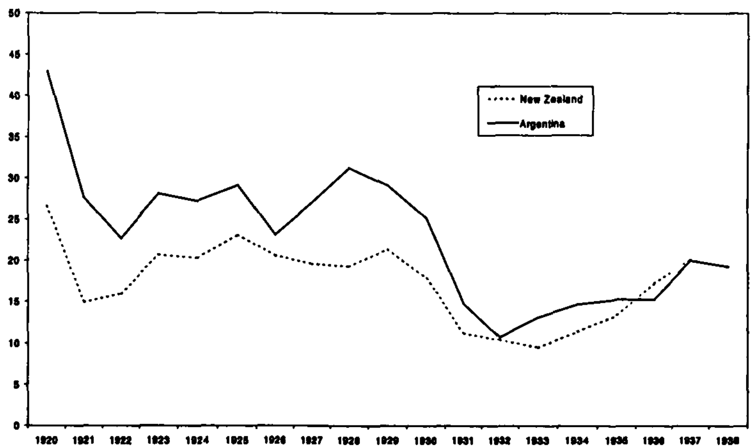
at the same time, subsidise its own domestic farmers. For New Zealand, the Ottawa Conference marked:

> *"...the beginning of a new and uncertain epoch in the economic history of the Dominion"*
> Belshaw et al (193, p787).

This uncertainty lasted for nearly 50 years as New Zealand officials tenaciously held on to the perceived gains brought on by the Ottawa Agreement. The uncontrolled commercial uncertainty of a relatively free market that had stood New Zealand in good stead, had been (deliberately) swapped for the uncontrollable political uncertainty of the managed market.

Figure 8 A comparison of exports from New Zealand and Argentina to Britain

Nominal prices (000's of pounds)



Source: Mitchell & Deane (1962, p326)

At the time, New Zealand was very happy with this relationship to a point of smugness. Ross (1994, p3), points out that:

> *"... right through until the 1960s one could hear people talking about the benefits of the Ottawa Agreement. What people in New Zealand tend to forget or ignore, is that we obtained those benefits at the expense of someone else. ... The effect of the*

Ottawa Agreement, however, was to greatly restrict Argentina's access to the UK market, and whilst New Zealand's trade with the UK prospered as the UK came out of depression, Argentina was unable to benefit from the new found growth, and entered a period of prolonged decline. As we ponder our own situation, following Britain's entry into the European Economic Community, and the gradual whittling down of our dairy quotas, we would do well to spare the odd thought for the poor Argentinean".

Figure 8 and Figure 9 show the impact of the depression and the Ottawa Conference on Argentinean imports and exports to Britain, relative to those of New Zealand.

The total value of imports from New Zealand to Britain dropped sharply in value terms after World War I and during the depression. The drop, however, was more dramatic for the value of Argentinean goods over the same time periods. The value of Argentinean exports declined as their country's exports were shut out of Britain—effectively to allow both UK and New Zealand farmers to share out the reduced demand among themselves.

The impact on the South America nation was disastrous. Furthermore, the Argentinean economy was already in long decline. It had been about as strong—at least in terms of the incomes per head generated—as the Australian and New Zealand economies before the first world war. By the time of the Ottawa agreement it had fallen behind in relative terms. After Ottawa however, military coups and popularist economic mismanagement pushed the Argentinean economy into a vicious downward cycle of negative interaction between economics and politics; a cycle which, 60 years later, still seems to be impacting on the Argentinean economy.

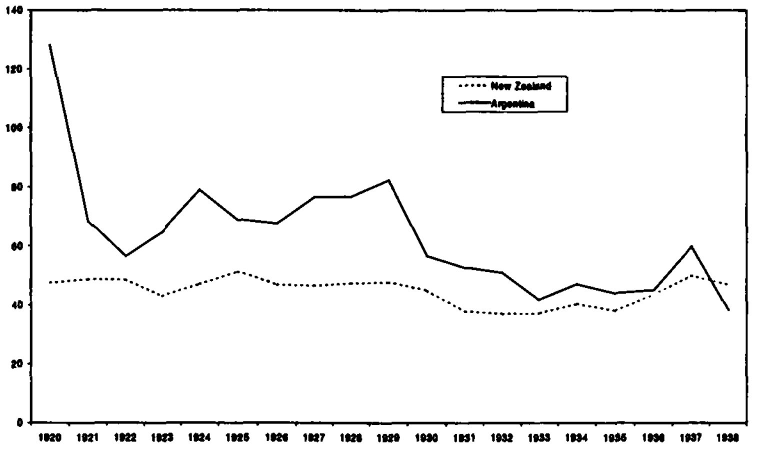
The preferential tariffs given to the Dominions came at some expense for the United Kingdom. They [the British]:

"...sacrificed the investments of a century [in Argentina] in order to eat for a few years". Condliffe (1959, p27).

Figure 9 shows that while British exports to New Zealand recovered, at least in nominal terms, the level of exports to Argentina dropped well below 1920 nominal levels.

Figure 9 A comparison of imports to New Zealand and Argentina of British goods

Nominal prices (000's of pounds)



Source: Mitchell & Deane (1962, p326)

The exclusive nature of the agreement was not sustainable long term—as a short-term, almost emergency, reaction to the crisis of the depression, the deal should probably always have been seen as interim. It had features that suited some countries well; but the reasons it was never likely to persist were many.

These include:

- The Dominions found that the strictest adherence to the Ottawa Conference deal created real problems with other trading partners with whom they sought accommodations. By 1937 the Canadians had replaced the Ottawa Conference accords with new agreements. Trade relations between some Dominions and 'foreigners' such as the United States and Japan in particular, were becoming more important, despite the existence of punitive tariffs.

- The formation, after World War II, of GATT, founded on the principle of 'most favoured nation' (MFN) status explicitly to reduce the likelihood of exclusive trading block, was at odds with the British preference system. And the initial negotiations saw the US seek to dismantle the system. But the UK was still the world's largest trader and created an uncomfortable niche within the GATT mechanism wherein the British preference system could actually be GATT protected. But the writing was on the wall for these preferential arrangements, as the old 'emergency structures' (Ottawa) gave way to the new more lasting post-war institutions.

Because New Zealand's trade with foreign nations was negligible, the Ottawa Conference was seen as vitally important. It created a new treadmill, however. In practically every year after the Ottawa negotiations, New Zealand officials were involved in market access talks about the UK market. These even survived the entry of the UK into the EEC.

This meant that there was an enormous amount of scarce time and valuable resources spent by ministers and officials shoring up access into the British, and later European, markets. Foreign policy may have been trade policy at this point in New Zealand history, but the trade policy conducted was mostly to do with market access[56] (Lattimore and Hawke, 1999).

While New Zealand and other Dominions gained with the expansion of market share through preferential access to the British market, they were also granted domestic manufacturing hegemony to British imports. The New Zealand tariff was a 'three column'

[56] Realistically, there were two reasons for this:

- The UK market was the 'natural destination' for the produce that New Zealand had at its disposal—the output had been selected and calibrated for the demand there and distribution channels were well organised.
- It was widely believed, probably correctly, that there was no other market where the prices would match those on offer in the UK.

Overall, these meant that price was not an initially salient factor. Once entry—at reasonable access prices—could be achieved, disposal at profitable levels of remuneration was not a problem.

structure with British imports having the right to a special rate (British preference or BP)—typically lower than the most favoured nation (or MFN) level—until UK entry into the EEC. After that, the bulk of the BP rates[57] was extinguished, leading to a messy GATT negotiation about compensation.

New Zealand and Australia did gain from the agreements at Ottawa. The immediate result for them was increased trade to Britain in dairy and meat products at the expense of other foreign countries. But as Habeeb (1988, p21) suggests, the lack of an alternative strategy put the Dominions in a weak bargaining position. This was illustrated when Britain signed trade agreements with Denmark, Sweden and Argentina in 1933. The United Kingdom agreed to allow some access of agricultural products into the British market from these foreign nations, in return for reciprocal access of British manufactured products. Dubbed the 'Three Black Pacts' in the Dominions, and combined with increased subsidies being granted to British farmers, the outcome exposed the weak bargaining position of the Dominions.

However, this weak position increased the focus of Dominion countries, particularly New Zealand. The tenacity to which the New Zealand politicians and officials held on to their share of the British market demonstrates the importance of focus. Furthermore, this focus extended to other parts of New Zealand's foreign policy that impacted positively on trade policy in the post war era. After World War II, the loyalty displayed by New Zealand during that conflict was also used to great effect in trade negotiations, particularly when Britain joined the EEC.

This also fits into the Habeeb framework. It illustrates that there is more than 'one right path' when it comes to deciding on strategies and tactics associated with trade policy issues from a small country perspective.

[57] As a matter of practice, the BP rates on motor vehicles and parts remained in place for a significant time after the rest. One reason for this was the significant amount of tariff preference involved, on what was a British industrial sector under ultimately fatal pressure throughout the 1970s and 1980s.

CONCLUSION

At the time of the Ottawa Conference, New Zealand was in a tight economic bind. Agricultural production was increasingly driven by technology, and demand in its only market, Britain, had reached limits. Combined with this, the onset of the depression had sent agricultural prices tumbling. The Ottawa Conference presented a chance to lobby for exclusive rights to the British market. If 'foreign' and other Dominions' agricultural exports had to be sacrificed to maintain New Zealand's 'rightful place' in the British market, then so be it.

With New Zealand's strong British heritage, and powerful farming lobby there was an overwhelming consensus amongst New Zealanders that they had a divine right to exploit the British market, even at the exclusion of others. The prosperity generated by exploiting the British market between 1880 and 1920 meant that any talk of the risks of depending on one market, or from producing a narrow range of commodity products, was quickly dismissed. There was little room for discussion on the long-term structure of trade, or the sustainability of the trade policy. The problem was both practical, and here and now; so the solution was a 'natural' one—the ties of Empire would mean something.

But the result had far-reaching outcomes. The Ottawa Conference was a major milestone which influenced New Zealand trade policy approach right up until the end of the Uruguay Round in 1994. Two important forces were at work, and they were sometimes in conflict.

There was a seeming lack of alternatives to the strategy already being pursued and in addition there was a short-term need to be responsive to compelling immediate imperatives. This appreciation of the situation dominated thinking in the 1930s. It was driven by a powerful farming lobby that exerted a heavy influence on trade policy—illustrated by the discussion, and then the finally agreed make-up, of the Ottawa delegation. Farming groups agitated for those representatives that they saw as friendly to their interests, making sure that their choices were included in the delegation. This reinforced the pre-eminence of farming interests in developing trade policy.

The strengths of this approach were the commitment and focus applied to the negotiating process. By pledging loyalty to the British position, New Zealand was partially able to stand aside from the ferocity of the attacks directed at the British by the Australian and Canadian delegations. New Zealand's commitment to all things British, not just at Ottawa, but in all aspects of New Zealand's foreign policy (such as defence) gave New Zealand a special position in British society and politics. This was to play into New Zealand's hands in latter negotiations, and become a major issue for British politicians when they were seeking to join the EEC.

Despite the satisfaction about the result in Ottawa, the lack of economic consistency and logic in the final agreement signalled a coming 'sea change' in policy. Over the long term, the agreements made at Ottawa were not economically sustainable—indeed, their logic contained their own destruction. The reasons they were able to be forced on the British was a product of the extreme nature of the situation. This was never likely to be permanent, and possibly would be addressed by the measures themselves. Thus at some point in the future, Britain would either limit volumes of New Zealand produce imported (which happened when Britain joined the EEC) or open up its markets again (which may yet happen under current and future WTO agreements).

No amount of commitment or focus in New Zealand's stance towards the British, through both trade and foreign policies, could overcome the need for New Zealand to diversify its markets and increase the range of products exported. The Ottawa Conference was the first sign that the British market was not a bottomless one. From this point on, New Zealand slowly began to be seized by the need to diversify its markets and products as Britain attempted to place limits on New Zealand agricultural imports. It also spelled the end to the brave experiment in free trade in the British market, and provided further evidence of the decline of British importance in world trade.

Case II: Britain and Europe

INTRODUCTION

> *"... in 1961 an event occurred which, overnight, was to profoundly change the whole basis of the relationship. In the House of Commons on July 31, Harold Macmillan announced that Britain intended to seek full membership of the Common Market.*
>
> *In the few seconds it took Macmillan to utter that phrase, one of the lynch pins holding the Commonwealth together was jerked loose. The reaction in New Zealand was one of profound shock. There had been comparatively little public discussion of either the implications or the immediate effect of such a move. For the first time, many New Zealanders were being forced to assess, in an entirely new light, the one factor in their lives which had seemed secure and unshakeable".* Robson (1972).

The new limits to access to the British market brought on by Britain's accession into the EEC signalled a structural break in New Zealand's economic trading relations. The first signs of this process can be traced, in trading terms, to the signing of the Ottawa agreement in 1932, which applied limits to the amount of agricultural products that New Zealand could export to Britain. Attempts to control imports of New Zealand agricultural products (as part of the large-scale balancing act the British government was intent on) continued throughout the 1950s and 1960s. It was the British accession into the EEC, signed in 1971 and implemented in 1973, however, that finally altered New Zealand's existing trade patterns as they had developed since 1880.

In some respects, the formation of the EEC and Britain's accession was inevitable. At one time or another, Britain and members of the Six[58] were world powers in their own right, most

[58] The members of the EEC before Britain, Ireland and Denmark joined were referred to as the 'Six'. They were the original signatories of the Treaty of Rome,

with significant empires. Two world wars, and the rise of the US as a major international economic (and political) power meant that their relative influence on world trade and affairs had waned.

For Britain particularly, events such as the 1956 Suez Canal incident served to reinforce their diminished position in the world and the need for greater economic co-operation with Europe. Non-economic considerations for Britain, such as security, were also important, particularly with the Cold War in full swing.[59] Joining with Europe was one way of attempting to regain some of Britain's former glory, albeit in a bigger grouping of nations.

The choice for Britain was relatively straightforward, despite its attachment to the Commonwealth. The European markets were large and their consumers were wealthy—and growing wealthier—just when the UK was regretting its sluggish growth. Without selling into Europe, Britain could not see where the export demand was to come from to sustain increased growth in its economy. The alternative Commonwealth markets were a mixture of the distracted (Canada had long ago focused entirely on the US connection), the sparsely populated or relatively poor (much of Africa and Asia) and were, in any event, grappling with increasingly diverse issues like de-colonisation. And for many members (including New Zealand), the UK economy's poor performance in the 1950s and 1960s had dragged down their own prospects. The group was unlikely to self-levitate. An outside source of economic dynamism was required.

And the European 'miracle' was already at hand. The recovery from the chaos of 1945 fuelled by the Marshall plan, trans-Atlantic generosity (and self-interest) coupled with the sustained restructuring of most of Western Europe into modern economies,

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and comprised West Germany, France, Italy, Netherlands, Belgium and Luxembourg.

[59] This is evident today as the EU (as it is now called) attempts to widen the net of countries it has on its eastern borders. One explanation for the willingness of the EU to accept new members is that they are attempting to 'lock in' the social and political changes now happening in Eastern Europe, over the long term.

had produced sustained growth rates the British could only wish for. Increasingly affluent markets of millions of consumers were busily trading in their two-wheeled transport for cars, and looking toward increasing their levels of consumer comfort. The manufacturing side of the British economy needed to access this demand.

So the simple economics was compelling.

Britain's future economic orientation was with nearby fast-growing, big-spending Europe, not the relatively poor, sparsely populated or far-flung former empire.

Furthermore, the formation of the EEC was an attempt to solve a pressing geo-political problem that had already caused three major conflicts in the previous 100 years. To prevent further European wars, France and Germany in particular, believed that some sort of tight European integration was necessary. This would include both a close political relationship and strong economic links to back it up. As it happened, however, the price for that integration was the development of an inward-looking agricultural policy that manifested itself in the form of the Common Agricultural Policy (CAP).[60] So in the end, lasting peace was bought partly by the use of agricultural subsidies—paid largely by the Germans and received, in large part, by the French.

The spectre of Britain joining the EEC was seen in a completely different light in New Zealand. At the beginning of the 1960s, as the

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[60] It is sometimes suggested by New Zealand commentators that it would have been preferable for Britain to join the EEC before the formation of the CAP. In that way, the British might have had a restraining influence on the generous support offered to European farmers, therefore creating over the long run a less generous CAP. This outcome would then have been more favourable for New Zealand.

For various reasons however, the British only applied to join the EEC in 1961, so entry would have been in 1963. This would have been a year after the formation of the CAP by the Six (1962). The CAP was also seen by the Europeans as the price they had to pay for a de Gaulle-led France entering the EEC. In hindsight, after two French vetoes in the 1960s, it is difficult to see how Britain could have entered the EEC (in the 1960s) without embracing some form of CAP, which must have involved forcing New Zealand out of its favoured status in the British market.

earlier quotation suggests, New Zealand was conscious of looking down a rather large barrel of a loaded and cocked economic gun. The sudden realisation that Britain was looking elsewhere for its economic development, and the real possibility of New Zealand being excluded, is illustrated by the title headings in the booklet that explained New Zealand's position on British entry into the EEC to the British public. These headings included: *New Zealand—Britain's Other Farm, The Sword Over Our Heads,* and *The Threat to New Zealand's Markets.*[61]

There was no doubt that New Zealand officials, government, and people were profoundly affected by the British intentions to join the EEC. Discussion of the issue dominated the media of the day.

Table 17 illustrates why New Zealand felt so vulnerable to British attempts to join the EEC. While some efforts were made to diversify New Zealand's markets after the 1932 Ottawa Conference, the export dependence on Britain remained.

In the booklet, *Britain, New Zealand and the EEC,* the point is also made that while New Zealand had attempted to diversify its markets, it had been constrained by EEC dumping of subsidised product in the third markets of interest. These same issues: access and subsidised dumping (predominantly by Europe) still impact negatively on New Zealand's economic performance.

Table 17 UK share of New Zealand exports of major products, 1970

Percentage	
Butter	90
Cheese	75
Lamb	86

Source: Adapted from New Zealand Government Statement (1971)

Table 18 shows the import/export profile of the New Zealand economy over the period 1939 to 1970. The figures show that there

[61] The quoted headings come from: New Zealand Government Statement (1971) *Britain, New Zealand and the EEC.*

were significant changes in the direction of increased diversification of the export/import profile during the 1960s. New Zealand recorded strong growth in markets other than Britain. Over the years 1939 to 1970, the movement away from Britain is also highlighted as post-World War II trade increased. These changes were driven by a number of forces, but one of them was the deliberate policy to develop new export products, new suppliers and new customers. This was reflected in the steady growth of the network of overseas-based trade promotion officers that New Zealand established throughout the period.

Table 18 New Zealand exports and imports destination and origin

Percentage

Exports	1939	1950	1960	1970
UK	81	66	53	36
USA	5	10	13	16
Japan	1	1	3	10
EC 'Six'	5	12	16	12
Australia	4	2	4	8
Imports				
Other	4	9	11	18
UK	47	61	44	30
USA	11	7	10	13
Japan	2	-	3	8
EC 'Six'	3	2	1	7
Australia	13	12	18	12
Other	24	18	24	21

Source: Statistics New Zealand, Yearbooks, various years.

THE PROCESS OF BRITAIN JOINING THE EEC

The negotiations for British entry spanned ten years, and three separate attempts, before accession was finally granted by the Six. The negotiation process was extremely difficult, as each side attempted to adjust their expectations about the likely conditions of British entry. For Britain, apart from what it was going to contribute to the EEC budget, the most difficult task was how best to deal with Commonwealth nations and the preferential access treatment they had enjoyed since the 1932 Ottawa Agreement.

In this regard, it was the question of New Zealand's role in the British market that required the most attention.[62] New Zealand was a special case with strong cultural links; it had enthusiastically stood by Britain in both the world wars; it efficiently produced bulk agricultural products; and its economy depended upon the British market to take its bulk agricultural products. The strong ties between Britain and New Zealand meant that there was a great deal of sympathy and admiration in the British parliament and amongst the British public for New Zealand's case. If the Six were serious about British entry, they would have to grant New Zealand agricultural products continued access to the British market. In the first two attempts, a 'de Gaulle's France' vetoed British entry even before serious negotiation on New Zealand access took place.

However, at the third attempt the talks were more serious. As the negotiations moved towards a conclusion, the question of New Zealand access to European markets in Britain's accession talks took centre stage. This was an unusual event, since how could a small country, geographically isolated from Europe, have such a starring role in the negotiations of such an inwardly focused block as the EEC? The special conditions that applied to these negotiations and how New Zealand attempted to exploit them are explored in the following sections.

Aims

The simple aim for New Zealand was to retain as much of the British market as possible.

The briefing papers that the Deputy Prime Minister and Minister of Overseas Trade, John Marshall, took to the final negotiations stated that: New Zealand would accept 85 percent or above in milk equivalents without consultation (with Wellington); anything below that would have to be cleared with the New Zealand Prime Minister, Keith Holyoake. It was also

[62] Other Commonwealth commitments by the UK had to be addressed, but most of those were dropped, or subsumed under existing EEC policy—this covered the recognised interests of developing countries in Africa and the Caribbean.

understood that the acceptable bottom line was 74 percent (milk equivalents), but the make or break point was 70 percent of milk equivalents. New Zealand would also press for lamb to be put on the negotiating table.

To achieve this sort of outcome New Zealand needed to ensure that the British government would argue New Zealand's case, and would thereby persuade the Six that minimum sufficient entry for New Zealand's agricultural products was a precondition for European entry.

So New Zealand needed to:

- Gain the support of the British parliament and people, so that New Zealand could effectively threaten to veto British entry if conditions were not suitable for New Zealand. This put intense pressure on the British negotiators to argue strongly for the New Zealand case.
- Explain New Zealand's position to the Six and make them understand that without a suitable accommodation for New Zealand, there was a real threat that Britain would not join the EEC.
- Construct and use economic and non economic arguments that would appeal to European politicians, or would be influential in swaying their opinions.
- Capture the language of the debate.[63]

Preparations

After Harold Macmillan announced Britain would attempt to join the EEC in 1961, Duncan Sandys, Secretary of State for

[63] The milk equivalents tables were an example of how the crucial language was captured by New Zealand officials. *Milk equivalents* translated tons of dairy product into amounts of milk required to manufacture the products. The use of 'milk equivalents' was favoured by New Zealand officials because it allowed for flexibility in the amounts of each particular dairy item it could export to the British market so these could be adjusted depending on market conditions. Instead of exporting a specified amount of cheese or butter, New Zealand dairy companies could maximise revenue by exporting to Europe the most profitable product.

Commonwealth Affairs visited New Zealand to explain the British position. Outside the final negotiations this was the most important meeting for New Zealand because it set the parameters for the negotiations that would finally take place ten years later. When the visit of Sandys ended, a seven-point communiqué outlining an agreed British-New Zealand position was formulated. Of most importance to New Zealand was the seventh point:

> *"New Zealand Ministers welcomed the assurances that Mr Sandys has given before and during any negotiations, that in any such negotiations the British Government would seek to secure special arrangements to protect the vital interests of New Zealand, that Britain would not feel able to join the EEC unless such arrangements were secured, and that the results of any negotiations would be thoroughly discussed with the New Zealand Government before the British Government took a decision to join the EEC".*

This communiqué formed one of the important building blocks from which New Zealand could launch its case for preferential treatment in Europe.

Another of the important building blocks was the New Zealand Minister of Overseas Trade, John Marshall's frequent trips to Europe. In the ten years from 1961 he made ten visits. On his first trip he established the pattern that revealed some of the subtle tactics required to maintain New Zealand's position in the British market. The visits were, for example, not confined to Britain. He made a point of visiting all capitals of the Six and explaining to key politicians and officials why it was important to make an exception for New Zealand. This process made careful use of both economic and non-economic arguments.

These included:

- *The war card.* New Zealand soldiers had fought and died on European soil in both world wars. New Zealand ministers, particularly, played this card using rather emotive and impassioned speeches to appeal to British and French politicians for access into Europe. It was the one argument, it seems from the comments made by Pompidou, the French President, to

Holyoake, which the French were prepared to listen to in favour of some accommodation for New Zealand.

- *The strong cultural and historical ties between Britain and New Zealand.* New Zealand made great play of the similar way of life and outlook given the common heritage of the two countries. This was personified by the quiet and unassuming reasonableness of Marshall, relative to the louder, more self-confident approach taken by Australian politicians.
- *The economic arguments and the possible impact of New Zealand being shut out of the British market.* Many stories detailing the efficiency of New Zealand farming (relative to the EEC) were printed in the British press. These stressed the lack of fairness of denying access to an efficient dairy producer, such as New Zealand. The stories would be followed up by others that detailed the possible reverse migration that could occur from New Zealand as a deteriorating economic situation followed a British market shut-out.

The most important target for New Zealand was British public opinion and their parliament. There was already a lot of goodwill towards New Zealand at Westminster, based on the historical contacts, New Zealand's role in the first and second world wars and the common ancestry of the people. These all meant that New Zealand's case would receive a sympathetic hearing. The stance taken by New Zealand was that at no stage should New Zealand be seen to interfere directly with the British position on EEC entry. However, moves would be made to protect New Zealand's vital position in the British market. So the economic and non-economic arguments were tailored to suit the audience.

For example, as part of the campaign, the High Commissioner, Sir Dennis Blundell, made frequent speeches to audiences in London and other cities in Britain, setting out the New Zealand position. Towards the end of the negotiations the High Commission was receiving literally hundreds of letters a day in support of the New Zealand position. It would be safe to assume that parliamentarians in Britain were getting similar letters in the same quantity—this served to keep the pressure on the British government. Robson (1972) suggests that this had the effect of a self-fulfilling prophecy, since the British media began printing stories saying that there was no way Britain would join the EEC unless New Zealand was accommodated, since parliament would veto the proposal. In this way, support for New Zealand gained further momentum.

Similar approaches were adopted in Europe, where Europeans were reminded of New Zealand's contribution to two world wars and the unfairness of shutting out a long-standing existing player who was producing farming goods efficiently.[64]

Above all, it was the appeal of the reasonableness of the New Zealand case that became persuasive. New Zealand was never presented as being opposed to British entry, but it was asking for recognition of New Zealand's special position. With that focused aim, booklets and pamphlets were produced to present the impact on the New Zealand economy and designed to be digested by interested parties in a neutral way. While other factors were important, it was the reasoned way in which ministers and officials went about the task of explaining New Zealand's case that became important.

Resources

As the British market was vital for New Zealand interests, resources were concentrated on the task. Examples of this were:

- New Zealand had strong representation in the Six's capitals and the best people in Wellington working on the 'problem'.
- Top political figures, Marshall and Holyoake, together with key senior officials, made trips to Europe as frequently as was necessary.
- The facts were pulled into a New Zealand picture. The New Zealand government produced books on the New Zealand economy that quickly became used by all sides, including the

[64] The war card of course was not played in West Germany. However, the West Germans were mildly sympathetic to the New Zealand cause because of the efficiency of the New Zealand farming effort.

French. The most influential publication was a booklet entitled: *New Zealand and an enlarged EEC*. It had reliable facts and figures about the New Zealand economy and farming and was translated into all of the languages of the Six.

- A professional public relations specialist was assigned to the European centre of operations, the London High Commission. The production of pamphlets and books from this point did much to sway the British public and parliamentarians. Gerry Symmans' appointment was an important step in raising the professionalism of New Zealand's bid for public opinion in Britain.
- Before 1961, New Zealand had embassies only in France and Britain. During the 1960s, New Zealand established embassies in the important European capitals. Of these, the most critical was the embassy in Brussels.
- By bringing influential European visitors to New Zealand, officials and ministers were able to demonstrate the importance of the British market to the New Zealand economy. While the French refused contact with New Zealand, other European agricultural politicians did visit New Zealand. According to Robson, this had a profound impact on some.

The negotiations

The initial announcement, that Britain would attempt to join the EEC in 1961, took New Zealand by surprise. By the time of the third British attempt at accession however, New Zealand officials and ministers had developed complementary sets of strategies and tactics to mitigate the impact of accession. The main strategy was to ensure that Britain negotiated hard on New Zealand access to the British market. The tactics revolved around gaining support for this position, not only in Britain but also in Europe.

The final negotiations began in Luxembourg on 30 June 1970 and lasted on and off for a year. Up until this time New Zealand had played a careful game, building the profile of New Zealand in Britain and the Six, attempting to influence events without giving the impression of interfering, and supporting its case through the publication of information demonstrating the economic efficiency of New Zealand producers.

Table 19 New Zealand's relationship with the Six, the European Commission and Britain

Country / Constituency	
Britain	Opinions ranged across the spectrum. (The British press reflected this).
Foreign Office	Would have sold New Zealand out as cheaply as possible. A few pounds of butter and lamb were worth sacrificing to join Europe.
Parliament	Were solidly behind New Zealand. Without New Zealand support for the British entry into Europe, the British Parliament would probably have vetoed entry.
British public opinion	Solidly behind New Zealand.
Ministers	Realised their future was in Europe, however, they read the numbers in parliament and pushed hard for New Zealand access.
France	Carried out a systematic boycott of anything beyond the most rudimentary diplomatic contact. No case existed for New Zealand to have preferential treatment.
West Germany	The West Germans were keen for Britain to join the Community and recognised New Zealand as an efficient agricultural exporter. They were mildly sympathetic to New Zealand's point of view.
Holland	Holland was very sympathetic to New Zealand's position.
Italy	Italy's vital interests were not at stake and they played only a minor role.
Belgium	Belgium's vital interests were not at stake, although they were mildly anti-New Zealand having special access, in deference to the French.
Luxembourg	Luxembourg's vital interests were not at stake. Therefore, they played only a minor role.
European Commission	Over the ten years of negotiations the Commission became more amenable to the New Zealand position.

Source: Adapted from Robson (1972).

One of the important issues was identifying who was friendly towards New Zealand's cause and who was not. It was quickly apparent to New Zealand diplomats that the main obstacle, apart from the French, to achieving the best result for New Zealand, was the British Foreign Office, who were the keenest of the Euro-philes in Britain. Unlike the politicians, they did not have to face the parliament or the electorate, and quite rightly saw Britain's natural future in Europe. And if that meant sacrificing New Zealand, then, to them, this was the price that had to be paid for Britain's future prosperity. Since the Foreign Office could not be convinced through argument, they were dealt with at the political level. The British politicians who did have to deal with the general public opinion in Britain and a possible parliamentary veto were the main target for New Zealand pressure. This made the task for Holyoake, and particularly Marshall, more crucial in influencing the final outcome. Table 19 shows in summary form the attitudes of the various players in the final negotiations.

Other tactical advantages also provided useful information to the New Zealand officials. The whole process of the British accession talks was incredibly porous. All sides leaked information and it reached the stage where documents were never actually released, but only leaked to the media. This made it more difficult for the British to manage the information flows to New Zealand officials.[65] It was a major advantage to New Zealand officials and ministers, since they were pushing a simple and clear message to all who would listen. This 'honest broker' tactic fitted perfectly with the basic strategy which was to get New Zealand a 'fair' access deal to the British market.

Over the ten-year period, New Zealand officials and ministers made a conscious effort to engage and foster contacts with the Six, while all the time recognising the important British targets. The intelligence gathering was an integral part of New Zealand officials' efforts and a vital part of the relative success of the New Zealand effort.[66]

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[65] This still did not stop the Foreign Office from saying one thing to New Zealand, and another in the negotiations with the Six.

[66] As relationships between New Zealand officials and ministers and the British delegation became decidedly chilly at the final negotiations, the British started making pointed remarks about the degree of information and the unerring accuracy of that information obtained by selected New Zealand officials.

The negotiations were many-sided. Members of the Six and Britain were directly negotiating with each other and Britain over the details of possible British entry into EEC. Mediating between the two was the European Commission, and, supposedly on the sidelines, was New Zealand. In some respects this made it easier for New Zealand and tougher for Britain. New Zealand officials, ministers and the general public were focused on one single outcome and were determined to achieve a good result for New Zealand.[67] Thus there was a bi-partisan consensus about what the end result should be.[68] On the other hand, Britain was constrained: Britain badly wanted to join the EEC but it knew that if New Zealand was not offered special conditions, then a veto might be forthcoming from the British parliament.

For the British to negotiate hard for New Zealand, a threat of a veto in the British parliament had to be credible. The clinching negotiating tactic for New Zealand was winning and maintaining the support from the British parliament and the British public. New Zealand ministers and officials did everything in their power to cultivate this support since, in the final analysis, without this support British ministers would not stand by New Zealand. This was easier said than done. It meant walking a tightrope between ensuring New Zealand got reasonable access to British markets, and not interfering (or be seen to be interfering) in the initial affairs of Britain.

As the negotiating phase developed, a careful set of tactics was developed whereby:

- The pressure was kept on agencies such as the Ministry of Food and Fisheries (MAFF) in Britain. They were deluged with information on New Zealand agriculture and the possible

[67] Even when the Leader of the Opposition, Norman Kirk, arrived in Britain he was very careful not to damage the negotiations by making statements criticising the British conduct of the negotiations or New Zealand's approach.

[68] Habeeb (1988) illustrates this point as an important possible strength in any negotiation.

impacts of New Zealand being shut out of any European arrangement.

- A campaign was stepped up to target opinion leaders and parliamentarians in Britain, reminding them of the New Zealand position and its 'reasonableness'.
- It was realised that, although important, Westminster was not Britain, and so the High Commissioner of the time, Sir Denis Blundell, developed an extensive network of contacts throughout Britain and spoke to numerous local chambers of commerce, trade groups and civic functions.

Knowing how far to push was also important. The French, for example, would never agree to permanent entry of New Zealand products into the EEC.[69] New Zealand officials adopted a line that called for 'continuing arrangements, subject to review'. This became something of a mantra, and was repeated to all who would listen.

Continuous involvement by Marshall was a crucial element in the negotiating process. As the Minister of Overseas Trade, he saw the negotiations through from beginning to end.[70] The delicate tightrope on which New Zealand walked seemed like second nature to him.[71] With strong support from New Zealand officials and deft handling of a sometimes hostile press, Marshall gave the impression of competence with total command of the subject.

He cultivated:

- A close rapport with some European ministers (Hans de Koster of the Netherlands and, surprisingly, Schumann from France).

[69] Although this is what was finally achieved with the signing of the Uruguay Round agreement of GATT in 1994.

[70] The extent to which this was a conscious strategy can be seen by the decision to split the Industries and Commerce portfolio from that of Overseas Trade so that it could stay with Marshall when the sudden death of Tom Shand in 1969 forced a cabinet reshuffle.

[71] One British reporter described Marshall's handling of the press like watching a bullfighter expertly working a bull around the ring (Robson, 1972).

By not totally relying on the British, New Zealand was able effectively to directly argue its case more widely in Europe.

- A style of understated reasonableness, particularly in Britain. This characteristic went down well with the British because it was seen as quintessentially a British trait. By not being seen to interfere in British internal affairs, playing on the close ties of the two countries, and demonstrating the efficiency of New Zealand production and the cheapness of New Zealand product relative to Europe, Marshall became well-liked by the British.

The role of the New Zealand Prime Minister, Keith Holyoake, rounded off the New Zealand approach. He was the longest serving Prime Minister in the Commonwealth and made sure the British were aware of that. His meetings with Rippon (the British negotiator) and Heath (British Prime Minister) left the British in no doubt that New Zealand would fight to the bitter end if Britain attempted to disregard its commitments to New Zealand.

The use of Holyoake, through carefully bringing him to Europe only occasionally, and the access that he was accorded in Europe, gave New Zealand valuable insight into European thinking on New Zealand. For example, Holyoake's meeting with French President Pompidou brought two important facts to light about the French position. Firstly, the French saw the New Zealand question as being left to the last negotiation session, and secondly, Pompidou, who had fought in World War I, recognised that they owed a debt to New Zealand because of the war. This meant that the French were prepared, for the first time, to make concessions on New Zealand access to British markets.

By the time the final negotiations took place in Luxembourg in 1971, France was ready to be more reasonable in its approach to the question of New Zealand's access into Britain. At that negotiating session, only the details remained to be fought over. However, as in all negotiations involving market access, the details matter—and particularly matter for a small economy such as New Zealand. In the end, an agreement was reached after a number of somewhat difficult meetings between Marshall and Rippon and all night negotiations between Rippon and the Six. Attempts by the British, particularly the Foreign Office, to browbeat the New Zealand delegation were rebuffed and New Zealand was able to achieve a deal that they could accept.

Outcomes

By correctly identifying the most important issue New Zealand negotiators were able to achieve a satisfactory result. The key to the relative success of New Zealand was the importance of getting the British to negotiate forcefully for New Zealand. After some prodding from Marshall and despite opposition from the Foreign Office, Rippon secured access for New Zealand dairy products into the EEC of a total equal to 71 percent of current exports expressed in milk equivalents. There was a right of renewal after five years—in 1977. A pricing formula was used which averaged out the 1969–1972 prices. The EEC also made commitments to develop policies that would not prejudice New Zealand's efforts to diversify its economy and trade. While this was agreed to by New Zealand, it was close to the minimum that New Zealand would accept (see *Aims* above).

Could New Zealand have done any better?

To answer this difficult question, the most obvious guide to the possible counterfactual is the treatment of other Commonwealth nations. The approach that the Australians took was rather confrontational, demanding, in their negotiations and through the press, that their interests should be looked after. This did not endear them to the British government nor, more importantly, to the British public, parliament and press. The Australians were completely shut out of the British agricultural market once Britain joined the EEC.

Other Commonwealth nations significantly damaged by British entry were the Caribbean sugar producers. The Commonwealth Sugar Agreement (CSA) ceased operation in 1974. That agreement had, since 1951, secured access for Caribbean sugar into Britain and Canada at prevailing world prices. A sugar protocol was attached to the Lome agreement in 1975, linking prices to internal EEC prices. This excluded the Australian producers completely and sharply reduced Caribbean quotas.

The special consideration given to New Zealand over dairy imports to the EEC was the first substantial breach of the EEC agricultural regime. Of course, like all agricultural reform in Europe, it really came about in response to internal European politics and with only cursory attention paid to outside interests. The reality was that it was not the reasonableness of New Zealand's case that won the concessions, but the realisation by European politicians that the British parliament was probably prepared to vote against accession if New Zealand agricultural produce was barred from the British market.

Post-agreement trading situation

Between 1973 and 1994 New Zealand invested heavily in maintaining access into the EEC. As Table 20 shows, New Zealand was relatively successful in maintaining market share in Europe. Prices have been well above world prices, but well below prices paid to Europe farmers. Looking forward from the 1971 agreement, few would have thought that the European quota arrangements would have remained and been enshrined permanently in the Uruguay Round agreement. In this sense, the 1971 agreement in Luxembourg exceeded New Zealand's expectations.

In keeping with the inward looking nature of the EEC however, and despite rhetoric bound up in the Luxembourg agreement, the EEC embarked upon an aggressive export subsidy programme. It increased its subsidies to European dairy farmers so much, that, from having been a net importer in the 1960s, it became the biggest exporter of dairy products in the world by the 1980s. EEC farmers were effectively given a blank cheque associated with incentives to increase milk production. The supply response from the EEC farmers was to increase production by two percent per annum from 1973 to 1984.

In this respect the evolution of the Common Agricultural Policy was a serious problem for the dairy industry of New Zealand. As EEC subsidies increased, the world price of dairy products was reduced by the same amount; in affect, administrators in Brussels were setting world prices of dairy products. And their only reference was to European farmers and their excesses of production.

Table 20 UK: New Zealand dairy and meat exports

Thousand tonnes

Year	Butter	Cheese	Year	Butter	Cheese
1973	165.8	68.6	1983	87.0	9.5
1974	158.9	61.0	1984	83.0	9.5
1975	152.0	45.7	1985	81.0	9.5
1976	145.1	30.5	1986	79.0	9.5
1977	138.2	15.2	1987	76.5	9.5
1978	125.0	0	1988	74.5	9.5
1979	120.0	0	1989	64.5	9.5
1980	95.0	9.5	1990	61.3	9.5
1981	94.0	9.5	1991	58.2	9.5
1982	92.0	9.5	1992	55.0	9.5

Source: NZ Dairy Board

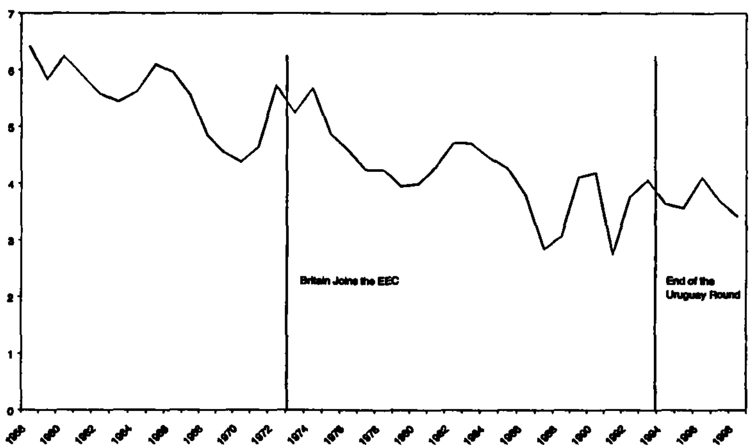
The Luxembourg agreement did not deal with sheepmeat. But since 1973 there has been a common external barrier to imports into the EEC. This 20 percent tariff was reduced in 1980 to ten percent and to zero in 1989. In return for these tariff reductions, New Zealand agreed to reduce its exports to Europe, under a voluntary restraint agreement, to 245,000 and then 205,000 tonnes. As a result of the Uruguay Round, access was increased to 225,000 tonnes and was adjusted upward with the accession of more European nations to the European Union. The lack of attention focused on sheepmeat reflected its lack of importance in Europe.

The success of the New Zealand effort needs to be reconciled with the prices received by farmers. Between the late 1950s and 1973 prices were generally buoyant because of the relatively free UK access granted to New Zealand farmers. But for the period 1973 to 1994, returns to farmers fell as access was restricted and EU subsidies increased—typically followed by a supply response from European farmers. This has been partially arrested by the signing of the Uruguay Round (see Figure 10).

One could argue that New Zealand negotiators failed to stop the decline in dairy returns to farmers but this ignores the realities of the situation. Britain was going to join the EEC at some stage, and while some accommodation with New Zealand was going to be reached, it would not inevitably entail 100 percent, or any other significant proportion of previous access for New Zealand dairy products.

Figure 10 Trend in prices received by New Zealand farmers for milk solids since 1958

June years, inflation adjusted, $NZ per kg of milksolids



Source: Dairy Statistics (1997/98)

The two solid lines have been used to identify different trading regimes in Figure 10:

- The period before 1973 when some limits were placed on New Zealand dairy products exported to Britain in a continuation of the Ottawa Conference agreement.
- The period between 1973 and 1994, which is illustrated by continued and increased support for European farmers.
- The post-1994 period when subsidies have been reduced slightly as a result of the Uruguay Round.

CONCLUSION

The Treaty of Rome that formed the EEC in 1957 was an attempt to stabilise Europe after three major European wars in 100 years. The wider 'price' paid for this political institution was the creation of an inward-looking economic organisation that could be captured by the political pressure associated with maintaining a relatively inefficient rural infrastructure, at very high costs.

To have an impact on the EEC policy, a non-member had to be able to influence a member or potential member of the EEC. In New Zealand's case, the 'credible threat' wielded was the ability to invoke a potential veto that the British parliament could have exercised—if New Zealand's interests were not looked after. Since the Six were serious about Britain joining the EEC on the third attempt, then some (broadly acceptable) accommodation with New Zealand would need to be found.

The key issue then was the real threat that there might be a political veto to British entry, if New Zealand access was not guaranteed. To obtain such strong influence over British public opinion and members of parliament, New Zealand ministers and officials carefully balanced protecting New Zealand's interests and being seen to stay out of purely British affairs. This was done by publicising the very real damage that would be done to New Zealand, stressing cultural and historical ties with Britain, and reminding the Europeans of New Zealand's loyalty to Britain and France over two world wars.

A large amount of resources was required to maintain this position. Embassies were opened in Europe, professional PR people were employed, influential Europeans were brought to New Zealand, and the Minister of Overseas Trade (and senior officials) visited Europe frequently. To get New Zealand's message across successfully required significant resources, both on the ground in Europe, in the support role in New Zealand and, possibly most significantly, in the continuing strategic oversight of the whole campaign.

From the first visit of a senior British politician, Duncan Sandys in 1961, the British agreed that some special consideration would be made for New Zealand. In the course of all of the trips that Marshall made to Britain and Europe, these assurances were repeated. This made it very difficult for Britain to back out of its commitments when the final negotiation took place.

One of the most difficult tasks was to balance the necessary stance (by New Zealand) of non-interference in British affairs, with the maintenance of the audible voice required to protect New Zealand's interests. This rather sophisticated balancing act was aided by the continuity of the core people over the ten years of the negotiations. There was virtually an unbroken line of long-serving ministers and officials involved in the process. This strong continuous strand of thinking at the heart of the approach taken by New Zealand meant there was no need to relearn or do more than review strategy and tactics.

There was also a consensus amongst politicians and the general public in New Zealand as to what the main objectives were—and what it was all worth. Therefore all the preparations and resources were focused on Britain and Europe and little time (and resources) were expended on developing a consensus domestically.

Case III: Trans-Tasman trade

INTRODUCTION

It would be difficult to find two sets of widely separated peoples more culturally alike than Australians and New Zealanders. While the two economies have different GDP drivers funding their respective living standards, New Zealanders and Australians have many common elements in their heritage. Most important is our shared colonial past stemming from Britain, and the influence that the British way of life has had on each country and its institutions. Australia's relative proximity to New Zealand, and the common aspects of our joint heritage form part of the 'cultural glue' that has allowed the two nations to forge close economic ties.

Table 21 The New Zealand and Australian economies
June estimates 1999

Economic Indicators	Australia	New Zealand	Total
Population (million)	18.9	3.8	22.7
Density (Persons per square km)	2.5	14	
Population growth(%)	0.4	0.5	
Labour force (million)	8.7	1.8	10.5
Unemployment rates (%)	7.4	7.0	
GDP ($NZ thousand million)	705.3	100.1	805.4
Exports (total NZ$ million)	8143	1850	9993
Exports as a % of GDP	11	18	
Overseas debt (total NZ$ million)	108359	101940	210299
CPI change since March 1999 quarter	0.9	0.2	

Source: OECD Statistics (1999) *Main economic indicators*, October; Statistics New Zealand (1999) *Key statistics*, December; , Reserve Bank of NZ (1999) *Financial statistics* August; IMF (1999) *International financial statistics*, November; Australian Bureau of Statistics (1999) *Key national indicators*, October.

The modern trans-Tasman relationship is based on both economic and security considerations. At the heart of the economic relationship is the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA or, CER). Table 21 provides an outline of the two economies. It is immediately apparent that even the combined size of the two economies is not large by world standards.

Both countries are dependent on exports to generate the wealth to sustain current standards of living. The New Zealand economy, being much smaller, is even more dependent on exports than Australia. The need to export has been a source of acrimony (1880–1960) and harmony (pre-1880 and post-1960).

Table 22 Trade with Australia: imports and exports

Percent share

	Exports to Australia	Imports from Australia		Exports to Australia	Imports from Australia
1860	27	42	1940	3	16
1870	46	36	1950	3	12
1880	21	31	1960	4	18
1890	15	17	1970	8	21
1900	14	17	1980	13	19
1910	9	14	1990	20	21
1920	5	17	1999	21	22
1930	3	8			

Source: Statistics New Zealand

Table 22 shows the importance of the trading relationship between Australia and New Zealand. In the 1860s Australia was New Zealand's most important market. With the advent of refrigeration, exports and imports were skewered in the direction of Britain. It is only with the decline in importance of the British market and the withdrawal of protection on New Zealand manufacturing goods that the Australian market has become significant again in the 1990s.

This chapter looks at the development of the modern trans-Tasman economic trading relationship.

Early trade[72]

The links between New Zealand and Australia start with European settlement. For a brief period, up until 1841, New Zealand was administered from New South Wales. In the early period, trade between New Zealand and Australia was significant, with Australia taking the largest share of New Zealand exports up until 1880 (Table 22).

In the 1880 to 1900 period however, technology, in the shape of refrigeration, created a new market in the south-east corner of Britain that would redirect trading patterns for at least 80 years.

For even longer, New Zealand and Australian economic relations were dominated by politics in Britain. One senior diplomat described the relationship with Australia in the following terms:

> *"New Zealand and Australia did not interact with each other directly across the Tasman, but only indirectly through a giant mirror placed in Britain".*

An attempt was made in 1906 to construct a preferential arrangement between the two countries. This failed when the New Zealand parliament did not ratify the tariff preference scheme.

In 1922 New Zealand and Australia signed their first trade agreement. Prior to this, though Australian goods had been imported into New Zealand at the same rate as British goods, New Zealand goods imported into Australia entered under the general tariff (a tariff for goods other than British). The Tariff Agreement Ratification Act (1922) covered tariffs on 129 items, to a level which was mutually acceptable to both countries. This, in some cases increased the tariffs (under infant industry arguments) and reduced others on the specified 129 items. All other items not mentioned specifically were admitted to New Zealand and Australia at the preferred British rate.

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[72] For a more detailed account see Holmes (1966).

Trade policy relations at this time were characterised by bitter disputes, with each nation attempting to stifle the other's trade with higher tariffs and quarantine restrictions. In 1933 all tariffs were reduced in line with British rates as a result of the Ottawa agreement of 1932. These changes, according to Bollard and McCormack (1985, p17), "had little impact on trans-Tasman trade" .

Similarly in 1944, New Zealand and Australia signed the Australian and New Zealand agreement (the Canberra Pact). This had little impact on trade and was more to do with wartime solidarity. However it did set up regular meetings between the two nations.

As Europe and Japan were rebuilt after 1945, two important issues emerged:

- After World War II, world trade developed rapidly, particularly between OECD nations.[73] With an eye on the protectionist policies of the inter-war period, governments from industrialised nations initiated successive rounds of multilateral talks (through the newly created mechanism of GATT) to reduce tariffs mainly on manufacturing items, facilitating the trade process as far as industrial products went.
- Both New Zealand and Australia were aware that Britain was likely to join the European Economic Community (EEC) 'at some stage'—Britain had earlier been involved in various European bodies (the iron and steel community) and actually joined the EFTA[74]— so diversification of markets was a priority. Freer trade across the Tasman Sea would help in developing new markets for each country's products.

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[73] Exports between OECD nations grew at twice the rate of national incomes, Bollard and McCormack (1985).

[74] At the time, the European Free Trade Area was a deliberately looser grouping than the EEC, with an explicit free trade area structure and limited binding formality aside from the trade ties. The members of the so-called 'outer seven' (in contrast to the 'inner six' of the EEC), were Portugal, Switzerland, UK, Denmark, Sweden, Austria and Iceland

It was against this background that the Australia/New Zealand Joint Consultative Committee on Trade was formed in 1960. One of its main aims was to explore ways of increasing bilateral trade.

NAFTA

The structure of the agreement

The first attempt at a freer trade area between Australia and New Zealand began in the 1960s.[75] This added urgency to the quest by the partners, particularly New Zealand, to diversify markets for products that they produced.[76] In this respect the combined Trans-Tasman market was a 'natural' extension of each country's existing trading frontier.

The New Zealand-Australia Free Trade Agreement (NAFTA) of 1965 was the outcome of the attempt to combine the trans-Tasman market. It was expressed in the Treaty in the following way:

> *"[to] promote a sustained and mutually beneficial expansion of trade" ...[and ensure] "as far as possible that trade within the Area [covered by the Agreement] takes place under conditions of fair competition".* Pomfret (1995, p178).

The realisation that closer economic ties would be beneficial to both nations was only partly reflected in NAFTA. Both nations were unable (politically) to deliver a comprehensive trade agreement and the major feature of the text was its restrictive coverage. Freer trade in goods and services was limited to those goods on 'Schedule A', which were listed and appended to the treaty. The goods and services on the Schedule A product list

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[75] Both countries were acutely aware of the impact of Britain joining the EEC. The EEC would do to Commonwealth countries what Commonwealth countries did to Latin American countries in the Ottawa agreement (1932) – see *Case I*.

[76] The EEC market was not so important for Australia. Firstly, Australia had started full-scale development of its mineral deposits, fuelled by demand from the fast developing Japanese market (Australia had signed a trade treaty with Japan in 1957 that partially liberalised trade between the two nations). Secondly, the range of agricultural products produced by Australia was not as reliant on the British market as those produced by New Zealand.

determined, to a large extent, what was freely traded between the partners.

The structure of the agreement and the associated implementation detail was important to NAFTA's eventual fate.

For instance:

- Those goods on Schedule A that faced import duties before the agreement was signed had eight years to be reduced to zero. Article 4, however, allowed this transition period to be extended for an unlimited time.
- Article 5 dealt with quantitative restrictions. Those goods under quantitative restrictions were to be abolished "at the earliest practicable date". Furthermore, to allay New Zealand fears over any rapid dismantling of the import licensing system, the elimination of quantitative restrictions would be engaged in "to the extent permitted by the balance of payments"[77].
- The establishment of new industries was an area that was almost exempt from the agreement. In both countries manufacturing was seen as a way of diversifying the strongly agriculturally based export side of their economies. One way of developing these 'infant' industries, it was then thought, was to erect significant trade barriers. Therefore, substantial waivers were written into the agreement to allow for 'new' industry development (article 8).
- A temporary suspension of imports (under article 9) was allowed for to prevention of serious injury to each other's industries, or to avoid future injury.
- Dumping or subsidised imports were prohibited (article 10), as well as the imposition of further quantitative restrictions (article 11).

These treaty details allowed for wide interpretation with plenty of scope for intervention by government and/or interested industries, who could very easily influence government. 'Fair' trade

[77] This wording, of course, is redolent of a similar loophole in the GATT ban on quantitative restrictions (Article XII).

meant different things to different participants. NAFTA was designed to facilitate trade but in effect its articles could be used to prevent trade-based competition occurring. Therefore, moves to achieve the more efficient use of resources in each economy, which was the whole point of having an agreement, were stifled.

The impact of the agreement

The NAFTA Agreement tried to increase trade across the Tasman without damaging either country's manufacturing industries or other sensitive sectors. The agreement was designed to run for ten years and then be reviewed. Since freer trade sharpens the specialisation between countries, it would be expected that some industries would gain and others would lose (in both countries). So the idea of having a free trade area, and also protecting various industries at the same time, set up a potential series of conflicting objectives.

These conflicts were clearly illustrated by the inability to move more items on to the freely traded list—Schedule A. To get around this problem, Schedules B, C and D were created in 1973 in the hope that the items on these, more circumscribed lists, would eventually move on to Schedule A. The creation of these other lists was symptomatic of the (essentially political) difficulty of moving items into the free trade category. Goods and services could not be moved onto Schedule A because vested interests in each country would be hurt by freer competition across the Tasman. In actual fact, the end result was that there was very little movement of items onto Schedule A, and the good intentions of the treaty designers were not translated into an adjustment process significantly enlarging freer trade.

The mechanics of maintaining the agreement were cumbersome. Twice-yearly meetings between ministers and officials of both nations were established. Ministers and top officials got bogged down in details that were taken to absurd levels. One of the most famous of these discussions was deciding how many pantyhose would be swapped for Holden cars. In describing what seemed, with the benefit of hindsight, as near-farcical negotiations, one senior New Zealand official apparently did a very good rendition of a 'Bean for you and a pea for me' set to the tune of 'Tea for two and two for tea'. These meetings produced little real reward, and were extremely time consuming.[78]

The structure of NAFTA was deeply flawed—with ample opportunity for vested interests to sabotage changes to the trading regime. The ability of interest groups to block real change was extremely high. Any proposals seemed to be able to be halted merely through a visit to the Minister's office. Politicians were subject to intense lobbying, and were not protected by the structure of the agreement, since the agreement specifically allowed for exceptions. The trouble was, that most 'sensitive' goods were exempt. Unfortunately, around these items a whole rent-preserving industry of lobbyists was built up to protect specific import licenses.[79]

In hindsight, the idea and rationale for NAFTA was naïve and reflected the wishful thinking of ministers and officials of the day. It was almost the classic 'Claytons' trade agreement; one between nations whose politicians and vested interests did not want to have a trade agreement that achieved anything. Both countries had highly protected manufacturing industries and trade had the potential to cause major disruptions to the piecemeal façade built up since the depression. One trade official described it as an "initial mating dance between two strangers".

One of the difficulties of the agreement was that it was an inward-looking agreement between Australia and New Zealand. It looked toward a restricted form of a customs union. The lack of an outward focus (looking toward trade with third countries) cut

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[78] These negotiations suited the New Zealand politicians of the day. It meant that they could see how marginal changes to the trading regime impacted on the all-important decisive voter. If sensitive industries in key electorates were going to be affected in a (politically) negative way, then progress on reform could be stopped. This incremental 'cut and try' approach to economic management, espoused by Holyoake, was later perfected by Muldoon.

[79] At this stage (1965–1979), Australian tariffs were about twice the OECD average, while New Zealand tariffs were similarly elevated, coupled with a system of quota controls through import licensing.

across the fundamental principle of GATT—most favoured nation (MFN) status—where the concessions made on tariffs and other trade barriers are then passed on to all other members of the organisation. This was a fundamental design fault that meant that vested interests on both sides of the Tasman were able to tightly control trade and by implication crop the rents from a protected trans-Tasman market.

The actual impact of the agreement was difficult to assess, given the rising levels of trade between OECD nations over this period. It is reasonable therefore, to expect that trade growth would have happened without the agreement.

According to Bollard and McCormack (1985), Australian exports peaked in the early 1970s while New Zealand exports rose steadily during the period. Quoting Thomas (1983), they (p18) suggest that the relatively strong New Zealand penetration of the Australian market was due to successive New Zealand devaluations, export incentive schemes and tariff reductions in Australia, and not NAFTA.

Some of the more specific shortfalls of NAFTA were spelt out in an analysis by Bevan:[80]

- The tardy addition of items to Schedule A—only 800 items, mostly minor, were added to the original one thousand strong list – mainly due to administrative haggling/industry objection.
- The ability to remove sensitive items from Schedule A if necessary.
- The fact that for many items in Schedule A, trade was free in only one direction.
- The maintenance of non-tariff barriers (for example, subsidies and tax incentives).
- The detrimental effect of high transport costs.
- The complete absence of item additions to Schedules C and D.

[80] See Bevan (1982).

In the late 1970s international realities imposed themselves on New Zealand. The Tokyo Round of GATT was bought to a shuddering conclusion in 1979 by the then chief US negotiator, Strauss, who had been given the mandate by President Carter to finish the talks before the US election in 1980. Both New Zealand and Australia were sold short in the rush by the US to close the deal—agriculture was left off the agenda, except in the form of a sort of 'talks about talks' construct.[81]

In terms of the trans-Tasman relationship too, the Australians were getting restless. The Australian Deputy Prime Minister responsible for trade, Doug Anthony, bluntly told the New Zealand government that NAFTA was finished and they wanted a re-think of the whole trans-Tasman trading relationship. New Zealand had little choice but to acquiesce to the radical Australian request.

CLOSER ECONOMIC RELATIONS

New Zealand is a junior partner in the trans-Tasman relationship. As a small economy, New Zealand could not set a trade agenda—New Zealand is, even in relationship with Australia, a policy taker. In this case, the economic importance of trade to the New Zealand economy, and the importance of the Australian market to maintaining the level of economic well-being meant that New Zealand's options were extremely limited.

Despite New Zealand being a 'policy taker', being a small country does have some situational advantages.

It means that:

[81] These were the so-called Morges meetings that consisted of the major agriculturally interested traders discussing domestic and international developments in a rather unreal environment, as it was not clear where they were going. It was a serious comedown from the far more grandiose fully GATT-related agricultural 'cathedral' foreseen by Tokyo Round negotiators, and illustrated again the way European negotiators would leave the hard sections of the deal until the last minute to try and bring serious time pressure to bear.

- Focus is of prime importance.[82] Significant resources can be bought to bear on getting the best result for New Zealand. A trade agreement with Australia meant far more to New Zealand, relatively, than it did for Australia. Therefore, the resources employed by both countries to negotiate the deal reflected the relative importance of the deal for both countries.[83]
- Resources were not wasted on trying to negotiate an alternative position. The options for New Zealand had narrowed significantly: Britain had joined the EEC, and the Tokyo Round of GATT had produced little in the way of tangible results for New Zealand. An agreement with Australia in the late seventies and early eighties was one of the few positive and achievable trade deals that could produce real benefits for New Zealand.

Aims

While the Australians had become exasperated with the NAFTA process, they had an open mind as to what type of agreement should replace it. This provided New Zealand with an opportunity to influence the process and shape the post-NAFTA trading environment.

Key to CER, was the fundamental position that everything was up for negotiation, including import licensing.[84] This was important, because whenever there was a process dispute, the negotiators referred to this statement to keep the agreement on track. While there were efforts to derail the agreement on both sides of the Tasman, the sweeping opening statement went a long way to forestall and nullify such opposition.

The importance of having the politicians on both sides signalling that everything was on the negotiating table cannot be

[82] In terms of Habeeb's (1988) framework, focus can be a real strength in negotiations.

[83] After all, Australia's main trade policy thrust was into Asia, while New Zealand, to some extent, was (and still is) seen as only of minor trade significance—though an important market for Australian manufactures.

[84] This was set out in the joint declaration between Muldoon and Fraser in March 1980.

underestimated. The leaders had given those who advocated freer trade a huge boost, particularly in New Zealand. After all, the struggle to sign CER was not just a negotiation between Australia and New Zealand but, at bottom, a battle between protectionists and free traders within each country. For New Zealand, the country with higher protection and consequently the more formidable opposition (with entrenched vested interests keen on keeping the status quo), the process outcome was unclear. So in effect, New Zealand officials had only the March Joint Ministerial Statement as a guide to negotiate with the Australians.

With all trading policies between Australia and New Zealand up for review, an opportunity was created to completely re-engineer New Zealand's long-standing trade policy. Despite division in New Zealand, key parts of the bureaucracy pushed for an economically rational agreement.

The key component of this strategy was *open regionalism*. To last, any trade agreement signed would have to be economically consistent, flexible and open to change as world economic conditions changed.

Open regionalism would:

- Allow any domestic economic adjustment to take place as changes occurred in the world economy. This was preferable to sheltering within a custom union, where there was the potential to distort adjustment patterns, and consequently would be more economically painful when they occurred.[85]
- Allow compatibility of trade policies with domestic policies. No longer would New Zealand officials argue for others to bring

[85] The Australian negotiators floated the idea of a customs union, which would mean imposing common barriers on third country products coming into Australia/New Zealand. This had the potential for rent seeking behaviour by New Zealand producers of goods and services, introducing unwanted inefficiencies into the design of the trade pact. It would inevitably—whatever decision mechanism was decided—produce a common tariff that was difficult to adjust rapidly as the two countries would both have to agree on the changes.

(agricultural) trade barriers down while protecting their domestic (manufactures) market.

- Increase efficiency of trade policy, and improve economic performance, relative to what would otherwise have been the case.

For the Australians, apart from the protectionists in transport, manufacturing and some sectors of agriculture, the aims were much clearer. Despite requiring a wider consensus amongst a range of groups in the Australian economy, a much more realistic view of the world had emerged. Their economic future was in Asia; the growth in Japan had generated a minerals boom since the 1960s, and other Asian nations were starting to follow the Japanese growth spurt. Australia's trade prospects were bright. New Zealand was at Australia's back door and Australian priorities reflected this position.

What were Australia's main concerns?

- They wanted a different agreement from NAFTA because it did not suit their interests. They believed they had spent too much time deciding what the tariffs were going to be on things such as 'sea water'. It was seen as a waste of their negotiators' time.
- At that time the Australians were frustrated, since the structure of world trade was in a shambles.[86] The Tokyo Round agreement suited key industrial producers, and virtually nobody else. The Australians were thus determined, despite some opposition internally, to get a 'sensible' agreement with New Zealand.
- Economic policy developments in New Zealand. Australian security officials were becoming worried about the possibility of economic and social instability in New Zealand. The Australians were particularly concerned that New Zealand had ignored the changing international trading regime of the 1970s and was

[86] The failure of the industrialised nations to agree upon a sensible agricultural trade policy in the Tokyo Round, and their inability to get a new round started in 1982, directly led to the all out agricultural export subsidies war between the EU and the US in the 1980s.

caught in an economic policy trap waiting for world markets to pay more for its (agricultural) exports.[87]

Preparations

One of the advantages of having such a structurally flawed agreement as NAFTA, is that there are a large number of mistakes to learn from.[88] The NAFTA years provided a rich library of case studies that trade policy officials could later point at, and in most cases, try to avoid.

NAFTA, for instance, represented a rather two-faced approach to trade policy. New Zealand had the highest tariffs in the OECD (mainly on manufactured products); meanwhile New Zealand officials were pushing for liberalisation in world agricultural trade. New Zealand's import regime and its domestic policies bore no relation to its advocacy of freer world trade. Policy discussions in New Zealand were conducted in a compartmentalised inconsistent fashion. CER was the first step in a process to construct a more coherent, seamless economic policy platform that would apply both at home and abroad.

The most crucial issue was the high level structure of the agreement. To a large extent every other issue was secondary. The tone was set from the outset in the joint Prime Ministerial Communiqué between the two Prime Ministers: Muldoon and Fraser (20–21 March 1980).

The principles were:

- An outward looking approach to trade.
- The most favourable treatment possible for each other's citizens.

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[87] See NZ Trade Consortium Working Paper no 6 for reasons why New Zealand agricultural prices are not expected to rise over the long term.

[88] The reason for NAFTA being such a flawed document is not because of the lack of skill of the officials and politicians putting the document together—it was a product of skilled craftsmen, who reflected the balance of political and economic forces of the day.

- The freest possible movement of their peoples between the two countries subject, at any time, to their respective laws and policies.
- The fullest consideration for each other's interests in all aspects of the economic relationship: in particular, prior consultation on international trade and economic discussions.
- Frequent discussions and consultations on matters of common concern.

An important part of the process was tapping public opinion. Trade negotiators knew that without public support, the New Zealand Prime Minister, Robert Muldoon, would never support a freer trade agreement. The trade bureaucracy led an extensive round of public consultation with businesses and the general public. Public meetings were held in all major cities to explain why CER was important for New Zealand's prosperity. This was an important part of the domestic consensus building required to gain support for CER.

Resources

As mentioned, Australian eyes were firmly focused on Asia. This is where their major growth markets were and where most of their foreign policy resources were focused. So the key policy makers in the Australian trade bureaucracy spent only a cursory amount of time, relative to their New Zealand counterparts, on negotiating the CER treaty.

It was a completely different story for New Zealand. Australian relations were the main game, and the vital interests of New Zealand were at stake. The consequences of the CER negotiations failing were very real, and the trade alternatives were, in effect, non-existent.

Quality and commitment

So New Zealand chose to:

- Have the best public service people involved in the task, including at the frontlines of the negotiating work.

- Undertake a lot of preliminary analysis,[89] so that the New Zealand government was well prepared and able to assess alternatives.

Domestic consensus

In addition, there was the commitment of considerable resources to explaining aspects of the potential CER agreement to businesses and the public. As well as the public meetings in the main cities, officials met with businesses on a one-to-one level. Businesses were kept informed and canvassed on specific CER proposals that would impact on them. While most manufacturing businesses remained lukewarm about the CER agreement and its potential threat to their established positions, the consultation process improved communication between government and business. The most important factor was, however, that polls eventually showed popular support for CER.

Small country focus

While New Zealand did not initiate the CER negotiations, its negotiators were well resourced, better prepared and more focused, factors which gave them an advantage in the negotiations Australian negotiators were not as focused on CER, they had less at stake and the possible consequences were not as dire.[90]

Negotiation process

Despite the New Zealand negotiators' ability to give priority to CER, the actual process of negotiation was very difficult. Partly this stemmed from the lack of domestic consensus. There were still fundamental disagreements between different parts of the New Zealand bureaucracy and between Ministers of the Crown. In

[89] This included broad preparatory material such as significant analytical work to examine the pattern of trade in some detail, and more particular analysis of the options, and the strengths and weaknesses of various negotiating strategies and tactics.

[90] In a number of the interviews conducted for this project it was mentioned that senior Australian politicians were furious with their negotiators for allowing New Zealand to dominate the negotiations.

some of the negotiating meetings and receptions held there was almost open acrimony between representatives of New Zealand government departments.[91]

The business community in New Zealand was also deeply divided, reflecting the various interests of different sectors. Some of those industries looking to expand their business into Australia strongly supported CER.[92] Others who had been given protection in the 1950s and 1960s under infant industry arguments, and who saw little prospect of external expansion, were less enthusiastic about a freer trading agreement. Therefore even the business lobby organisations were under pressure from different sides.

CER however, had one key difference to past trade negotiations. The Prime Minister of New Zealand, Robert Muldoon, watched the negotiations closely, so responsibility for chairing the CER interdepartmental committee was given to the Prime Minister's Department—a group that was firmly in the free trading block. This broke the deadlock that existed in New Zealand between the traditional protectionists and the freer traders in the New Zealand bureaucracy. But by this time, in those departments that might have been expected to be cautious about CER, such as the Department of Trade and Industry, key positions were held by officials who took a wider view and were more disposed to consider a freer trading agreement with Australia.

One of the great conundrums of the CER negotiations was the role of the Prime Minister, Robert Muldoon, during the negotiations. Muldoon, the arch incrementalist,[93] was being asked to sign up to an agreement that would commence the reform wave

[91] This has to put in the context of NAFTA. Departments such as Trade and Industry, and particular officials in those departments, had for decades been very close to the protected businesses. Many members of Trade and Industry had grown up with import licensing as a development mechanism. CER would lead eventually, of course, to the end of the system.

[92] Although it was said they suffered in social settings for taking this stance.

[93] See Gustafsen (2000) for a voluminous, but strangely incomplete picture of this remarkable New Zealand politician, who was, by the time of the CER *negotiations, edging toward the end of his reign.*

that would not only ultimately radically change New Zealand, but clearly and immediately destroy the careful pressure group balancing act that was both NAFTA and the hallmark of his style.

The risk to his famed ability to control the economy sufficiently to satisfy the typical voters (otherwise known as 'Rob's Mob') must have been apparent. CER would allow increased trade, bringing a degree of unpredictability to the New Zealand economy that government could not control.[94] On occasions, during the negotiations, Muldoon would give speeches along with his Trade and Industry Minister (Lance Adams-Schneider) that threatened to derail the negotiations. Yet Muldoon, when it was all over, said CER was his finest achievement.[95]

One possible answer for Muldoon's prevarication over CER was his mixed feelings over the association with Australia.[96] There was a shared colonial past and the pressing need to diversify trade further, as well as general public support for CER. There was also, however, the entrenched business and bureaucratic interests which supported Muldoon's political and social goals, and these were not great supporters of freer trade. But the final clinching feature for Muldoon may have been the general public consensus that CER was the 'best deal' possible for New Zealand. And Muldoon's touchstone of course, was to provide voters with 'New Zealand the way you want it'.

New Zealand negotiators also pushed for two other key structural components:

- An outward-looking free trade area, rather than an inward-looking customs union. A free trade area allows participants to extend individually selected tariff arrangements to third countries, whereas a customs union sets up common levels of

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[94] It would mean that some sectors would grow and others would decline, without reference to the government.

[95] At the time, officials seemingly walked a tightrope with Robert Muldoon, as they never really knew his true views on CER.

[96] Officials report that Muldoon could not leave the CER negotiations alone, and was consistently involving himself in the process.

protection against third country products.[97] The strength of this argument was enhanced because of the behaviour of the European Union—this is a customs union that even today is a major impediment to world trade reform.[98] The case for a free trade area was strongly and successfully argued by New Zealand negotiators.

- Once set in place, the agreed tariff reductions, whatever the level, would be automatic. This would protect politicians and officials from backsliding under pressure from vested interests on both sides of the Tasman. It would thereby encourage firms to think proactively about how to change in order to adjust to a new environment, instead of investing heavily in lobbying activities.

While New Zealand did well out of the negotiations, the role that Australian negotiators played in CER should not be overlooked. After all, it was they who 'tore up' NAFTA and forced radical trade policy reform on New Zealand. It was also the Australians who used their power when the New Zealand government proposed piecemeal solutions,[99] since the political reality was, that under the administration of the day, New Zealand could not reform its trade policy alone.

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[97] Aside from the policy and economic reasons for a free trade area, there is another practical consideration in addition to those mentioned above. All common factors of customs unions, such as levels of tariffs for example, have to be decided—and often re-decided—at times of political pressure. Small countries may justifiably believe that their views are likely to be given little weight in such a decision process. And New Zealand observers may consider that this factor has been characteristic of the various joint decision bodies that have been created and operated since.

[98] Having a Free Trade Area means that all entries to each country have to be checked, as each has different treatment for third country goods. It therefore puts great pressure on the administration of entry process, particularly on the rules of origin (these are the means to assess what is to be classified as an Australian or New Zealand good) since partially made up goods can be imported from third countries and re-exported to the partner.

[99] On a number of occasions the negotiations broke down on the issue of Australian insistence for a comprehensive deal, rather than a piecemeal NAFTA approach as put forward by New Zealand.

Outcomes

The CER agreement was signed in December 1982. The agreement went beyond the usual rhetoric associated with free trade agreements. The opening preamble to the agreement talks of "the strengthening and fostering of links and co-operation in such fields as investment, marketing, movement of people, tourism and transport". Furthermore, the agreement mentions a commitment to an "outward-looking approach to trade" which would lead to the extension of the agreement to neighbouring nations, in particular South Pacific and South East Asia nations.

CER provided for:

- The elimination of practically all tariffs on goods traded between the partners by 1 January 1988.
- The immediate elimination of tariffs on all goods with tariffs of five percent or under.
- The progressive and automatic phasing out of tariffs by an agreed automatic formula over five years from inception.
- No increases in tariff quotas or quantitative restrictions.
- The gradual phasing out of quantitative barriers to be completed by 1995.
- The elimination of subsidies and incentives on goods traded in the area by July 1987.

It was agreed that all products and services should come under CER at 'some stage'. The exceptions to these general principles were those goods that were subject to industry plans under the Industries Assistance Commission (IAC) in Australia and the Industries Development Commission (IDC) in New Zealand.[100] Products under these plans included clothing, motor vehicles, tobacco, furniture, iron and steel, rubber goods, electronics and

[100] In essence, these classes of goods were subject to a political mechanism to achieve adjustment that was not able to be delegated to the market processes. They were the 'hard basket'—but under CER there was no 'too hard basket'. The IAC/IDC plans were political economic adjustment devices that used a degree of interim 'bribery' to the industries concerned.

ceramic sanitary ware. Other arrangements were made for approximately 20 other product groupings that were subject to ongoing (political) debate.[101]

There was also a series of exemptions. These include radio and television broadcasting, postal services, coastal shipping and stevedoring, telecommunications, health and third-party insurance, and airport management and air traffic control. These exemptions were in a sense 'bounded'—no new exemptions could be added to this list.

As a reflection of the higher quantitative restrictions that applied in New Zealand, the timetable for full implementation was extended to 1995. Five-yearly reviews would also be set up—the first of which was to be in 1988.

Post-agreement outcome

CER transformed New Zealand trade policy from a narrow, reactive, almost introverted view of the world toward a proactive and outward-looking focused trade policy. Since its signing in 1982, it has become the cornerstone of our trade policy and arguably the most successful free trade agreement signed.

Its outward-looking nature meant that firms either adapted to the new environment or did not survive over the medium term. Opposition to the agreement collapsed when those with a vested interest in protecting various products or sectors realised that the automatic reductions in tariffs and quantitative restrictions were unable to be stopped politically, without effectively undermining the whole agreement. This meant that instead of funnelling resources into lobbying ministers on both sides of the partnership, businesses under threat either became more competitive, or found other lines of work. The result was that opposition to CER dissolved quickly, and the agreement was implemented ahead of the time-tabled schedule.[102]

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[101] These product groupings were as specific as 'ball point pens' and as generic as 'dairy products'.

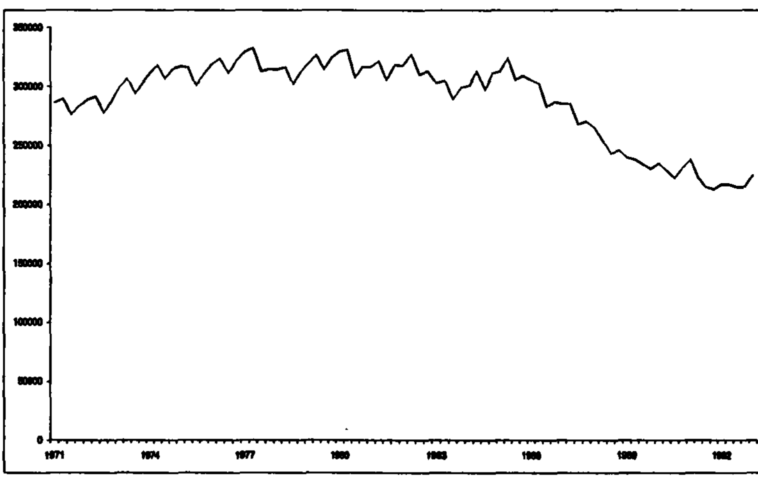
[102] Free trade in goods, but not all services, was achieved by 1990.

By 1999 New Zealand had gone further down the deregulation track freeing up sectors such as telecommunications, coastal shipping, postal services, clothing and a large number of other areas that had been protected.

The downside was that 45 years of import licensing and high tariffs (well above Australian tariffs, which were twice OECD averages) had insulated significant sections of the New Zealand economy from international competition. This made the transition to world levels of costs and productivity a lot more difficult for protected sectors than those that were honed by international competition.

While there are other factors at work (including the general tariff reduction programme, and the macroeconomic setting which caused high levels of the real exchange rate) CER contributed to significant rationalisation in local industry. Jobs in manufacturing, for example, contracted sharply during the 1980s before some rebounding in the 1990s (Figure 11).

Figure 11 Total manufacturing hours worked



Source: *HLFS consistent labour market data*, NZIER WP 94/16

Trans-Tasman trade has increased since the CER agreement was signed. Australia is now New Zealand's most important export destination. Looking at trade since 1966, Table 23 shows the increased diversification of New Zealand trade and the growing importance of Australia as an export destination. The growth of New Zealand's export share into Australia has increased dramatically since NAFTA was signed in 1966.

Table 23 NAFTA to CER: major destinations of New Zealand exports

Year ending June, percent

	1966	1976	1986	1996
UK	44.6	20.1	9.0	6.1
USA	14.1	12.1	16.0	9.0
Japan	7.5	13.9	14.0	16.1
France	5.3	3.0	1.8	2.5
Australia	4.3	12.1	17.0	20.4

Source: Statistics New Zealand

A number of the trends have emerged under CER:

- Commodity trade across the Tasman has expanded. As a percent share of trade, the impact has been larger for New Zealand's exports to Australia.
- Before the CER agreement, goods exported to New Zealand from Australia exceeded New Zealand exports to Australia by 40 percent. After the agreement was signed, trade tended to equalise, although it has recently turned back in Australia's favour.
- Australian exports to New Zealand are growing at the same rate as exports to other countries.
- The share of New Zealand exports going to Australia (21 percent in 2000) is greater than the share of Australian exports going to New Zealand (six percent in 2000).

As well as implementing the agreement ahead of schedule in the 1988 review, CER was extended to include services, and referred to aviation and harmonisation of business regulation.

CONCLUSION

The first 100 years (1780s–1880s) of trade contact between Australia and New Zealand was generally harmonious as both colonies struggled to expanded economic activity. The two countries were important trading destinations for each other over this period. Flax, native timber, gold and whaling products were major exports from New Zealand to Australia.

From the turn of the twentieth century to the period up until World War II, trade disputes occasionally became bitter and fractious between the two fledgling economies. Both nations seemed to compete with each other for 'trade policy attention' from Britain, eyeing each other, in a trade policy sense, through their reputations in Britain. It was to Britain that both nations looked for their trade-based economic prosperity. The 'beggar thy neighbour' trade policies that existed in the world at the time extended to relations between New Zealand and Australia.

NAFTA was the first real attempt to integrate the two economies. Signed in 1965, NAFTA was a recognition by both nations for the need to diversify and expand trading links. Britain, both countries' major market, was about to join the EEC, and NAFTA was an important step in the process of deepening trade links with the rest of the world.

Unfortunately, NAFTA was a deeply flawed agreement. It was the agreement a country has when not fully committed to having an agreement. For at least ten years this suited both countries, particularly New Zealand. It meant that New Zealand politicians and vested business interests could manipulate the various schedules, and protect uncompetitive sectors from competition. In New Zealand, lobbying by business interests and political foot-dragging effectively stopped any hope of reform.

By the end of the 1970s, the Australian government had had enough. Australian economic orientation was in Asia, and New Zealand was of secondary concern. The relationship was bogged down in the detail of NAFTA and was not progressing as intended into a real free trade area. Not for the first time (or last time) in our trade policy history, heavy pressure from abroad shaped the general structure of our trade policy (underlining the extent to which New Zealand is a policy taker even when talking with Australia). Australia wanted to review the whole structure of the trans-Tasman economic relationship and New Zealand had few viable alternatives but to participate in that review. CER was the outcome of this process.

Although international (Australian) pressure pushed New Zealand into the fundamental rethink of trade policy (that became first CER, and then a wider approach), the focusing of resources and the careful preparations made, gave New Zealand an advantage in the actual negotiations. This was consistent with Habeeb's view that, while small countries may have few or no alternatives (a possible disadvantage), weakness can be turned into advantage through focus and concentration on the detailed process of the negotiation.

In terms of political support for CER, the perception that CER was the 'best deal going' for New Zealand, may have persuaded a sometimes reluctant Prime Minister to sign the final agreement. Given Muldoon's renowned ability to be in touch with middle New Zealand, it is difficult to see him signing an agreement without believing that the public was behind it. The favourable consensus of public opinion was therefore a crucial positive element in the CER negotiation.

While there were divisions in the ranks among the New Zealand bureaucracy, businesses and politicians, there was also offsetting pressure from the Australian negotiators and from key parts of the New Zealand negotiating team. This group wanted a long-lasting and outward-looking agreement that would be consistent with other parts of New Zealand's new trade and economic policy. Putting the structure in place was vital in fulfilling this criteria.

Important features of the structure include:

- *The opening statement*: the joint communiqué by Muldoon and Fraser made it clear that everything was on the table to be negotiated—including import licensing.

- Once agreed, the tariff reductions were set on an automatic path so that politicians were protected from lobbying as the agreement was being implemented.
- Long lead times were associated with the tariff reductions, to give business time to adjust and feel comfortable about supporting the agreement.
- CER was an outward-looking agreement, so that the partners could extend tariff reductions unilaterally to third countries, rather than having to achieve the agreement required in a customs union with a common tariff border.
- An extensive domestic consultation process was undertaken. This helped develop a general consensus view in New Zealand that the CER agreement would benefit New Zealand economically.

The CER agreement is the most significant piece of trade legislation in New Zealand's modern trade policy history. It is an economically rational agreement that has set the style and tone for all other trade negotiations that New Zealand has been involved in since its signing in 1982. The CER agreement is as close to open regionalism as any trade agreement signed anywhere.

Case IV: GATT\WTO and the Cairns Group

INTRODUCTION

The drive for the formation of the General Agreement of Trade and Tariffs (GATT) and its successor organisation, the World Trade Organisation (WTO), had its roots in the failed international organisations and international trading chaos of the inter-war years (1919–1939). The experience of that period had been both scarring and educational. There was a determination, particularly among policy advisors in the United States, that the economic mistakes made in the past, especially those that were seen as having contributed to the depression and the ensuing war, would not be part of the new international trading regime.

Those who started to look beyond the current concerns to the shape of the post-war world in a series of conferences (including the gathering at Dumbarton Oaks in 1944 that laid the foundations of the International Monetary Fund and the World Bank) were conscious of:

- The risks from a thirst for economic revenge, which translated after World War I into the reparations provisions of the Treaty of Versailles with their fundamental weaknesses.
- The failure of the League of Nations, including its limited forays into economic issues.
- The highly protectionist Smoot-Hawley Tariff Act (1928) in the US, which elevated tariffs and thus isolated the US market.
- The Ottawa Conference agreements which created the British preferential system and virtually eliminated non-Commonwealth countries from the UK market.
- The 'beggar thy neighbour' policies that were unwittingly encouraged, including the disabling competitive devaluations.
- The potentially disastrous economic consequences of World War II.

The overwhelmingly dominant position of the United States economy in the post-World War II era meant that its influence on the shaping of the international trading environment was paramount. According to Pomfret (1995, p192), there was a strong view among US leadership that rising protectionism had contributed to the depth of the 1930s depression and that it had been one of the primary causes of World War II. The United States also had a strong dislike of preferential imperial schemes, given their colonial past. Therefore their philosophy for the world trading regime after World War II was built around non-discrimination, lower trade barriers and increased international competition.

The principle that all participants of GATT sign up to, is that of the most favoured nation (MFN). Put simply, the trade privileges negotiated with one (favoured) trading partner must be extended to all trading partners. So a nation cannot discriminate between trading partners.[103] This cut across the mercantilist policies that had been practised during the previous period (see *Box 1*).

The second guiding principle of GATT is to establish transparency in border protection. In practice, this means favouring tariff barriers, relative to non-tariff barriers. Again, according to Pomfert (1995, p192):

> *"..the GATT aimed to establish the rule that non-discriminatory tariffs would be the only generally acceptable trade barriers, and if signatories broke the rules then other signatories were allowed to retaliate. The threat of approved retaliation is the only GATT enforcement mechanism, but it has been successful in discouraging both explicitly GATT-incompatible actions and unregulated trade wars such as occurred in the 1930s".*

The only other effective enforcement mechanism—which in practice works to supplement and reinforce the retaliation threat—is the sheer 'embarrassment' of being adjudged by due

[103] Although customs unions and free trade areas are exceptions to this rule (Article XXIV of the GATT).

international process to have been caught breaking GATT rules. The effectiveness of the threat of being embarrassed depends on the country size, and country-specific cultural values.[104]

From small beginnings, membership of GATT/WTO has mushroomed. In 1948 the membership of GATT comprised the industrialised nations and a few independent developing nations, such as Brazil. Through successive rounds, the number of member countries grew as participants benefited from trade liberalisation.

At the beginning of the Uruguay Round of GATT, there were approximately 100 members. By the end of the Uruguay Round there were 128. Growth in membership has also corresponded to growth in criticism of the organisation. But this has not stopped more countries wanting to join: at 1 January 2002, 144 members belonged to GATT's successor organisation, the WTO.

GATT was formed for political and technical reasons, and was not an international organisation as such. The 1947 negotiations in Havana (the Conference on Trade and Labour) produced a draft charter for a new international organisation (the International Trade Organisation—ITO) that the United States Congress was assessed as unlikely to ever to ratify. So the core trade rules were extracted from the ITO draft and became the General Agreement on Tariffs and Trade.

This was, as its name implies, cast in the form of an inter-governmental treaty, to which the US could more easily adhere. This gave rise to a series of anomalies. Some were minor, like the labelling of governments that joined GATT as *contracting parties* rather than members; and some more fundamental, like the frozen membership of the original executive body, the Interim Committee of ITO (ICITO).[105]

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[104] For a small country like New Zealand, which depends on strong international rules and has a self-image as a nation with integrity, breaking those rules would be highly embarrassing. Even for some large countries, such as Japan, breaking international rules is also seen as highly dishonourable.

[105] This group had been elected in the early days and retained intriguing countries such as China, even after China withdrew from GATT. The legal form only

As time went by, and tariffs were reduced over the successive negotiating rounds, GATT evolved into something approaching the originally envisaged ITO, with a permanent council,[106] significant staff and its own institutional structure. The Uruguay Round formalised this position by creating WTO, an international organisation that oversees and administers multilateral trade agreements negotiated by members.

These include:

- GATT: which refers to trade in goods;
- GATS: which refers to trade in services; and
- TRIPs: which refers to trade in intellectual property rights.

WTO covers only relationships between governments. It regulates the actions of governments in the area of trade. It does not have any jurisdiction over individual businesses—this is left to the governments concerned.

And the creators of GATT were worried about more than the free flow of world trade. They had more fundamental reasons for creating a multilateral system:

> *"... the [perception of the] founders of GATT was that multilateral institutions facilitating co-operation between countries were important not only for straightforward economic reasons, but that the resulting increase in interdependence between countries would help to reduce the risk of war".*
> Penrose (1953) and Hirschman (1969) in Hoekman and Kostecki (1995, p12).

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mattered for issues of real moment, such as the choice of a new director-general or of day-to-day relevance.

[106] In the early days all business was done at annual meetings, quaintly known as gatherings of 'contracting parties', but the pace of international developments demanded the ability to address issues more frequently, and the monthly council meeting became an executive body.

Box 1 Mercantilism

The basic mercantilist philosophy is to maximise exports and minimise imports. The rationale is that trade surpluses and economic power are strongly correlated. At the heart of mercantilism is the pre-eminence of the nation state and the nationalistic pride fostered by its success. However, the results of strong or extreme mercantilist policies have been unfavourable to the well-being of world economies, particularly in the twentieth century.

The policy implications from mercantilism favour support of exporters through direct subsidies, while imposing restrictions on imports through a range of tariffs, non-tariff barriers, taxes, quotas, bans, and state monopolies.

The folly of this type of behaviour is readily apparent. If all nations engaged in these sorts of trade practices, world trade is stunted. This approach is literally a 'beggar thy neighbour' approach to trade. Trade tends to create enhanced welfare—we can see this in consumption terms. Exports provide additional income for consumption, while *imports are consumption*. So constricting trade stifles growth prospects. It also creates instability. In the opinion of many commentators this instability made an important contribution to the slide into World War II.

The period between 1919 and 1939 was an era when such nationalistic policies were most intense. The piece of legislation that epitomises mercantilism was the Smoot-Hawley Tariff Act in the United States. This act led to a rise in average US tariffs from 38 to 52 percent. The result was devastating: a round of retaliatory trade restrictions and attempts to make countries' exports more competitive (mainly through currency devaluations). The least protected markets were then exposed to exports from countries that had adopted mercantilist policies. Prices fell in those markets, increasing local protectionist pressures further. This vicious spiral went on for a large part of the 1930s. In New Zealand it was this international setting which led to the imposition of import licensing in 1938, with the resulting isolation of the local market from the benefits of competitive imports.

The formation of GATT in 1948 was deliberately intended to counterweight the domestic attractiveness of the mercantilist policies, through offering international benefits.

Source: Allen (1991) and Hoekman and Kostecki (1997).

Functions of the multilateral trading system

The world has no powerful central governing body to co-ordinate relationships between states, so any international co-ordination requires a degree of co-operation between states and a degree of facilitation. WTO, for reasons already canvassed, is a creation of its member states. Its aim is to facilitate mutually agreed trade co-operation between member states. Its role fits the earlier definition of Kasner (1983) as:

> *"..[providing] sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations".*

While countries monitor each other's compliance with the "explicit principles, norms and rules", the multilateral system depends, in the end, almost entirely upon self-regulation.[107] Since 1947, the world trade system, while perhaps not presenting it this way domestically, has relied almost exclusively upon self interest to enforce the mutually agreed principles.

Of major importance to the functions and operations of WTO is its role in facilitating dialogue between members. In facilitating the negotiation process, WTO depends on a mutually agreed-upon code of conduct to reach and enforce an agreement. Each member brings a different mix of attitudes, interests and ideas to a negotiating process, in the same way as individual buyers and sellers bring their own characteristics to the interactions in a market.

For small countries, the focus is on the rules of the 'multilateral market'. They have little market power, particularly on a bilateral basis with bigger nations, and have little to gain from imposing trade barriers. As *Box* 2 suggests, their best option is to reduce barriers unilaterally.

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[107] This comes about because there is no super-national power of any form to provide enforcement—a point underlined in New Zealand's experience by the lack of follow through after its 'success' against French nuclear testing at the World Court in 1973. If a WTO member refuses to accept a judgement that it has infringed the rules, the going becomes complex. It essentially demands a one-off solution.

Box 2 Opportunity cost, specialisation, freer trade and WTO

The works of Adam Smith and David Ricardo are closely associated with the development of trade theory. The 'building blocks' for modern trade theory are the concepts of opportunity cost and the gains from trade associated with specialisation.

All economic activities, such as producing a product (or consuming it) come at the cost of not producing (or consuming) something else. This has major implications for thinking about trade, since if one region is relatively better at producing one product or service relative to another area, it can be said to have a comparative advantage. Therefore one region's opportunity cost of producing that product will be less, relative to some other product. Combine this concept with the important economic theorem that gains from trade can occur if a region specialises, and the importance of the linkages between opportunity cost, specialisation and freer trade become apparent.

If regions (typically individual countries, though increasingly groups of countries) are allowed to specialise in goods and services in which they have a comparative advantage, that region, their trading partners, and indeed, the world can produce more goods and services than they could otherwise have done from the same resources.

It has been this structure that has, on average, enhanced regional specialisation and directly increased the level of consumption (or effectively, real incomes) by about four times in the last eight decades (Hoekman and Kostecki, 1997, p21).

The freeing up of trade between nations is a major objective of WTO, and has two major impacts:

- It brings about the reallocation of resources within an economy into areas where that economy has a comparative advantage.
- More efficient use of resources generates higher incomes, and increased the ability to import goods and services from other countries. In fact, the more exports produced by one country or region, in a free trading environment, the more that country imports. Trade is not a zero sum game in welfare terms.

This has two important implications for small countries like New Zealand:

- New Zealand has a strong interest in maximising its comparative advantage, since small countries are more susceptible in international economic shocks. Therefore, freer trade and freer markets both domestically and internationally are very important to the economic health of the nation since they produce a more efficient allocation of resources in a country. Even if other nations are supporting their industries it makes no economic sense for New Zealand to do the same.
- For a small country that is usually a price-taker (and also a policy-taker), the rules of the international trading game are very important. Without the restraining influence exerted by institutions such as the WTO, large nations will be more able to exert their raw trade power, and lose less economically than smaller nations through protecting industries and affecting world prices.

Source: Adapted from Allen (1991) and Hoekman and Kostecki (1997).

For big countries, with sizeable productive capacity and large domestic markets (which allow for significant market power), restricting imports or otherwise influencing trade flows is common policy.[108] They have possible welfare improvements to seek. World growth, however, would fall with the imposition of trade barriers by big countries, since these actions restrict specialisation and thus inhibit potential economic benefits (see *Box* 2).

Figure 12 Why big countries find freer trade difficult

		Small country	
		Impose trade barriers	*Pull down trade barriers*
Large country	*Impose trade barriers*	World economic welfare declines for all countries. Conditions are reminiscent of the 1920s and 1930s.	World economic welfare may decline. Big countries can gain through market power in their home market. Small countries lose, but know that putting up their own barriers will be even worse.
	Pull down trade barriers	World economic welfare increases. Big countries gain over the long run. Small countries lose.	World economic welfare increases for both big and small countries over the long run.

Source: NZIER

[108] This is based on the 'optimal tariff' idea. It depends on using a high degree of detailed knowledge about markets and assumed reactions by other countries and their authorities, to work out the best level of tariffs to force consumers or producers in other countries to contribute to local welfare.

Figure 12 illustrates the problem facing the multilateral system and shows why small countries have such an interest in organisations such as WTO. The top left quadrant is the nightmare scenario. It occurs where all countries put up trade barriers and all countries lose. As already shown, the inter-war years are an example of this position. The consequences of this type of trade policy are readily apparent.

Small countries often complain about the lack of consistency in the way large countries approach trade negotiations. The top right quadrant in Figure 12 explains why this occurs.

Large countries realise that reducing their trade barriers will increase their own, as well as the world's, economic welfare. By reducing their own barriers unilaterally however, large countries will more than likely cut across carefully built up political alliances within their own country. While the pain from reducing trade barriers would be short term, the results for the politicians and officials who unilaterally removed trade barriers would be severe. The size and power of vested interest groups is formidable—by their very nature they have the potential to influence the outcomes of the political process in that country. In the terms used earlier, they have real trouble forming a simple domestic consensus on trade.[109]

Furthermore, increasing trade barriers may actually increase economic welfare in large countries—or more particularly, in those which choose to exercise market power—while reducing overall world economic welfare. So when politicians in large countries are faced with difficult issues such as trade liberalisation, the typical response is to fudge the issue and opt for some compromise. This is why conflicting signals on trade are sent by larger countries. Policies of large countries are usually a mixture of trade-favourable rhetoric, highly protectionist legislation covering 'sensitive' sectors,

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[109] This qualifier is added to allow for the prospect of piecing together a consensus by aggregating a complex 'basket' of selected trade liberalising ideas, which contains a 'pay-off' for each of the important groups.

and freer trade-orientated export policies.[110] The precise mix and distribution of these aspects depends at any time on the strength of lobby groups in each industry.

It follows that the most heavily protected areas are those where the relative strength of the protectionist lobbies are strongest. This view is supported by Becker (1983, pp371-400) who argues that (large) governments will only correct market failures with the view to favouring the politically powerful.

The top right quadrant also reflects the bind of a small nation. A popular refrain by politicians and interest groups in small countries is to increase trade barriers in response to large country actions. Increasing trade barriers sends the small country back to the top left quadrant reducing its own economic welfare even further over the long run. Therefore the only option open for small nations—those who want to increase economic welfare—is to operate free and open markets regardless of the actions of large countries. This is why it is technically a 'one-sided prisoners dilemma' (a type of game theoretic structure), since larger countries have more influence over the international trading environment than small countries.

The bottom left quadrant almost never occurs. For a big country to unilaterally reduce barriers without supposedly 'getting something in return' has happened on only a few unusual occasions.[111]

The bottom right quadrant reflects the theory and practice associated with trade. Trade produces positive welfare results, relative to the alternative, for those countries that participate.

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[110] Events in the US in early 2002, including the (aptly named) Farm Bill and the tariffs imposed on steel imports, could be seen as typifying this picture, described earlier.

[111] It is almost impossible to 'sell' the idea to large countries that unilateral reductions in tariffs and other barriers will increase economic welfare for that country. This is because the benefits are diffused through the country and thus unsupported by any pressure group sufficiently substantial to offset the strong specific protectionist lobbies.

An important conclusion to be drawn from Figure 12 is the critical role that the multilateral system plays for smaller countries. Specifically, it shows why small countries are interested in strengthening the multilateral rules. Since big countries are likely to be unwilling to unilaterally withdraw barriers to trade, because of internal tensions described above, the WTO rules assume greater importance. Large countries, knowing that freer trade will increase economic welfare for most countries including their own, are more amenable to reducing barriers if ways can be found to assist large countries to 'sell' the deal to various domestic constituencies.

One way of putting across the small exporting nations point of view and persuading larger nations to actively pursue trade liberalisation is to form co-ordinated groupings of nations, such as the Cairns Group. In this way small nations are not liable to being 'picked off' by large nations offering special (usually, bilateral) deals.[112]

THE TRADE LIBERALISATION PROCESS

Unfortunately, this has had a number of unintended side effects to the multilateral process:

- Countries tend to blame international agencies for (economically sensible) deregulation of their own economies. Rather than openly debate the (sound) reasons for further liberalisation of the domestic economy, officials and politicians take the course of suggesting locally that organisations such as WTO are forcing deregulation upon them. This is an easier option than embarking on a programme of explaining why trade liberalisation is good in economic growth terms for all countries in the long run.
- Large trading nations have shown themselves as being frequently incapable of effectively chairing major multilateral ministerial meetings in their own countries. This is because

[112] This has been a standard tactic of the larger economies when faced with pressure to liberalise across the board.

domestic political pressures do not allow that country, as the chair, to act independently—at least under the close scrutiny of their local media. This creates international mistrust, since the direction of the meeting is slanted towards the aspirations of the host country, rather than the wider international or global good.

- WTO, at least in part because of large country influence (though small countries can be similarly unhelpful), has become legalistic in the development of trade rules. Large countries, have large trade policy organisations and their often bureaucratic members are frequently lacking in flair (since they are cut off from their centres of power), and so go for systematic and rule-driven agreements.
- There is a danger of losing sight of reason for the multilateral organisations, and the underlying purpose of the agreements in the successive rounds. Instead of accepting that it is the search for freer trade that improves the welfare of citizens over the long run, large countries are engaged in a complicated task dominated by the need to balance domestic interests. This flows over into negotiating strategies and agreement implementation. In search of political 'wiggle room', agreements are not implemented in the spirit of the agreement, but on strict legal reasoning to square away domestic concerns. This inevitably tends to reduce the effectiveness of any agreement reached.

SUMMARY OF EARLY GATT ROUNDS

The GATT negotiating rounds started with the formation of GATT in 1947. At this first round, major tariff cuts were made, mainly on industrial goods by the 23 members.

The next rounds, the negotiations in France (the Annecy Round) and Britain (the Torquay Round), were primarily concerned with new country accessions to the organisation. By the finish of the Torquay Round another 13 countries had entered the agreement and 4 had left (including China, though it retained a seat on ICITO!).

In 1955, an agricultural waiver (covering the supposedly domestic Agricultural Adjustment Act) was granted to the United States, following the application of significant political pressure to members,[113] and a move to reconstitute ITO in the form of an organisation for trade co-operation failed. Before the start of the 1956 Geneva Round, strong support from the US saw Japan enter the GATT—though not all countries were prepared to accord them full reciprocity.[114] Minor tariff cuts were undertaken in the Geneva Round.

Table 24: GATT/WTO rounds

Year	Round (location)	Description of topics dealt with	Members Start/end of Round
1947	Geneva	Tariffs/accession of new members	23
1949	Annecy	Tariffs/ accession of new members	29
1951	Torquay	Tariffs	32
1956	Geneva	Tariffs	33
1960-61	Geneva (Dillon Round)	Tariffs	39
1964-67	Geneva (Kennedy Round)	Tariffs and anti-dumping measures	46/74
1973-79	Geneva (Tokyo Round)	Tariffs, non-tariff measures, & framework agreements	99
1986-94	Geneva (Uruguay Round)	Tariffs, non-tariff measures, rules, services, intellectual property, disputes settlement, textiles, agriculture, creation of the WTO etc	103/ 128
2002- ?	The next round (Doha Round?)	?	144+

Source: *Economist*, (1998) "World trade survey", 3 October

[113] Interestingly, though Australia was persuaded to vote for it, New Zealand and relatively few other countries were openly opposed and voted against the proposal, which still passed.

[114] The GATT rules allow for 'clubs within the club'. That is, while all members have to accord one another certain fundamental privileges, there is provision for countries who have taken this stand to otherwise treat new members as non-members.

Under GATT rules, those countries that raise trade barriers when joining a customs union were required to negotiate compensation for those countries adversely affected. Negotiations, under GATT auspices, were entered into in 1957 between the newly formed EEC and those countries hurt by its formation. In conjunction with these talks, the Dillon Round (1960–1), named after the US Under Secretary of State, was completed. It produced little in the way of meaningful tariff cuts and no concessions were made on industries such as agriculture. The agricultural waiver given to the United States, and the formation of the EEC and CAP meant that effective barriers on agricultural trade rose.

The Kennedy Round (1963–67) was the first round to examine not only tariffs but also non-tariff barriers. Average tariff reductions were negotiated and an anti-dumping code was concluded. A formalised agreement was also reached on the preferential treatment for developing countries.

The participants of the Tokyo Round (1973–79) represented 90 percent of world trade. Talks ranged more widely than in the other rounds as countries tried to bring more of world trade under GATT rules and regulations. As well as broad tariff reduction, there were code agreements on subsidies and countervailing measures, technical barriers to trade, government procurement, customs valuation, import licensing procedures and a revision of the Kennedy Round anti-dumping code. In addition, international arrangements on bovine meat, dairy products, and civil aviation were negotiated.

Benefits of the early rounds

Table 25 shows the impact of early GATT rounds on manufacturing trade (note the higher tariffs in Australia and New Zealand). The general reduction in tariffs allowed increased access to markets that had been closed before World War II and increased trade and world welfare dramatically.

Of the early rounds, the most important reductions in tariffs came in Geneva in 1947. Baldwin (1986) points out that the United States cut tariffs by 21.1 percent in 1947, while in the next three rounds US tariffs were reduced by 1.9, 3.0 and 3.5 percent respectively.

Table 25 Average manufacturing tariff
Selected industrial countries, 1925–1970

	1925	1970
Australia	27	23
Canada	23	14
USA	37	9
EU[1]	-	8
Japan	13	12
New Zealand	30[2]	30

Notes: (1)EC tariffs in 1920 ranged widely from close to zero in Britain and the Netherlands, to above the US rates in Spain.
(2)Tariffs on all goods entering New Zealand.
Source: Anderson (1987) in Pomfret (1995, p193), Statistics New Zealand

Improved economic welfare was only one of the reasons for the willingness of nations to further integrate with the world economy. The EEC, which was essentially an economic-political agreement between France and Germany to secure peace for Western Europe, is the best example of the dominant political concerns. Unfortunately, these events had adverse implications for world agricultural trade. Securing peace through greater economic integration was a driving factor for the European economies, while its impact on world agricultural trade was of lesser or no importance for them at that time.

The example of the United States was also an important signal to other nations. The agricultural waiver was granted to the United States, because of pressure from its domestic farm lobby. It was particularly important, since it allowed other regions to seek a derogation from GATT rules. The Japanese (with the formation of the 1961 Basic Agricultural Law) and European (formation of the EEC) governments, following on from the United States example, ignored the spirit of GATT rules when developing their domestic agricultural regimes. The waiver effectively reinforced the notion, already abroad in early GATT drafting (at the behest of the Europeans), that GATT rules did not really fully apply to agriculture. It was seen as a form of second class trade, to be discussed in terms of wider domestic political issues—an attitude that persists in concepts like multi-functionality.

Not entirely incidentally, while manufacturing trade boomed, effective barriers in agriculture and subsidised agricultural trade both increased. These contributed (along with technological advances) to a real decline in world agricultural prices, and relative stagnation of agricultural trade. Even in the Tokyo Round, a global food crisis at the start of the round (1972/74) reinforced the resolve of the Japanese and European politicians to retain high levels of agricultural self-sufficiency at any cost. It was not until the Uruguay Round, after an agricultural trade war between the United States and Europe, that agriculture was finally, realistically, put on the GATT rules negotiating agenda.

Despite the repeated failure to deal with agriculture, the GATT rounds were slowly increasing in size and complexity as more countries joined, thereby increasing the amount of world trade under its auspices. GATT also widened the coverage of trade barriers that it dealt with. An anti-dumping code was introduced in the Kennedy Round, as well as preferential treatment for developing countries. The Tokyo Round extended the number and reach of codes, as described earlier.

However, the structure of the GATT codes, unlike GATT disciplines, meant that countries could opt out of any agreement.[115] Countries could negotiate between themselves on different codes picking and choosing which codes they wish to join. This effectively watered down the agreements since GATT disciplines applied to all members.

New Zealand's approach (1947–1979)

New Zealand was a founding member of GATT in 1947 and took part in all negotiating rounds. Its role, however, was somewhat

[115] Note (as referred to above) an earlier analogue of this approach had been incorporated in GATT from the start. The code approach is often referred to as *GATT a la carte,* as each country chooses its own detailed mix of rights and obligations.

ambivalent. While being a developed, or at least a relatively high-income nation, New Zealand sided with developing nations that refused to reduce their own trade barriers, but expected others to reduce theirs and allow New Zealand goods to be traded freely. New Zealand used protectionist special pleading arguments (and had, in fact, at Havana pressed for the inclusion of an infant industry exception clause that was carried through into the GATT text) to defend its position. The argument was that we needed a more diversified economy so development based exceptions were required.

A similar situation occurred in Australia, so while the industrialised nations' tariff rates were being significantly reduced, New Zealand and Australian tariff rates were similar to pre-war (and depression) rates. According to Pomfret (1995, p194), Australia in the 1950s and 1960s could have been said to have been "swimming against the trade liberalisation tide". (See Table 25).

The same is true of New Zealand. The introduction of import licensing in 1938 to address a 'temporary' problem—triggered by the impending reluctance of London bankers to roll over sovereign loans to a Labour government (seen as a bunch of socialists)—stifled competition and innovation in manufacturing up until the CER era in 1982 and beyond. High (and flexible) effective rates of protection on manufacturing goods[116] made it difficult for a competitive manufacturing industry to emerge in New Zealand.

Trade policy, and more specifically trade access issues, consumed the New Zealand trade bureaucracy over this time. The total of New Zealand's limited trade policy resources was directed at access questions to the extent that all its 'negotiating eggs were in the one, British, basket'.

[116] The levels of protection that were applied under the import licensing system were implicitly higher than measurement shows. The fundamental policy was that if the good could be made locally, then entry would be denied. This means, technically, that relative prices (the typical basis for measurement of protection associated with quantitative restrictions) only reflect the situation as it happens to exist when the measurement is done, not the full extent of price differences possible under the system.

This contributed to viewing GATT as a lower priority. Gradually however, the realisation that Britain was going to be more closely integrated with Europe pushed New Zealand towards thinking more seriously about the multilateral system. But these were halting steps, since the 1965 NAFTA customs union with Australia and the comprehensive import control system were questionable under GATT rules. They would thus be in danger of challenge if New Zealand were to become more active.

It was not until the formation of CER, which was GATT-consistent (and which clarified New Zealand's trade policy future aims) and the onset of the wider economic reforms that established a new view of the role of tariffs and other forms of protection, that New Zealand could play an integrated and effective part in the multilateral negotiations. As it happened, this effectively coincided with the start of the Uruguay Round.

THE URUGUAY ROUND

> *"The Uruguay Round is not a dance".*
> A badge worn by Fred Bergsten, Director of the Institute for International Economics, at the G7 summit in Houston Texas 1990.

The trade policy focus for New Zealand was on the agricultural negotiations in the Uruguay Round since, as noted, the restrictions on world trade in agricultural goods has a huge impact on the New Zealand economy.

The limited impact of the Tokyo Round on agriculture was a disappointment that only emerged in the closing stages of that negotiation. Previously, there had been hope that the 'cathedral' talks on agriculture would build something lasting. In the end these merely began an informal talk-shop process and left agriculturally concerned economies dissatisfied. This feeling was reinforced by the subsequent failed attempts to launch a new round in 1982.

The upshot was that large countries (EU, US, Canada and Japan) continued to support their farmers heavily. The EU and the United States competed to sell their over-production, caused by price support schemes. This was unloaded as subsidised farm products on world markets, so the subsidy component of the returns to farmers increased. The continual increases in subsidies not only disadvantaged small agriculturally dependant countries who had been selling their produce at reasonable prices, but also led to an agricultural trade 'war' between the EU and the US. It reached the point where even the large countries recognised that it was becoming unsustainable.

Timing is everything in negotiations. The trade war created the 'heat' or appropriate preconditions for sensible rules to start being applied to agriculture in the Uruguay Round. The round began in the Uruguayan city of Punta del Este in 1986 and ended with the closing rites in the Moroccan city of Marrakech in 1994.

The Uruguay Round of GATT was by far the longest, most comprehensive and ambitious round of multilateral negotiations ever undertaken. The agreement included a wide range of different agenda items, 14 in all. These included specific (problem) sectors such as agriculture and clothing and textiles, and new areas like intellectual property rights, as well as GATT's traditionally successful field, industrial goods. By far the toughest negotiations attempted were those on agriculture.

While the round was long and arduous, the outcomes were extremely important for small open agricultural nations. Sensible rules within an acceptable implementation framework was their aim. This was because reinforcing international rules in trade is the only way, apart from goodwill by large countries, that smaller nations can have any hope of competing on a relatively even playing field in the international market place (Figure 12). If rules are 'enforced'[117]—that is, have some likelihood of being carried through—larger countries are relatively less likely to impose

[117] We use inverted commas around *enforced*, as the only real sanctions on large countries are those that are self-inflicted—there is no international trade police force. If large countries do not accept the suggested sanctions (say, because of domestic concerns), they typically have other options to pursue. But the process of accepting (and thereby disappointing domestic interests) is 'easier' in a multilateral setting with the eyes of the world focused on them.

unfavourable trading conditions on smaller nations. Therefore, strengthening the rules of the international trading environment is extremely important to smaller nations. The Uruguay Round negotiations on agriculture were so difficult because large countries, for a mixture of reasons, did not want to give up their existing privileged positions.

Aims

New Zealand, mindful of previous failures in the multilateral setting, had one overriding goal in the Uruguay Round: to put agriculture on the GATT agenda and so increase the likelihood of longer term agricultural liberalisation. Given the importance of agricultural trade to the New Zealand economy (see Table 23), and taking into account the amount of protection afforded agriculture in the industrialised world, this aim was of central importance.

Once the issue had been taken out of the 'too hard basket' and was being treated like other GATT challenges, the direction of movement toward freer trade was inevitable. The speed of movement, however, might be another question.[118]

New Zealand negotiators, given the success of CER, were also concerned not only to put agriculture on the GATT agenda, but also to ensure that the structure for further (inevitable) liberalisation was put in place. The New Zealand delegation was mindful of some of the lessons learned during the tough negotiations with Australia. They wanted to put these lessons into effect, bearing in mind that the GATT Round was far more complicated than the bilateral negotiation with Australia. So there had to be a degree of tailoring the ideas to the forum and this meant:

- Being part of a wider group of countries that could co-ordinate strategy and tactics as the round progressed. New Zealand, by itself, could not effect any sort of significant change in the international rules for agricultural trade in GATT. New Zealand was thus a founding member of the Cairns Group that actively pushed for agricultural liberalisation.

[118] One that persists to the present day.

- Locking in political commitment at the beginning of the round for agricultural liberalisation and not allowing agriculture to become a secondary issue. If the topic became less than central, it might be jettisoned in the scramble to close the round for political reasons—as had occurred at the close of the Tokyo Round.
- Putting the right structural framework in place, once agreement on liberalisation of agriculture was achieved.
- Ensuring that the liberalisation process was consistent with New Zealand domestic economic aims.

To achieve these aims New Zealand negotiators needed to develop strategies and tactics that would allow them to have an influence. They sought to find and make contributions, that would make them 'useful to the process' and listened to by the others.[119]

New Zealand needed to play a constructive part in the negotiations by:

- Regularly coming up with good ideas to bridge the gap between various core parties (usually the EU and US). This was especially valuable where there was a risk of the whole process grinding to a halt through lack of dialogue between the majors.
- Being seen to participate fully in all negotiations and not just 'harp on about agriculture'. If New Zealand participants were 'helpful' in devising constructive compromises in other parts of the negotiations (often of limited interest to New Zealand directly, and where there was thus the chance of representing a thoughtful neutral position), then their counterparts from other countries would be more inclined to take New Zealand's position on agriculture seriously.

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[119] A common error, made particularly by New Zealand economists and other commentators, is to presume that countries listen to New Zealand negotiators because of this country's economic and other reforms. Unfortunately, such developments count for little in a negotiation. Countries are, after all, having to manage their internal politics. If a country adds nothing to the negotiation it does not get to influence the outcome.

New Zealand negotiators hoped this positive role would put them in an influential position on those areas of the GATT negotiations that were of vital interest to New Zealand.

Preparations

As with all major international efforts, the key to real success is in the mix of prior action and thinking that is undertaken. A critical move took place long before the international consensus had even hardened around the prospect of what would follow the Tokyo Round.[120]

It involved the use of diplomatic processes that had become part of the New Zealand 'kitbag' as experience had been accumulated. The relatively small New Zealand trade team stretched around the globe was used to working closely together; carrying initiatives between international fora was part of the New Zealand style—made simple by the scale and continuity of the team involved.

OECD and GATT

New Zealand Prime Minister Robert Muldoon was Chair of the OECD Council of Ministers—a powerful group, typically consisting of Ministers of Finance—in the mid-1970s. He needed a speech for the annual meeting and asked Richard Carey (a Treasury officer then serving in the NZ Embassy in Paris)[121] to write notes for the speech. Carey prepared a strong piece on the inequity and inefficiency of agricultural protectionism. Muldoon delivered it in hard-hitting style, causing everybody present to agree to an OECD special study of the issue. The Multilateral Trade Mandate project (MTM) was born.

OECD (with significant New Zealand and Australian staff members) built on the Josling PSE methodology to put together a

[120] New Zealand's dissatisfaction with the lack of results outside the holding action of the consolidation of the arrangements that was the International Dairy Agreement, caused our representatives to call for a stocktake of the results in early 1980, almost before the ink was dry on the Tokyo Round settlement. This was deliberately intended to start the process which would lead to the next round.

[121] Later to become a longstanding senior OECD staffer.

whole package that would serve as a negotiating platform at the future GATT talks. One of New Zealand's most experienced agricultural trade academics, Professor Bruce Ross, the newly appointed Vice-Chancellor of Lincoln University,[122] was seconded to OECD to sell the results of the MTM study to members.

This methodology and the model results obtained really helped make it possible to secure a place for agriculture when the Uruguay Round was launched in 1986. It showed the seriousness of the 'agriculture protection' problem to many countries, especially least developed countries (LDCs). It also provided a framework capable of handling the complex administered pricing (non-tariff) models that countries had erected to bypass GATT structures. Finally, through its technical side, it grounded the process that (somewhat unfortunately) became known as tariffication, which allowed the traditional GATT negotiating style (developed out of the tariff-cutting exercises of the early days) to be applied in a reasonably simple way to the plethora of non-tariff measures in agricultural trade.

Domestic

Domestically, very little by way of political preparations was required. There was a consensus in New Zealand at that stage that agricultural trade liberalisation and generally more open markets were good things; most New Zealanders supported this position.

Preparation was on two fronts:

- *Data and information collection and analysis.* The new width of the negotiations and the strategic commitment of New Zealand to take part in areas previously neglected as peripheral, meant whole new work challenges arose for the 'backroom'. The round was also rather more sophisticated in the intellectual tools it used (such as PSEs) and people had to be totally au fait with these new concepts as well as know where New Zealand (and its negotiation targets) stood empirically. As always, there was the task of gathering the 'ammunition' to be used in the

[122] He was later to become the Director-General of MAF.

discussions with other countries, and the potential 'rebuttal' support for the defensive lines that were to be run—though the domestic economic situation had reformed to the extent where traditional weak points had been mostly eliminated.[123]

- *Domestic consultation.* A wider group than the usual network, which consisted largely of agricultural organisations such as the producer boards, had to be pulled together. Again the wider scope of the round was an influence, but the strategic way New Zealand was approaching it including the decision to 'go public' early showed the commitment to achieving something in this round.

International

New Zealand's focus was on organising an international consensus between nations to further liberalisation in agricultural trade. On this front, the most significant preparation undertaken by New Zealand was the decision to join the Cairns Group of nations.

The Cairns Group, a group of relatively unsubsidised agricultural exporters, was particularly keen to make agriculture the prime focus of the Uruguay Round. By being part of a wider group of countries from both 'north' and 'south', with the single objective of increasing the likelihood of agricultural liberalisation success, they hoped to influence the stance of the EU and US to agricultural reform.

Even the larger country drivers of the group, as individual nations, were policy takers in this area. Collectively however, it was hoped that they would carry sufficient weight to be able make a nuisance of themselves and thereby make some difference on agriculture, relative to previous rounds of GATT.

[123] The classic New Zealand policy weakness was the persistence of the system of quantitative restrictions long after we had foresworn the available protection under the balance of payments loophole in Article XII, at a time in the early 1970s when there was a brief upsurge in agricultural prices and a record surplus on the current account.

The Cairns Group was formed over a series of meetings in 1986.[124]

Table 26 *Cairns Group: selected statistics for 1986*

	Population (millions)	GNP (per capita $US)	GDP (total $US)	Agriculture as a % of GDP	Agriculture as a % of exports	Labour force (%) employed in agriculture
Argentina	31.0	2,350	69,220	13	73	13
Australia	16.0	11,920	184,940	5	39	7
Brazil	138.4	1,810	206,750	11	41	31
Canada	25.6	14,120	323,790	3	18	5
Chile	12.2	1,320	16,820	-	25	17
Colombia	29.0	1,230	29,660	20	67	34
Hungary	10.6	2,020	23,660	17	23	18
Indonesia	166.4	490	75,230	26	21	57
Malaysia	16.1	1,830	27,580	-	38	42
Philippines	57.3	560	30,540	26	26	52
New Zealand	3.3	7,460	26,630	11	68	11
Thailand	52.6	810	41,780	17	54	71
Uruguay	3.0	1,650	5,320	12	58	16

Notes: Statistics on Fiji, a member of the Cairns Group, are not available.

Source: Cooper and Higgott (1986)

The core group met first in Uruguay to discuss strategies and tactics for the proposed up-coming round in early 1986.[125] Later that year, other nations joined the group at a meeting in Thailand.[126]

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[124] The creation of the Cairns Group was a collaborative effort between Australia, New Zealand and Uruguay. Credit for the original idea depends on the nationality of the trade official consulted. One strand has John Pryde, senior fellow at Lincoln University, ex-CEO of Federated Farmers and an experienced lobbyist and consensus builder, recognising in the mid-1980s that agricultural exporters would need combined weight to countervail EU and Japanese (and other) inclinations to let agricultural issues slide (again) in the new GATT Round. He suggested a grouping of agricultural exporters (both developed and developing countries) to lead the charge in the round. This was put to his friend, Mike Moore, who was Minister of Trade. Moore realised that New Zealand did not have the resources to put the group together and talked his Australian counterpart into doing it. Thus the Cairns Group came into being. Who, in fact, originally thought of the Cairns Group is not of overwhelming import here. The relevance of the group was its effectiveness in getting its message across to larger countries. A large amount of its operational success was due to the resources devoted to the Cairns Group by the Australians.

[125] Argentina, Australia, Brazil and New Zealand.

At that time, the talks in Geneva on starting a new round were progressing well, except for one area: agriculture. Five Cairns Group countries (Argentina, Australia, Chile, Thailand and Uruguay) decided to withhold their assent to the draft objectives for the agricultural negotiations.[127] Opposition from France stopped the EU from agreeing to have agriculture on the agenda. So even before the round had started there were major disagreements on agriculture.

In November 1986, ministers from 13 agricultural exporting nations met in Cairns, North Queensland. The attitude of the EU, in particular the French, toward agriculture, increased the resolve to work together and co-ordinate a negotiation strategy. In December when the actual negotiations started they were referred as the Cairns Group.

The formation of the Cairns Group illustrates the value of groups of countries coalescing around a single issue. A unified group of smaller and medium sized countries that act strategically can have a much more effective input in a multilateral process.

Given that negotiations are about trade-offs, such groups are forced to invest significantly in large amounts of preparatory work—discussing their objectives, their methods, and how far to go to achieve their ends—to produce the agreed action through co-ordinating strategies and tactics.[128] These coalitions are 'high

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[126] Canada, Chile, Columbia, Hungry and Thailand. They were joined by other ASEAN nations at a meeting hosted by Thailand.

[127] This was to mirror negotiating positions in the actual round quite closely. The Australians and the South Americans pressed hard for acknowledgement of agricultural liberalisation in the text to be negotiated in the Uruguay Round, while New Zealand diplomats adopted a softer line with an eye to putting together compromise solutions. These different, almost natural or stereo-typical, tactical roles played by each Cairns Group member was perhaps accidental. But it was one of the strengthens of the group, since it provided diversity of action and did not compromise the overall objective: liberalisation of agricultural trade.

[128] Hence the large number of meetings of officials and ministers of the Cairns Group in 1986. This co-ordination continued on a formal and informal basis right through the round.

maintenance' requiring constant contact and great mutual understanding of all members' positions and preferences.

It also means that countries need a 'nimble' approach in:

- The types of coalitions they form. The more focused (single-minded) the group is, the more effective they will be. A single-issue group may be more effective than one which has to compromise (and thus decide complex multi-market trade-offs among their members) over a number of different issues.[129]
- The types of ideas brought to the negotiating table. Their more innovative ideas and ability to 'bridge the gap' between negotiating positions (between the EU and the US) gave small countries who were focused largely on this area some advantage in the negotiations.

Countries who formed the Cairns Group were able to give 'voice to a repressed interest' (Oxley, 1998, p10)—a reference to those countries with a strong and direct interest in agricultural liberalisation (see Table 27), but little effective way of representing their views at the GATT table alone.

Resources

As we have noted, a major strength of the Cairns Group in the round was its focus on one issue: agriculture. [130] Fourteen countries combined available resources to focused on a single issue and within that, a single goal—agricultural liberalisation. This made it more difficult for the major players in the negotiations, EU and USA, to completely ignore (or talk to death) agricultural issues. In fact, as the negotiations progressed, both major players supported various Cairns Group positions at different times, as a way of advancing their own strategic positions.

By pooling resources, Cairns Group members were able to play different roles in the negotiation, a strategy which contributed to

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[129] Such as the G77 Group of developing nations formed under UNCTAD, whose members have a large number of different agendas.

[130] This conforms to Habeeb's theory that focus can be a major strength in any negotiations.

the group's effectiveness. New Zealand, for example, saw its role as a peacemaker, bridging the gap between entrenched positions. It needed a stream of innovative ideas and a freedom to act on those ideas at the right time. Other Cairns Group members saw a different tactical position for themselves and they played a more militant role.

A number of other advantages accrued as a result of working off a larger resource base:

- The total intelligence available to the members of the Cairns Group improved and thus their ability to act tactically.
- The diversity in membership (crossing the north-south split, from different parts of the world, and so on) enhanced their creditability. It also increased the ease of selling the group's ideas, as the various members had contacts and appeal across the spectrum of GATT members.
- Despite their diversity, the common interests of the group outweighed any difference in tactics (Oxley, 1998, p11). This was notwithstanding the fact that in each agricultural commodity, members of the group were in competition with each other on world markets. The focus was kept on liberalising markets along MFN principles, rather than trying to secure preferential access for any one market or for any one country.

Negotiation process

The negotiating phase of the Uruguay Round was the most difficult undertaken by GATT—even before the negotiations began, getting agriculture onto the agenda was highly contentious.

The Cairns Group did influence the balance of power in the agricultural negotiations. In previous rounds, the US and EU[131] set the framework of GATT negotiations in a pyramidal 'trickle down' structure. Once these two had agreed the basic structure and informally explored where the trade-offs would be, then other

[131] Or at least the countries that by the early 1990s made up the EU. During the Kennedy Round, the UK had still been independent, and a serious world trader. It had then been part of the 'small inner group' trying to organise the round.

countries would be gradually invited 'into the room' and the shape of the negotiating process was thus gradually expanded until all the participants were involved.

While this basic structure remained, Oxley (1990, pxiv-xv) shows that for the agricultural negotiations at least, the dynamics did change:

> *"The day before the formal opening of the conference (the Uruguay meeting) US and EU officials met quietly at a pre-arranged venue. ... [At that meeting] The European Community passed over to the Americans a sheet of paper with some formulations of words designed to straddle the differences between them. [The Americans, in the form of Secretary of Agriculture Dick Lyng said] Before we give you a reply to this ... I would like to know what the Cairns Group think of it".*

Later on in the round, when the US was dragging its feet with an eye to protectionist lobby groups at home, the EU and the Cairns Group put pressure on the US to close the deal. Essentially the issue that faced GATT then (and WTO now) was how to get the EU and the US to enter into the spirit of the negotiations, and adhere to GATT disciplines across the board. This was the aim of the Cairns Group in the round.[132]

New Zealand diplomats played a significant part in keeping the whole round on track when difficulties arose before the round, at the mid-term Montreal Ministerial meeting, the Brussels Ministerial meeting and at other times. Mike Moore, New Zealand's Overseas Trade Minister at the time, made the comment that he ..."did some of his best work at Montreal [when the round was in danger of collapsing]" (Mike Moore, 1999). In a role reminiscent of John Marshall and his team, a succession of New Zealand trade ministers and officials took a constructive role in keeping the process moving and so ensuring a GATT deal in the Uruguay Round—at least eventually.

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[132] This has been clearly shown in the recent Seattle Ministerial Meeting, where the lack of genuine interest expressed by the major powers resulted in the proposed new round being stalled for a time.

Table 27 Strength through diversity: the Cairns Group

	Role	Strengths	Links
Argentina	Strong supporter of a united Cairns Group.	Played a vital brinkmanship role in the UR. Made sure agriculture was kept on the UR main agenda.	Has a role in the G77, UNCTAD and other developing country fora.
Australia	Leadership role in the group.	Had the resources to co-ordinate the Cairns Group.	Has good relations with the US and other major agricultural exporters.
Brazil	Leadership role in developing country politics.	Played a vital brinkmanship role in the UR. Made sure agricultural was kept on the UR main agenda.	Has a leading role as an exporter and importer in the G77, UNCTAD and other developing country fora.
Canada	Introduces a moderating influence and has an understanding of big power realities.	Able to play a leadership role occasionally.	Is a member of the G7 and the Quad. It has a strong bilateral relationship with the United States.
Chile	Strong supporter of a united Cairns Group.	Played a vital brinkmanship role in the UR. Made sure agricultural was kept on the UR main agenda.	Links to Latin American and developing nations.
Colombia	Strong supporter of a united Cairns Group.	Played a vital brinkmanship role in the UR. Made sure agricultural was kept on the UR main agenda.	Links to Latin American and developing nations.
Fiji	Represented the views of very small states.	Micro state agricultural exporter.	Links to other Pacific Island and micro states.
Hungary	Large European exporter of grains and livestock.	The only European member of the Cairns Group.	Broadens the range of opinions in the Cairns Group.

Table 28 Strength through diversity: The Cairns Group, continued

	Role	Strengths	Links
Indonesia	Represented developing nations as both a major exporter and importer.		Access to Asian caucuses and developing countries.
Malaysia	Represented developing nations as both a major exporter and importer.		Access to Asian caucuses and developing countries.
New Zealand	Founding member of the Cairns Group.	Was able to provide useful ideas to keep the process moving.	Good links with the US and EU and important player in developing Cairns Group strategy.
Philippines	Represented developing nations as both a major exporter and importer.		Access to Asian caucuses and developing countries.
Thailand	Represented developing nations as both a major exporter and importer.		Access to Asian caucuses and developing countries.
Uruguay	Founding member of the Cairns Group and host of the Uruguay Round.	As host, it had good access to the majors and was able to play a constructive role in the negotiations. Was part of the group that 'embarrassed' the EU and US into more sensible discussions when they walked out in Montreal.	Bridged the gap between developed agricultural exporters and developing nations.

Source: NZIER interviews, Oxley (1998), and Cooper and Higgott (1986)

They had to come up with novel solutions and ideas to bridge what seemed, at times, intractable gaps between various players on quite differing issues. Their usefulness to the process enhanced the prospect of their being listened to on issues close to New Zealand's national interest.

The 'good cop' routine played by New Zealand was complemented by the 'bad cop' routine of other Cairns Group participants. When the EU and the United States could not agree on agricultural reform at the Montreal Ministerial meeting, the situation threatened to relegate agriculture to a secondary issue in the round.[133] The South Americans in the Cairns Group then pulled out of those talks—a crucial move in keeping agriculture as the central issue of the round. Without their 'brinkmanship' (Oxley 1998, p12), little progress towards agricultural liberalisation would have occurred when the EU and US resumed talks in Geneva, after the failure of the Montreal meeting.

While brinkmanship was important, the Cairns Group also knew the limits of its ability to push for liberalisation in agriculture. The actual degree of liberalisation was a modest one, falling short of what was sought—but the structures had been created. So when a deal was reached between the EU and US on agriculture, the Cairns Group was well aware of the "finite limits of its influence" (Oxley 1998, p12).

The group also understood that getting the structure right for the liberalisation process was of foremost importance.

Key structural elements were:

- *Bound tariffs.* Once the diverse range of non-tariff barriers to entry were converted into tariffs, then those tariffs were bound. By binding tariffs in the GATT framework, countries are constrained from raising them above the fixed level without reaching agreement (and typically offering an alternative undertaking) from those most affected.

[133] As it had been in the Tokyo Round.

- *Adjustment time.* Countries were given lead times to introduce the agreed reforms. This gradualist approach to liberalisation gave countries time to organise their adjustment, including finding political schemes to mitigate the impacts. Developing countries were given longer lead times to introduce reforms.
- *Irreversible and non-discretionary.* The liberalisation process would be automatic in application, protecting governments from being subject to an internal lobbying process.

In the Uruguay Round, New Zealand ministers and officials themselves took different roles. Officials made themselves useful to the process by playing a constructive and positive role in the negotiation process as well as undertaking their normal negotiation duties. In the 'fog of the negotiations' they had been given enough flexibility (in a negotiating sense) to make a difference. Building on the groundwork of the officials, ministers used their personal contacts with counterparts overseas in an attempt to bridge the gap between different positions, or to find ways to break any deadlocks happening at the officials level. In this complementary way, officials and ministers worked in tandem at different levels to achieve reform.

Outcomes

WTO was instituted as an international organisation tasked with the responsibility of overseeing the multilateral process and agreements. WTO is a sort of international 'holding organisation' and oversees the operation of GATT, GATS and TRIPs. For a number of years GATT had performed this role in a de facto way, but the formation of WTO formalised the process.

The outcome of the Uruguay Round was further liberalisation of trade in goods and, for the first time, services. After years of prevaricating, the larger nations finally agreed to re-introduce agriculture, textiles and clothing to the full GATT treatment, and expand GATT disciplines. In addition, new areas affecting the trade in services and intellectual property were also negotiated.

Briefly, some of the main results of the Uruguay Round were:

- Tariffs on industrial and manufactured products were reduced by almost 40 percent from around 6.4 percent to 4.0 percent (Hoekman and Kostecki, 1996 p18).
- Agricultural reform in GATT had four features:
    - Domestic support, as measured by the aggregate measure of support (AMS). AMS was to decline by 20 percent from a 1986–88 base;
    - Export subsidies were reduced by 36 percent in value terms and the volume of subsidised exports by 21 percent from a 1986–90 base;
    - Barriers, tariffs were reduced on average by 36 percent from a 1986–88 base;
    - Market access: by the year 2000 at least, 5 percent of the market for commodities subject to tariffication should be taken up by imports.
- Agreement on textiles and clothing. The existing arrangements are being phased out over a ten-year period (1995–2004) in a three-stage process:
    - In 1995, 16 percent of the categories would be integrated into GATT rules;
    - In 1998 a further 17 percent of tariff lines would be subject to GATT rules;
    - In 2002, 18 percent of tariff lines would be integrated;
    - This leaves the remaining 49 percent of tariff lines to be addressed at the end of the process.
- The GATS agreement brought the rules governing trade in services in line with those covering trade in goods. These included:
    - A set of principles and rules that apply to all areas affecting trade in services;
    - Specific commitments outlined in a member's own (undertakings) schedule;
    - An understanding that other negotiations will be undertaken to liberalise trade in services progressively;

- A set of attachments and annexes that relate to the implementation of the agreement.
- The TRIPs agreement includes:
  - Establishment of minimum standards and rights for (domestic) intellectual property regimes;
  - Prescribed procedures and remedies that a member must undertake;
  - Allows the same disputes mechanisms available for other agreements to be applied to intellectual property;
  - Applying the usual WTO criteria of transparency, national treatment and MFN status.

Post-agreement trading situation

The main problem that followed the Uruguay Round agreement was the mindset or 'cultural baggage' which countries still seemed to have. Political forces could cause them to see trade as a threat to domestic interests.

So once the deals were made, it was as if the gains were just taken for granted and, instead of honouring the spirit of the agreements made, countries set out to exploit any loop-holes that existed.[134] This has led to a rather 'letter of the law' approach to the GATT agreements. The actual reasons for reform are lost sight of, as countries try to circumvent or backtrack on the commitments they previously made. This has made the multilateral process much more difficult over the past ten years.

The agreement on agriculture in the Uruguay Round was modest in the reform it achieved. Of the areas targeted for reduced subsidises, the most telling constraint was that placed on export subsidies (see Rae and Nixon, 1994, for more detail). The main victory was ensuring that the structure of the agricultural agreement was satisfactory. Among the positive aspects of the agreement were that agriculture was firmly on the agenda, a start was made on the cutting subsidies, although very limited, and the

[134] Industrialised nations were and are the worst offenders.

cuts were even over five years and were to be achieved through automatic annual increments.

By contrast, the clothing and textiles sector had 49 percent of its cuts in tariff protection backloaded to the final year, 2004.[135] This will create real problems for both developing and industrialised nations, since cutting tariffs by such a large amount in one year could cause major dislocation in the short term, not to mention a strong reaction from politicians and lobbyists in industrialised nations.

It also creates (justified) suspicion in developing nations that industrialised nations are not entirely serious about freer markets. The structure of the tariff cuts, relative to agriculture, has led some in the developing world to accuse industrial nations of not obeying the spirit of the Uruguay Round. Developed nations had, it is alleged, increased the price of wheat (through agricultural reform), without giving developing countries sufficient ability to pay for such basic staples. While the agriculture agreement has been implemented,[136] the reform of the clothing and textiles sector has been long and drawn out and is still by no means certain to occur.

But one of the major achievements of the round is that the agricultural trade war experienced in the 1980s has not returned. No longer are the EU and the US ratcheting up support payments and other subsidies to compete for agricultural markets. The limits on export subsidies have had the effect of expanding the market, particularly in dairy, for non-subsidised players, and provided certainty to existing quota allocations.[137]

CONCLUSION

New Zealand learned the negotiation craft in various cycles of trade negotiations from Ottawa on. The intellectual framework for the

[135] More importantly, industrialised nations are reluctant to remove their quantitative restrictions.

[136] Despite very high tariff walls and increasing incidents of non-tariff barriers.

[137] New Zealand no longer has to negotiate every year with the EU over dairy and sheepmeat quotas. This frees up trade policy resources for other activities.

departure from the apron strings of the UK was developed during the negotiations for the CER agreement, which set out the framework for modern trade policy in New Zealand. But it is the ongoing WTO negotiations that are the main focus of current New Zealand trade policy. The potential for New Zealand to gain, in terms of future prosperity, is considerable, since most trading nations are members of WTO. There are massive economies of scale in this context, as achievements are generalised. And the more comprehensive the membership, the more the small country benefits from the rules and the more likely structures are to remain in place, as the largest players find it harder to resist the international pressure to conform.

The early years of GATT, however, were met with some ambivalence in New Zealand. New Zealand's market of interest was in Britain to which New Zealand had created preferential access. GATT was also, at that stage, largely focused on industrial goods trade and agricultural trade was not fully covered. More importantly, fundamental GATT principles were at odds with the New Zealand preferential trading relationship with Britain. The MFN clause promoted even competition in markets between GATT adherents.

It was only with the formation of the Cairns Group and the beginning of the Uruguay Round in 1986, that New Zealand seriously devoted sustained and substantial time and resources to the multilateral process.[138] Agriculture was finally included in the agenda, and the quota arrangements, while still anomalous, were no more seriously threatened than they had been in the 1970s and 1980s.

Trade policy resource allocation was solely focused on developing international consensus for change. Little time was

[138] There had been earlier forays into the use of the multilateral process to liberalise agricultural trade by New Zealand. These included attempts to bring together commodity exporters under the UNCTAD umbrella, which left as its lasting impact the group of 77, and a brief fling at taking the FAO seriously. Neither of these had the necessary practical outcomes New Zealand demanded.

required to develop a political consensus domestically as farming groups, other interested parties and the general public were united in pushing for agricultural liberalisation through GATT. Careful technical staff work was done in-house though.

Internationally, some of the available resources were focused on forging a consensus between like-minded agricultural exporters. New Zealand was a founding member of the Cairns Group, which developed into a highly successful pressure group.

The characteristics of the Cairns Group were crucial to its modest success in the Uruguay Round:

- The preconditions were there for a successful GATT outcome. The EU and the US had been engaged in an expensive agricultural subsidy war that neither side could win. There was a realisation by both that this situation could not go on. Furthermore, it was the farmers in the Cairns Group of nations that were being hurt by the continued ratcheting up of agricultural support by the EU and US. This unified the group and gave voice to very real trade concerns based on a situation that was win-win once the politics could be sorted.
- It was a single-issue entity and there were no major conflicting goals. This meant that the group's focus was never lost, as time was not spent on too much preparatory deliberation,.
- The strength of the Cairns Group was in its diversity (see Table 27). Each member had links to different groups within the negotiation process and also played different roles. So South American members were the 'shock troops' (being prepared to pull out of talks if agriculture was downgraded to a secondary role). By contrast, New Zealand played a helpful role in this process by offering constructive suggestions in the negotiations and attempting to bridge the gaps between various negotiating positions.
- New Zealand negotiators were given enough flexibility to be able to capitalise on opportunities that arose as negotiating positions shifted.

- Getting the structure of the whole subsequent liberalisation process right was more important than an immediate liberalisation payoff. New Zealand's experience in the CER negotiations had shown the significance of this. The implications were that:
  - No special deals would be done to allow access for one country and not another;
  - Cuts to subsidies would be even and automatic, and introduced gradually;
  - Tariffs resulting from translation of non-tariff barriers would be bound.
- At various times both the EU and the United States found it (strategically) useful to support a particular Cairns Group platform. In this way, they could generate additional pressure to force one or other to back down on its protectionist demands. This opportunistic wavering by the superpowers improved the chances of getting the required deal signed.

The real success of the Uruguay Round was to subject the largest countries—who are ambivalent about thorough-going freer trade—to relatively sensible rules governing agricultural trade.

Case V: APEC

INTRODUCTION

> *"It has been well-observed that the organisation closest to APEC is Alcoholics Anonymous. The members know perfectly well what is in their interests and they know that their futures depend on their own actions rather than on what anybody else does, but they come together from time to time to provide mutual reassurance, and, by exchanging knowledge of their own goals, they provide themselves with reinforcement for their self-discipline".*Gary Hawke, NZIIA seminar, Wellington 1999.

The phenomenal growth of Pacific Rim economies through trade in the latter part of the twentieth century stimulated efforts to bring the region into a loose regional grouping. In the 1980s, private individuals and non-governmental organisations began promoting the idea of a 'Pacific community'. While not wanting to recreate the overly bureaucratic and rather inward-looking experience of the European Union, Pacific Rim nations saw advantages in a Pacific community focused on trade and representing the diverse economies of the region. It could also be an important international economic forum.

The Australian government under Prime Minister Bob Hawke was instrumental in getting the Asia Pacific Economic Co-operation (APEC) process off the ground. At first, this was not going to include North America. But after advice from the Japanese government, who strongly supported North American participation, both the United States and Canada were included.

The first meeting at ministerial level was held in Canberra in 1989. By the time the first Leaders' Summit was held in Bogor, Indonesia in 1994, APEC had become a significant 'economic event' on the international calendar. The Leaders' Summit is an annual meeting, hosted each year by a different member. In 1999, New Zealand hosted a leaders' meeting in Auckland.

APEC works on a number of levels. As well as a Leaders' Summit, there is also a series of other APEC ministerial meetings that take place between the regular cycle of summits.

The process includes:

- An annual finance finisters' meeting.
- Meetings at ministerial level on: education, energy, environment science and technology, human resources development, small-to-medium enterprises, sustainable development, telecommunications, transportation, and women's affairs.
- The APEC work programme is managed by APEC officials, who meet approximately four times a year to review the workings of APEC committees.

With contact between members at an official level being relatively frequent, substantial time and quality resources are required by the member governments to service these APEC obligations.

The members of the APEC forum comprise a substantial part of the world's population, trade, and energy consumption (see Table 29). More importantly, APEC's proportion of the global totals in these areas is growing rapidly. What these countries do economically and as a group is seen as significant by the rest of the world. So the mere fact that these economies are talking to one another about economic matters, and particularly about ways of liberalising their own economies, causes ripples in world trade policy circles.

The creation of APEC implies some degree of common interest among the region's economies. These core long-term common interests are:

- *Freer trade and open regionalism as desirable goals.* The 'Bogor goals', agreed to in 1994, have focused the group on achieving freer trade and investment in the region. There is still a good deal of debate, particularly since the 'Asian crises' of the late 1990s, about the likely achievement of these rather sweeping goals. The currency instability associated with the crises has jolted the confidence of some APEC members.[139]

- *The thrust has remained strongly economic.* APEC has largely kept away from having foreign policy issues on the formal agenda. In the numerous bilateral meetings that occur, and especially at the inevitable 'informal' meetings associated with the process, political issues are more than likely to be discussed.[140]

Table 29 Significance of APEC countries
1998

World statistic	Percent
Population	38
GNP	56
Technology exports	64
Energy consumption	49
Merchandise trade	44

Source: Adapted from Yong Deng (1998)

The shorter run goals are more 'opportunistic' in nature, and depend upon the current trading environment.

They include:

- *Pushing for further multilateral liberalisation.* The mere existence of APEC was said to have put pressure on the European negotiators in the Uruguay Round to reach a deal (Mike Moore, 1999). In this way, it may have been a contributing factor to the multilateral agreement reached. APEC is seen as a credible potential alternative negotiating forum—and one that does not

[139] It is ironic that various publicly-espoused APEC initiatives, such as the 'strengthening markets' initiative, are aimed at making members' domestic policies more transparent and open. It was the lack of transparency, and the types of government/business practices that accompany the lack of transparency, that contributed to the scale and scope of the Asian crises.

[140] By avoiding political issues, the economically dedicated APEC agenda has made significant progress. This is in sharp contrast to European efforts to engage the Asian nations in a similar manner to APEC. Unfortunately their efforts have turned into protracted arguments about political issues.

include European countries.[141] Whether it is or not can be argued about, but the perception can be used to create a 'credible threat' in negotiations. Given serious, if so far futile, European attempts to set up a similar leaders' forum with the Asian nations, it shows the degree of interest that the European Union has in the APEC process.

- *It provides regular contact between regional leaders.* APEC provides a forum for bilateral and informal meetings between countries. The Auckland summit, for example, was the first time that Chinese and United States leaders had met since the United States bombed the Chinese Embassy in Serbia. Although this issue was not on the formal APEC agenda, the APEC forum provides the US and China with a regular platform for the two countries to discuss such events at the highest level.

Other unique features of APEC are:

- *It is the first regional trade organisation that Japan has joined.* The Japanese have rebuffed every attempt to encourage them to join a regional economic grouping or block, except for APEC.
- *All three 'Chinas' are members.* Both Hong Kong and Chinese Taipei (Taiwan) have joined the organisation at ministerial level. China has not objected to these two economies participating because of the economic rather than political focus of APEC. This is the only significant international forum where this occurs.
- *Non-institutionalised approach to negotiations.* Agreements on trade issues in APEC are reached by consensus rather than confrontation.[142] This can be an uncomfortable experience, particularly for Anglo-Saxon countries (and Anglo-Saxon commentators).

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[141] Crudely it could be seen as approaching a 'not the EU' gathering of WTO movers and shakers, though lacking several key African countries.

[142] While most effective international organisations work this way—giving each member the fabled 'veto' of the five great powers in the UN Security Council—it is rarer in the cut and thrust of detailed trade work not to have a degree of face-to-face 'horse trading'.

The APEC process is another example of how the interface between international and national economic policies is being slowly integrated. In this environment, it is now very difficult for nations to increase border protection, particularly when a leader has to explain behind closed doors to fellow leaders, why they have embarked on that course of action.[143] APEC plays a supporting role in making each country more responsible and aware of its own economic actions and pronouncements. The prospect of hosting meetings, for example, makes some countries feel obligated to positively manage APEC outcomes. Both Japan (1995) and Indonesia (1994) have played very positive roles while hosting APEC summits, when some commentators and governments thought they would not, given their highly protected economies backed by strongly entrenched domestic political forces.

For a small country like New Zealand, the membership of a regional organisation, which meets frequently and represents a significant part of the world's economic power, can be beneficial in advancing a freer trade agenda.

Two economic concepts we have reviewed earlier are relevant to New Zealand's negotiating position:

- New Zealand is a policy taker in the international negotiation market. New Zealand is also too small a nation to set the international agenda. Despite this, it can be effective by working within the current policy framework set out by the major players.
- Not only is New Zealand a goods and services trader with the world, it is also a policy trader with the rest of the world. The rationale that underpins this is that any forum that advocates and promotes liberalisation of trade on a consistent basis is a forum that New Zealand wants to take part in, since it is confident that reduced trade barriers will improve welfare for

[143] Although such views about the imperative to support the reduction in tariff barriers have not stopped some economies from attempting to increase their non-tariff barriers.

New Zealand citizens overall.[144] Whether or not an organisation (such as APEC) achieves concrete goals is immaterial. The process of having the goals advanced in APEC can assist in their actual achievement in other international fora, such as WTO.

As a policy taker and policy trader New Zealand finds, in APEC, an annual chance to interact at the highest levels of international trade diplomacy, thereby achieving access to the politicians and senior public servants of its major trading partners. Before the start of the APEC process, it had become increasingly difficult to get access to high-ranking officials from the European Union, Japan or the United States on trade issues. The New Zealand dairy and meat quotas are fixed by the WTO process, so European and United States officials saw no reason to talk to New Zealand about subjects such as freer world trade. APEC provides New Zealand officials and politicians with this potential access.

APEC gives politicians and public servants the chance to understand the different views about deregulation and ways of managing the deregulation process. By building up these contacts, developing a rapport, and improving mutual trust with counterparts around the Pacific, the New Zealand influence is stronger than it would otherwise have been.

APEC: 1989–?

Given the diversity of regions represented, APEC has, from small beginnings, developed into a 'must go' for the leaders of the Pacific Rim. Despite criticism from politicians, media and NGOs, its popularity seems undiminished.[145] The broader APEC and specific New Zealand aims and objectives, details of the negotiation process and the achievements of the APEC process so far are set out below.

[144] This does not mean that some sectors in New Zealand will not suffer from increased liberalisation. Within agriculture, for example, New Zealand meat would face increased competition in a freer trading world (see Rae, Nixon and Gardiner 1999).

[145] If popularity is judged by the number of countries trying to join APEC.

Aims

Broader APEC aims

The long-term aim of APEC is very clear: to increase growth in the region through freer trade between participating economies. The rationale is simple: regions should deregulate out of self-interest, since reform through trade liberalisation improves welfare domestically. APEC, through mutual political level agreement, aims to encourage this process.

APEC has also developed a number of 'opportunistic' sub-themes which may well prove over time, almost accidentally, to be more important than the original goal. These sub-themes have occurred because the process of interaction between regions has thrown up its own ideas with their own dynamics. The very fact that APEC regions are discussing the nature of economic development in the region and attempting to liberalise, generates positive opportunities to explore creative and alternative approaches to improving living standards.

These sub-aims include:

- *An alternative path for trade liberalisation.* Liberalisation of trade is being pursed in a number of ways. By far the most important pathway is through the multilateral (WTO) process. At the end of the Uruguay Round, further liberalisation in APEC was used as a 'credible threat' by the United States as an alternative to a failed round. It was possibly one of the contributing factors to a successful conclusion to the Uruguay Round.[146] This role has continued with the failure of the Seattle Ministerial to kickstart a new multilateral round. APEC has the potential to be an important forum to move the multilateral process along further. Liberalisation is also being pursed bilaterally through the APEC process.[147] At the summit in Auckland, some APEC members

[146] However, it should be noted that it was the United States that dragged its feet over finishing off the Uruguay Round.

[147] This fits in with the 'four tracks' policy enunciated by the Ministry of Foreign Affairs and Trade in MFAT (1993). In this explanation of strategy the Ministry

started discussing ways of liberalising trade between each other.[148]

- *Turning trade policy into economic policy (Hawke, 1999).* Getting domestic trade policy frameworks 'right', with common policies throughout the APEC region, means that the integration between domestic trading regimes and international regimes becomes much easier. By developing consistent economic policies with the aim of maximising economic welfare for citizens internally, through the process of liberalisation and economic integration, APEC economies will be able to harmonise internal economic policies with trade, reducing the need for a separate trade policy.
- *Developing a broader view of trade barriers.* It has long been recognised that such formal structures as tariffs are only part of the trade barriers that exist. For improved welfare, increased integration between APEC regions requires comprehensive removal of *all* trade barriers, including non-tariff barriers. By involving the private sector in its discussions, APEC is not confined to a traditional view of trade policy.
- *Deeper co-operation.* Instead of developing a confrontational and legalistic style to trade and trade policy issues, the APEC process has fostered a collegial, consensus-orientated approach to solving trade policy issues. This includes careful use of peer pressure to resolve disputes, avoidance of explicit economic commitments and assistance with policy development (for example, assistance in developing policies to encourage sustainable fishing).

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identifies four different pathways to encourage liberalisation: domestic economic policy, multilateral policy, regionalism, and bilateralism.

[148] The efforts of 'core' APEC members to set up free trade agreements among themselves have been mixed. The proposal for an arrangement (P5) between New Zealand, Australia, United States, Singapore and Chile has foundered, while bilateral discussions between New Zealand and respectively, Singapore, Korea and Chile have been more promising.

Specific New Zealand aims

New Zealand's concern, as a policy trader, is to maximise economic welfare through the potential of this forum and this will typically involve a degree of trade liberalisation.

How can this be achieved?

- Being 'in the room' where decisions are made is important. As a small country and a policy taker, New Zealand has to be visible. As previous discussions have shown, New Zealand's preferred position is to be useful to the process. This has allowed us to have a positive influence on policy. Unlike the multilateral setting, where those countries who are able to get inside the GATT 'Green Room' have the most influence on the nuts and bolts of policy reform, in APEC, New Zealand is already on the inside.
- New Zealand trade policy can be focused solely on how we can be useful to the process. The 'strengthening markets' proposal is an example of such an attempt. Influencing the domestic regulatory frameworks of APEC members means that policy development can start on the 'ground floor' in these regions. The adjustment to deregulation and liberalisation process is then smoother than would otherwise have been the case.
- By using every lever possible at the bilateral, plurilateral and multilateral level to push for freer trade. By promoting freer trade in APEC or within a group of APEC regions, for example, New Zealand can indirectly put pressure on the liberalisation process in WTO—its success has given it sufficient status to constitute a serious 'credible threat' to the established negotiation forum. This means pressure can be applied to those non-APEC countries (such as the EU) that have been known to resist forward momentum.
- Through the use of APEC as a mechanism to try out New Zealand policy initiatives before taking them to a wider audience. New Zealand's reforms have provided a range of ideas that can be discussed at the international level as a prelude to tabling them in other fora. Bringing practical ideas to the table is also a way of demonstrating serious intent and commitment;

it is not unappreciated by other participants, who can demonstrate their appreciation both within and outside APEC.

Preparations

Preparations for APEC meetings are at two levels:

- The work done for the lead up to the APEC leaders' meeting, including:
  - The normal 'housekeeping' issues—matters of protocol, transport, accommodation, and other more perfunctory tasks required for the organisation of the summit.[149]
  - Policy development. It requires a major effort for New Zealand to insert an item on an already crowded APEC agenda. Furthermore, to fulfil the aims described earlier, the item has to be of major interest to other APEC regions and not seen as a naked grab for the exclusive betterment of New Zealand. The agenda item must also be consistent with the aims of further liberalisation in the APEC region and promoting growth. The New Zealand 'strengthening markets' initiative is a successful example of developing an agenda item that will have a long-term beneficial gain for New Zealand, but is not being seen as a blatant attempt to further New Zealand's interests in the short term. At the time it was introduced, the 'strengthening markets' proposal was the only new agenda item. New Zealand officials spent nearly two years talking to other APEC nations about the need to focus on this topic to achieve this result.
- Hosting an APEC meeting requires a unique set of skills.
  - The logistics of hosting a meeting can strain the resources of a small country—the visitors include, for instance, the US President and his entourage, with huge demands for comprehensive security. Meticulous preparation is required, and a large amount of extra resources are devoted to stage managing the event.

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[149] Including, of course, the famous item of clothing that each host now has to select and have available in the appropriate size for all the visiting leaders.

- A domestic consensus and then a wider APEC consensus has to reached so that:
  - Extensive local consultation and other groundwork is required. In New Zealand, before the Auckland summit, internal groups such as trade unions, local authorities and iwi were given information about the importance to New Zealand of having the gathering here. Officials from the Ministry of Foreign Affairs and Trade (MFAT) spent almost a year speaking to interested parties about the aims and goals of APEC.
  - There has to be agreement among the APEC regions about the agenda of the summit. In the run-up to Auckland, MFAT deliberately separated the briefing work and membership of the New Zealand delegation to the conference, from the responsibilities of chairing the meeting. This was done to clearly delineate between the independent responsibilities of the chair, and those associated with the New Zealand position.

Both of these tasks were important to the success of the meeting.

Resources

APEC members are committed to minimising the role of the secretariat in order to avoid bureaucratisation. This is a deliberate act to avoid the type of dead-weight losses incurred by the development and maintenance of the European Union. Since APEC has an outward focus and is committed to lowering trade barriers, it has been left up to individual countries to carry the load of policy development. The secretariat is based in Singapore and has a small budget.

Unlike other negotiations, the APEC process is an on-going series of summits. It means an on-going servicing role for the bureaucracy, devising strategy and tactics for the various meetings, and a long-term commitment to the APEC process.

An APEC summit is a major undertaking, requiring a large amount of resources to deliver a smoothly run meeting. One of the reasons for the successful stage management of APEC in Auckland was the substantial resources set aside for this task. MFAT staff started work almost as soon as the previous summit in Malaysia finished. Resources were devoted to:

- The logistics of setting up the venues;
- Setting up an independent 'chair' (group) for the meetings;
- Organising lead-up ministerial meetings;
- Building a consensus in New Zealand for having the meeting take place and explaining its importance.

The negotiations

The APEC forum is not a traditional type of international negotiation. Its aim is to encourage open regionalism through a consensus-driven decision process. APEC is voluntary, revolving around the use of peer pressure of fellow leaders (Hawke, 1999 p19). The characteristics of meetings are extensive consultation, information exchange and consensus-building. This is, in itself, a cause of tension, since immediately there is a cultural difference between the way Anglo-Saxon regions approach trade negotiations (confrontational and legalistic) and the way Asian cultures negotiate (avoidance of conflict and emphasis on maintaining face).[150]

Negotiating under these conditions calls for a great deal of careful positioning, lobbying and groundwork preparation among APEC members. For example, the most significant APEC pronouncement so far has been the Bogor Declaration, where APEC members agreed to the goal of achieving free and open trade in the APEC region by 2010 for APEC's developed member economies, and by 2020 for its developing regions. Rather than announce the goals in a country committed to free trade, the 2010 and 2020 goals were announced in Bogor, Indonesia—one of the most regulated

[150] There is much misunderstanding and frustration expressed by Anglo-Saxon regions when negotiating with Asian countries. Not only are the market place structures opaque, but there is great surprise when Asian countries agree to deregulate. This occurred when Japan unilaterally reformed its beef quota regime in 1988, albeit under heavy United States pressure.

economies in APEC. By hosting such an important meeting the Indonesians made sure that failure did not occur on 'their watch'.

Similarly in 1995, at the Osaka meeting in Japan, the Japanese put together an action plan for achieving the APEC goals. While there was a lot of negative feeling about what would be achieved at Osaka, the Japanese skilfully handed Asian opposition an action plan and moved the process on. This particularly surprised the Anglo-Saxon members of APEC who had misunderstood the importance of the behind the scenes negotiations and the importance of 'face' for the Japanese.[151]

Small countries need to plan well in order to influence bigger economies. The 'strengthening markets' initiative required almost two years of lobbying and clarification, before it became the only new APEC agenda item accepted for that year (1996). The resource-intensive nature of the process requires careful selection of the type of policy New Zealand would like APEC to adopt—that is, a discerning application of the usual criterion of, 'if New Zealand had $1 to spend on trade policy, what would give it the best return?'.

Putting competition policies on the APEC agenda was important for New Zealand because:

- The fast-growing economies in the APEC region have not fully developed their competition policies but they will. And these policies have the potential to become non-tariff barriers.
- By attempting to influence such policy at a high level, a more coherent and consistent domestic and international trading regime will be created. This will be valuable in a region where New Zealand's trade is expected to grow.

[151] The Japanese took great care in not refusing the Malaysian suggestion to lead an Asian trade block before the Osaka summit. Instead, they settled the matter informally with the Malaysians, thereby not being seen to criticise a colleague's initiative in public. By successfully keeping the Malaysians 'onside', the Japanese were able safeguard the broader strategic goal of making sure that APEC did not fail while Japan was in the chair.

By not taking sides in the debate, and by focusing the 'strengthening markets' initiative on competition policies—and not just one policy such as anti-trust legislation (favoured by the United States) or anti-dumping (favoured by countries who export to the United States)—New Zealand is being constructive.

Outcomes

The agreements made in the APEC process have not been binding, but instead are viewed as goals to work towards. This creates a tremendous amount of confusion about what has actually been achieved by APEC. A legitimate question is: does APEC need to achieve anything concrete? Or put another way, if APEC is the answer, then what is the question?

This may be a little unfair, so a better way of approaching the question would be to ask: if APEC did not exist, how would New Zealand promote liberalisation in the Pacific Rim? New Zealand is a very small open economy and its ability to convince other regions to move along the path of liberalisation is very limited. If APEC is one of the few alternatives we have to promote freer trade, then it is worth having.

In this light, what are the main outcomes of APEC?

- The most significant summit for APEC was the one that produced the Bogor Declaration (referred to as the Bogor goals).[152] At the Bogor summit, Pacific Rim leaders agreed to the goal of achieving free and open trade and investment in the APEC region by 2010, and for its developing nations by 2020. In the following summit at Osaka, Japan, each APEC member put forward individual action plans to document progress towards these goals. These plans are updated annually.
- An advantage for smaller countries is that the meetings are held on a yearly basis and the leaders are able to talk on a one-to-one basis. Thus they are able to have some serious contact with larger nations at least once a year. It puts some pressure on larger nations to respond to smaller country regional concerns,

[152] Bogor, in Indonesia, was the site of the second informal gathering of leaders.

particularly if the small country is promoting a coherent and consistent policy initiative that is soundly based on economic principles.

- Wider perception of APEC may be as important as the substance of the APEC process. If trading blocks such as the European Union perceive that APEC will liberalise faster, with resulting long-term real growth increases, then it puts pressure on the European Union to come to the multilateral negotiating table and not risk being left out. This 'credible threat' may even have been one of the forces operating to pressure the EU during the Uruguay Round.

Getting an agenda item 'on the table' is a success in itself for a small country.[153]

New Zealand has had useful, though relatively minor, success in influencing APEC processes:

- New Zealand has been a major sponsor of the 'strengthening markets' initiative. Increased globalisation has highlighted the importance of competition policies in the Asia Pacific. New Zealand, by steering a middle course between the United States (who wanted to focus on anti-trust legislation) and Asian nations (who wanted it to focus on anti-dumping measures only), has succeed in focusing it on higher level rules, such as the role of government in the economy and creating principles of good governance common to all APEC economies. By promoting a broad focus on creating more efficient domestic competition rules New Zealand can influence the process by:
    - Getting in on 'the ground floor'. Most APEC economies, for instance, have not given much thought to the development of competition policies.[154] If these countries can be influenced by the 'strengthening market' initiatives, harmonisation of the

[153] Some may scoff at this so-called advantage; however having access is a necessary first step before one can influence another country's politicians.

[154] They have been busy trying to feed their fast growing populations, improve life expectancy and maximise economic growth.

competition policy impacts on international trade will become a lot less problematic. This may then mean that the associated adjustment process, and transition phases that inevitably accompany the dynamics of shifting competitive advantage between countries, will be less damaging.

- Not being seen as a one-issue economy. In the past, the intervention most often made by New Zealand diplomats at bilateral and multilateral fora was effectively: 'Mr Chairman, what about agriculture?' By focusing on competition policies (which include the development of more efficient agricultural policies by APEC economies) New Zealand is not seen as pushing a 'one sector' line nor always harping on about one's own special interests.

- Free trade initiatives. The informal nature of the APEC process has led to some surprising results. For at least 15 years now, New Zealand has been willing to extend its existing free trade agreements. However, it was only after informal discussions held at the 1999 APEC summit that serious talks have taken place to examine the possibility of free trade areas between Korea and Chile, New Zealand and Singapore, and very tentatively between New Zealand and Korea.

CONCLUSION

APEC was conceived in the 1980s as a way of improving the integration process between the established developed nations, and the faster growing regions of the Pacific. With a limited bureaucracy, the APEC process has turned into an international 'must go' for the leaders of the Pacific Rim countries involved.

The APEC process is far from being complete. Its ambitious goals, however, of working towards full liberalisation in the Asia Pacific region by 2010–2020 already look decidedly shaky.

Does this mean that APEC has failed?

The best way to answer this question is to look to the realistic alternatives. What would have happened if APEC process was not there? How would member countries in the region then be able to examine ways of liberalising their economies, and developing the concept of open regionalism that improves growth and wellbeing for all?

Without the APEC structure, regional liberalisation would be more haphazard and ad hoc. The risk of trade diversion and the resentment among nations who were left out of the process would be greater. Despite APEC's failings, the Pacific Rim is far better off than it otherwise would have been without APEC.

While the big prizes of complete liberalisation may be not achieved in the next 20 years, APEC's successes have been at a more subtle level. The success of APEC is the dynamic that is created by leaders, officials and the private sector of fast-growing economies discussing trade issues and the best way to liberalise their economies, given the institutional issues that each leader faces domestically. That is:

- Yearly leaders' summits have been important to smaller nations, because they provide a level of access to the leaders of larger economies that they would not have otherwise have had. They also bring leaders of larger economies face-to-face with the problems of smaller economies, as expressed by fellow leaders.
- APEC has provided a credible alternative to the multilateral process. While the value and impact of this is difficult to measure, the mere fact that a large part of the world's economy (see Table 29) is talking about ways to liberalise their economies internationally puts pressure on others, particularly the European Union, to at least contemplate further liberalisation.
- Small countries can influence the process with consistent and coherent economic frameworks that will, if adopted by member regions, greatly enhance the trade liberalisation process. The New Zealand initiative of 'strengthening markets' is one such example.

And lying ahead?

The five case studies discussed in the previous sections are more than merely illustrative of past events and practices. They provide a series of specific and generic insights into key features of the New Zealand trade policy style and its achievements that will potentially carry over into the future.

One thing we can be sure about is that the future will be markedly different from the past. What does this mean for the New Zealand trade policy style and its potential in the new world?

This section briefly develops a view about the critical aspects of the international scene that are already showing up, and which will be probable features of the medium-term future (up to 25 years hence). This analysis draws on the shape of the crucial trade policy episodes discussed earlier.

CRITICAL FACTORS

The preceding discussion contains both analytical and empirical elements. From it we can distil the critical features of the New Zealand trade policy approach over the last 70 or so years. The general framework for this is the model put forward by Habeeb (1988), which we have employed to understand the role and potential for a small country such as New Zealand when it looks to become involved in crucial trade negotiations.

The importance of the Habeeb framework is that it distinguishes between *absolute power* and *situational power*. New Zealand has no absolute power to set the international agenda (that is, it is usually a policy taker). With careful preparation, however, and the shrewd use of situational power, small countries can go at least some way toward controlling the circumstances which determine the achievement of their trade policy objectives. One of the most important ways of doing this is by playing a role that is, by its nature, denied to the few countries with real absolute power: becoming an intermediary, a player useful to the advancement of the negotiation process itself.

The task of being useful to the process requires: the ability to be opportunistic and entrepreneurial; the capacity to come up with innovative ideas for progress; and the innovative skills to propose novel solutions to the inevitable sticking points in any negotiation. This suite of capabilities in turn demands a system which has: focus and commitment; quality staff resources; high levels of intelligence about the situation of other players; and real flexibility.

The necessary conditions for negotiation-level flexibility and flair in a small country include:

- *A domestic 'consensus'*. This must be a conscious agreement to approve and underpin the direction in which citizens (New Zealanders) wish to proceed on trade policy. Prior to 1990 in New Zealand, the idea of agricultural trade liberalisation had been taken for granted as the logical policy likely to achieve the best economic outcome. As part of this view, it was assumed that most New Zealanders were (or could be persuaded to be) supportive of this approach. When CER was under discussion, it was recognised that the move to further liberalisation was not widely supported; many New Zealanders had their doubts about the new proposals. And by the time New Zealand was to be the host for the APEC summit, addressing the issue of public perception was built into the planning. In this case, a lot of careful effort went into explaining why the policy strategies being adopted were the right ones, and why, therefore, the meeting in Auckland was an important event in a worthwhile process. This led to 'international' resources being set aside for a domestic dialogue.
- *A focused approach.* Resource constraints (including the economies of scale often involved in international relations) mean that small countries—which in theory face all the same possible issues as larger countries—need to focus on a limited number of objectives. This starts with correctly identifying where and how New Zealand can be most effective in achieving its aims. And this type of decision demands a careful appraisal of the way New Zealand's scarce resources are best deployed, as

well as detailed and dynamic understanding the ramifications of the particular outcomes sought.

- *The right relationship between the authorities and the negotiators.* Being flexible requires a high degree of contact between the negotiators and the capital, balanced by a significant amount of trust in the judgement of the 'on-the-ground' operators, within a common set of goals.[155] The ability to be entrepreneurial in a negotiation depends on the discretion that the negotiators have been given in any particular situation, and this inevitably involves the mutual attachment to a clear understanding of the aims or values of the country in these talks. In practice, this is best exercised where the representatives can both rapidly take advantage of situations that develop within negotiations when the 'shifting sands' of various positions allow for opportunistic behaviour, and also 'clear their lines' frequently with their capitals. Negotiators need freedom to engage in various types of freewheeling and somewhat 'risky' experiments to be able to achieve the 'useful to the process' position. This entails innovative behaviour such as suggesting and facilitating deals, and trialling new and innovative ideas (kite flying). Above all, it means being allowed the organisational trust to make occasional mistakes in the process of experimenting with new and diverse ideas.[156]
- *Having a long-term commitment to the process.* There are always two aspects to any significant negotiation. The 'back-up' and the 'front-up'. The back-up, or backroom work done in private, or at

[155] It is interesting to note, in passing, that this element is conceptually similar to the Peters and Waterman prescription of 'tight-loose' in their famous diagnosis of the causes of success for well managed businesses. The idea is to engage staff by allowing them to be innovative about the how, while brooking no discussion about the what (seen through the notion of values). See Peters and Waterman (1982).

[156] The nature of public sector innovation and the tight connection with risk management and the policy environment is explored in more detail in Yeabsley and de Raad (2002).

least away from the negotiation scene,[157] must tie into and support the front-up (the on-the-ground resources, negotiating strategy and tactics, including shrewd deployment of Ministerial time and personalities) which carries through the process and links with the counterparts. In particular, it means:

- *Understanding the specific circumstances.* This includes having an analytical handle on the conditions surrounding the issue being negotiated and also ensuring ability to influence outcomes. A lot of time and energy, in the GATT/WTO rounds, is put in by New Zealand representatives to ensure that they have some influence over decisions affecting New Zealand. A key aspect to this is being 'in the room' or as close to the door as possible, when the critical decisions are discussed and made. At the APEC summits, New Zealand is already 'in the room' (on a regular basis). In both cases, being useful to the process, and coming up with innovative ideas so that one is, in general, 'adding value', are key contributions to ensuring one has prior knowledge about the issues and thus the ability to organise influence over the outcomes.
- *Knowing what will lose or gain advantage in the negotiation.* This is vital for the long-term economic success of any agreement. To understand and interpret the possible gains and losses requires a 'New Zealand Inc' approach to quantifying the costs and benefits, as well as working on the 'sensitivity analysis' of alternatives. The complicated nature of the quantitative approach and the moving target(s) associated with negotiations means there should be close collaboration and co-ordination between negotiators and analytical researchers. This allows for more understanding of the limits and capabilities of the analytical tools being used, by the front-line negotiators, and a better appreciation of issues

[157] Not all of the preparatory work is secret; it can include a deal of co-ordination with allies or potential allies (as happened within the Cairns Group), or public posturing and persuading (as happened during the UK-EEC accession process).

confronting New Zealand in the room, by the analytical researchers.

- *Choosing and using the right tools and language.* The tools used need to be acceptable (or at least credible) to those around the negotiating table (and to their technical advisors). The use of 'unorthodox' tools, unacceptable analytical language, or results that are not replicable by other researchers means that the analysis is worthless from a negotiation viewpoint. In this complex area, the only relevant constraint on the negotiators from large countries is the professionalism of their advisors and their determination to be logical and technically competent. So the representatives from small countries have to employ material that fits within the bounds of acceptability.
- *Experienced team.* The training of negotiators requires on-the-job systematic experience. Negotiating skills are more like a craft than a science and are acquired through long and varied experience. There is useful theory, but skilful negotiation calls for a combination of individual flair and sound judgement in being able to select the right tactics for the right situation. It is underpinned by complementary skills in the rest of the negotiating team, strong back-up and a supportive environment (including the appropriate degree of latitude for error). In addition, in many of the circumstances that New Zealand negotiators find themselves, there are situational or institutional details that matter. This suggests that the individual who becomes a successful operator is likely to have extensive (including possibly serving in the 'second chair') experience under the relevant conditions.

- *Economic soundness for sustainability.* All the above are necessary conditions for the long-run success of any negotiation. The fundamental sufficient condition is that it is an economically sustainable and thus fundamentally sound approach. Without an economically logical and coherent agreement, the desired aims will not be achieved because of strong (and uncontrollable) forces acting to negate it. The importance of economic coherency can be demonstrated by comparing and contrasting NAFTA with CER. NAFTA was supposed to usher in free trade between Australia and New Zealand. But the hard (political/economic) decisions were put off to some time in the future. The time lapse gave vested interests on both sides of the Tasman opportunities to water down and/or delay meaningful decisions. The agreement became increasingly moribund and then fell apart because its structure was economically unsound. It focused too much attention on discretionary item-by-item negotiations and delivered limited economic benefit to both sides. CER had a comprehensive plan for freer trade from the outset, and delivered on that plan in a scheduled round of automatic cuts in tariffs. It worked because it was economically logical, realigning resources (at some pain to New Zealand and Australia) to those sectors that were more efficient.

KEY CHANGES IN THE POLICY ENVIRONMENT AND THEIR IMPACT ON NEW ZEALAND

The changing nature and composition of world trade is reflected in the changing role and shape of trade policy issues confronting New Zealand. The nature of the international institutional setting and the domestic political environment have altered too. Below we have documented the significant recent shifts that we think will have an impact on the environment for the development of New Zealand trade policy.

The external trading world and New Zealand's place

The rise and rise of services

International trade has shifted notably in its focus over the years since the second world war. One feature has been the dramatic rise in role of services both domestically and internationally in developed economies. This new element changes the nature of negotiations and increases the importance of newer trade areas, relative to issues such as agricultural trade. Because services trade is important to European and North American economies, there is a strong likelihood that it will be given a prominent role in any future multilateral round.

From New Zealand's perspective, this both complicates matters and makes the actual management and support for the round harder. Complications occur as inevitable conflicts of negotiating priorities will tend to be resolved (by the big players) in favour of services, and also because, in this new area, we have relatively little idea of what the true importance of the emerging sector is for the New Zealand economy. It is not a trivial task to gather the new information required to understand the services sector now and in the future. It demands significant statistical and research funding—this would inevitably be at the cost of some existing resources in the 'negotiation resource budget'.

The management task will be made more demanding physically at the negotiations, where more sessions will be held in parallel and thus more able bodies will be needed to fill the New Zealand seats. But, even more demandingly, the New Zealand strategy will become more difficult to co-ordinate domestically. There will be additional trade-offs to be considered and publicly assessed. This will make the domestic presentation more blurred. There will also be potentially greater pressure (probably slopping over into the domestic scene) from other groupings within the OECD to adhere to 'modern' international agreements.

Commercial integration

To maintain and improve competitiveness, serious international companies have increased the amount of trade they do with their subsidiaries. This comes from a more strategic approach to both firm management, and to the business of the international sourcing. Modern firms see long-running strategic relationships (including part or full ownership) as the key to building and maintaining competitiveness. The days of serious procurement occurring by going onto the market 'cold' for the supply of any vital products that have not been commoditised are over. Companies create strategic advantage and add value through focusing their efforts on all the critical features of the their operations. This means that international flows of vital inputs are the last stages of an organised and strategically designed chain of communication that has been in progress for sometime, rather than the start of an adventure by an entrepreneurial trader.

In selecting locations (and the necessary associated international flows), firms are driven by currency differentials, tax rates and labour costs, as well as productivity levels and infra-structural issues, including economic and political stability. The increasing pace of commoditisation and growth of international competition have driven companies to locate in regions where the most profitable operation can be maintained.

This is another complication in the negotiation story for New Zealand. Other countries—who are the bases for higher numbers of multinational corporates—are concerned to ensure that these modern internationally distributed firms are appropriately treated by any trade deals. The new round will have to take account of the interests, and thus possible responses of these businesses, in coming to international decisions about the rules governing trade. Such complications will make the New Zealand task harder by adding to the issues on the table and, indeed, probably by adding to the matters that big countries may regard as more important than New Zealand concerns.

Partners and products

Compared with the time when New Zealand was occupied with the Ottawa negotiations, or even the period when the UK accession to the EEC was in train, New Zealand now has a completely different trading profile. We are serious traders with many more countries, have more export and import products, and are virtually unattached to any particular trading partner (aside from Australia), or organised block. Long gone are those days when most of our export income came from several bulk agricultural commodities, and we traded with one country (the UK) at stable exchange rates within a special political and preference structure.

As a result, it is impossible to envisage the sustained all-round single country pressure, which was a feature of both the Ottawa and the UK accession negotiations, being applied today. This approach stemmed from our particular history as an intensely focused economic and political partner of the UK. Today we maintain a series of more 'arm's length', but friendly relationships, with a wider range of countries.

In effect then, New Zealand is now a less important trading colleague for far more countries. This evolving status changes the strategies we can draw upon, and means that we have to be more innovative and develop 'new tricks'.

International institutions and players

The GATT 'club' 25 years or so ago was—in terms of countries that took part in the decisive meetings and had the engagement of their politicians—made up of about 25–30 members. And in terms of world trade volumes, this covered most of the trade that then took place. Many of these nations were also involved with OECD. A small number of developing countries (such as Brazil) were associated with GATT from the start. But their involvement tended to be pragmatic and reflect their specific economic interests rather than any wider international political game. Under these conditions, finding out the lie of the land on an issue or trying out an initiative, which involved an amount of co-ordination between multilateral and bilateral efforts, was reasonably possible to manage alone, even for a small player.

Since the Tokyo Round and the growing politicisation of the world economic institutions, what was the cosy and manageable GATT with relatively few active members, has now become a new organisation with new powers (WTO) and includes over 140 countries as members. New countries bring new priorities and problems, complicating the process of discussion and final conclusion. Many of the new countries are larger in economic scale and trade volumes than New Zealand.

With so many countries now active in WTO, the challenge for the organisation in seeking to move freer trade forward globally has become more complex. The organisation has to deal with the sheer numbers of new countries joining: each with a new set of priorities; all wanting to be heard; all their representatives wanting to prove to their domestic masters that they are 'making a difference'. This growth by itself tends to clog the agenda prioritisation process, for instance, and make the design of final workable deals more difficult.

In addition, new members want their nationals to have opportunities inside the pleasant administrative structure of WTO itself. These matters have to be solved smoothly to prevent disputes that could spill over into the negotiation process. The greater the pressure to have representatives from new countries sitting inside the organisation, the harder the task of maintaining secretariat quality—an important traditional feature of GATT/WTO that contributed in no small measure to its previous success.

The issues that WTO are having to deal with are less system-wide and increasingly fragmented—in some cases they are virtually country-specific (for example, the intellectual property concept of 'geographical indications' seems largely driven by the concerns of very few countries, virtually all European). This splintering puts further pressure on the WTO process in its task of trying to 'stitch' together a deal that will satisfy all active countries. It increases the chances of the process becoming bogged down over specific issues.

Moreover, and closely related to this because of the differing priorities that prevail within the countries of members, increasing membership numbers complicate the necessary make-up of any final 'deal'. The result is that the negotiations have to be increasingly complex and multifaceted to generate appropriate political 'wins' for each of the participants. But regularly, players from big countries—frequently those with limited actual negotiating experience—suggest that there needs to be a 'streamlined round' or some kind of 'early harvest'. (It typically involves generating quick outcomes of political interest to the proponents, such as an IT round, while delaying settlement of the more complicated deals of wider interest, like agriculture.) While this could be seen as naivety, it is often a none-too-subtle power play of trying to confine discussions to the issues that they profit from, in an attempt to trim their transaction costs.

Such somewhat gauche manoeuvres are not all bad. One role for New Zealand, as an opportunistic small and well-organised player, is to assist in smoothly sorting out these 'misconceptions'. And the task can include suggestions of sensible and practical solutions. If possible, we can look to adding doses of international realism where potentially required. It does tie up resources, however.

Another changing feature of the international scene is the new group of players. In the past, WTO has only had to deal with governments. Increasingly, international NGOs are seeking a prominent part in shaping the actual negotiation process. We have yet to see how these organisations will impact on any significant final trade agreement. Their contribution has to prove itself, to be seen as constructive, and the risk is that they will merely complicate the issues—if only by adding to the numbers engaged, or by further publicising or politicising underlying economic and policy matters.

Whatever the upshot of NGO participation, it poses a potential challenge for small countries. One problem is that in the real 'clinch' the NGOs may occupy a seat in the 'inner council' that would otherwise be available to one of the cast of helpful small players. More generally they may influence the wider 'technology' of the negotiations—say, by insisting that all stages of the process have a public exposure portion. This would, at best, require the smaller players to learn new skills; and, at worst, demand significant additional resources to cover the spread of new activities.

Domestic political structures

The MMP environment contributes locally to the more complicated trade policy formulation process. After a referendum in 1993, New Zealand adopted the Mixed Member Proportional system for the 1996 election. One of the expected outcomes has emerged: an MMP parliament more closely represents the voting patterns of society and thus incorporates representatives of a wider range of views in the parliament.[158] The loosening of party

[158] The intriguing tale of where the change came from, and the various views, is covered well in McRobie (1993), for instance. Hawke (1993) casts light on likely issues, with particular reference to the potential impacts on policy and process. For the subsequent evolution, see for instance, Vowles, Aimer, Bandicci and Karp

discipline, which was a further inevitable consequence of the new system, has also contributed to this significant enhancement of the diversity of views, and these have readily available public platforms. There are many more visible 'anti' views now on offer. And their proponents are soundly motivated to speak up, by the need to politically differentiate themselves, and their positions, from the rest of the MPs and their parties.

Moreover, the aggregate spread of second ballot 'ticks'[159] that has so far characterised MMP elections, has denied any single party the power to control parliament alone. Large parties have to seek collaborators, therefore, in order to pass legislation or otherwise exercise power. This can be done either in terms of formal coalitions, or on an issue by issue basis. Whichever strategy is adopted (and both have been tried), the scene is ripe for 'log-rolling', whereby different issues are negotiated through together on an 'exchange of support' basis across a total package. So despite the continuing support (via their party vote) of most voters for parties that generally support freer trade, any New Zealand government has to be mindful of those people and parties who hold opposing views. The time may well come when every vote counts—possibly in the context of selecting potential coalition partners.

Overall, the evolution of this situation has made the task of assembling a reasonable domestic consensus on trade policy issues harder than previously.

Domestic resource management

Within New Zealand's own dedicated resource base for trade policy there have been significant challenges and changes. We now have representation in many countries, only some of which are

(1998), or Boston, Levine, McLeay and Roberts (1997), who discuss and analyse the system, its electoral outcomes and its wider consequences. Or for something completely different, see Hunt (1998).

[159] The proportionality of the New Zealand parliament comes through the party preference—conveyed on the ballot by ticks.

relevant to trade policy developments.[160] Some of these posts, of course, reflect the previous point about the increasingly diverse nature of the political interest groups.

Tighter attention to the formal requirements of fiscal accountability in New Zealand,[161] following the Public Finance Act 1988, and the accompanying rather oversimplified budgetary cycles have meant that short-term objectives are tending to prevail over long-term research in the foreign relations area. There is an increasing preoccupation with one-year funding cycles, and with detailed pre-specification of resource commitment. This cuts across the inevitable shifting risks and uncertainty associated with both political priorities[162] and international relations. It means that effort redeployment is increasingly formal, difficult and resource-intensive. The informal response to the shifting priorities of operational needs (keeping some resources as 'reserves') discourages the long-term relationship building required for the successful marriage between the work of commissioned researchers and the needs of negotiators.

Those projects that are commissioned are largely organised on a one-off ad hoc basis, have limited budgets, and tend to be focused on issues that have a relatively quick political pay-off. The days when a group could be seconded from other agencies to the Treasury to work for many months on the implications of the UK accession to Europe are over. What's more, they seem unlikely to return as current agencies—in these days of fierce lines of accountability overseen by the Auditor-General—are both less

[160] Changes in the trading world facing New Zealand complement external political challenges. Issues for general New Zealand (political) diplomacy raised by the end of the Cold War, and other significant recent developments, are discussed in Harland (1992), for instance.

[161] For descriptions of the changes, see Scott (1996), who was one of the architects and an implementor, or Boston, Martin, Pallot and Walsh (1996) for a collection by observers.

[162] For a useful collection of material by diverse hands and dealing with various aspects of this topic, see Sundakov and Yeabsley (1999), with the *Introduction* serving as an overview.

inclined to co-operate over longer term projects, and more tightly resourced and staffed to the pre-identified and budgeted needs of the day.

This latter point means that the natural way to access longer term research output is to form strategic relationships to provide it. There are facilities in the wider public service and funding mechanisms, which could be seen as possibly contributing to this sort of Coasian 'buy, rather than make' approach. These include the MoRST/FRST Cross-Departmental Research Fund (CDRF) and the FRST Public Good Science Fund (PGSF), as well as internally funded research.

A quick review of the current projects being funded by the CDRF showed none that, on the face of things, was relevant to the trade policy issues New Zealand is facing. This fund was to spend about $1.9 million fresh money in the coming year. The topics to be investigated ranged from capturing national Mäori information to looking at the risk substances in sewage.

A search of the PGSF results (the best documented), on the other hand, revealed that over the last six years, there had been ten projects funded (see Table 30) which mentioned the words 'international trade policy' in their abstracts, and which were relevant. The average size of the projects was $144,500, and several of them stretched over multiple years.

An initial reaction to this very superficial review is that the resources available are not being exploited to the full. It is possible to suggest various explanations. For instance, this may be a consequence of the sheer 'stretch' that the trade policy agencies are under and which prevents the resources being available to make the applications or to co-operate with potential research providers; or it may stem from the lack of ability to develop a forward-looking research agenda. On the other hand, it may suggest that trade policy strategists do not see a high rate of return in commissioned research.

Table 30 PGSF projects with trade policy, 1995–2001

Year	Title	Organisation	Allocation ($)
1995	Trade and environment: impacts on New Zealand	NZIER	65,000
1996	New Zealand's development and trade: prospects and trends	NZIER	80,000
1996	Economic development—the interaction of trade, investment, and migration	NZIER	78,000
1997	New Zealand's development and trade: prospects and trends	NZIER	160,000
1998	World trade and the environment	Lincoln University	150,000
1998	Our trading future: challenges in a new environment	NZIER	180,000
1999	World trade and the environment	Lincoln University	200,000
1999	Our trading future: challenges in a new environment	NZIER	180,000
1999	APEC's agenda and New Zealand's competitive advantage: selected themes	University of Auckland	172,000
2000	After Seattle...	NZIER	180,000
		Total:	1,445,000

Source: Edited from FRST website

The main point though, is that the 'buy' option does not seem to be used to the extent it could be, whatever the reasons. New Zealand's research back-up to the actual trade effort appears to be significantly in-house based, or reliant on publicly available material.

This situation means we are not matching the capacity development model discussed in the initial section,[163] which stressed the need to build a common language. The requirement for that is to have in progress sound research material, which can be quickly hooked into established frameworks that are accepted by authorities round the world.

International communication

The use of new technology has transformed information flows around the globe. This has two relevant effects. First, outward, as no longer can governments straightforwardly control the type of information transmitted from their domestic domains into the international arena. To name but two instances, CNN and other global broadcasting operators, and the internet (with the power of individuals to publish to a potential world audience at extremely low cost), have both changed the understanding and expectations of the public and politicians everywhere.

Effectively, the ability of the reasonably dedicated 'outsider' to gain a detailed knowledge of the international dealings has come to surpass that previously available to the 'insiders'—say, at the time of the Ottawa negotiations. Add in the ready (often virtually 'real time') commentary coming from academic experts from all points of the compass, and the value added to the capital's understanding of many international situations by information-oriented, official representation is now very low without specially focused and successful efforts to penetrate the most secluded discussions.

The increased quantity of information available does not necessarily mean the quality of information has improved—in fact it complicates the process and adds 'noise' to the system. It means it

[163] See Figure 2.

is hard to 'sift the wheat from the chaff', unless one has independent access to reliable cross-sightings. This could come from a better quality flow of information, or from high calibre understanding of the issues, usually associated with the specialisation of experts.

All this suggests, effectively, that the representation game has significantly changed. Thus, specialisation, which is likely to enhance both access potential, and analytical comment and assessment becomes more useful. Alternatively, it may be appropriate to look again at the possibility of using economies of scale, say by cutting back the number of posts, and substituting roving commissions for representatives. The implications may be for a 'hollowing out' of international placement, with better resourcing at (a few) vital foreign capitals or organisations and others serviced on a visiting basis.

Secondly, inward, as the quantity of information entering a country has exploded—and the cost of its access has effectively disappeared. This process means that the domestic audience now is potentially exposed to the full range of different possible opinions about all international developments.[164]

So the nature of the challenge of forging a domestic consensus has changed. Agricultural trade liberalisation and simply increasing incomes (measured through GDP) are just not seen, by some groups at least, as being particularly important, let alone the overriding objectives for New Zealand trade policy. To a degree, it might be noted that this has always been the case. What is

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[164] One way of thinking about this is that it represents a shift from costly resource based access and display of opinion—as was the case when distribution media were expensive machines (even photo-copiers qualified here until recently)—to one based on access and distribution via remarkably cheap electronic media. So anyone with strong feelings can display their ideas for all to find and read. And there is no external standard of editing or quality control for such material. While normal market 'branding' effects might help sift out more worthy sources from the less reliable, the lack of significant investment costs, aside from the time involved, is minimal. So those with strong feelings can continue posting their views.

changing, though, is the extent to which these views find similar groups abroad who can supply new material to support the ideas, and effectively by taking advantage of economies of scope (by mounting similar arguments in many countries at the same time), magnify their influence.

Again the task suggests the need for increased focus and greater resource commitment to engage the debate domestically on a continual basis. Previous campaigns to confirm the domestic consensus have been successful when carefully planned and mounted, but the new challenge is more sophisticated and unremitting. It deserves serious and continuous attention, to ensure that the issues are given the airing they require.[165]

POLICY QUESTIONS AND CHALLENGES

New Zealand trade policy development has been relatively successful (and cost-effective) in the way it has been constructed and negotiated in the past. It has been able to produce some important results, particularly when the chips have been down and the results really counted.

What about the future? It is clear that important elements in the scene are changing rapidly and 'complexity' seems to be the dominant character of the emerging pattern of international trade relations. Moreover, various forces are operating to make the achievement of a robust domestic support base for trade liberalisation a real task.

In the previous section, some of the more important changes in trade and trade policy issues have been briefly documented. This discussion shows that the changing world trade environment is undermining the way we have done things in past.

The advice from the theory (Habeeb, 1988) suggests there are no 'free lunches' in the trade policy grind—small countries have to

[165] The creation of the Trade Reform Network as a private initiative in 2002 is an interesting move on this front.

keep being smarter and more thoughtful in the way they approach trade policy issues.

In the small country case of New Zealand, successful trade policy will mean:

- Spending more time and expert resources developing a trade policy domestic consensus within New Zealand. This requires finding cost-effective ways of consulting widely and communicating with interested parties the details of New Zealand's selected strategic choices. The government may need to embrace a wider circle of trade specialists outside government to hone and pre-test ideas about strategy to ensure that they are likely to 'fly' domestically. This would allow these people, in their turn, to champion the cause of freer international markets and publicly discuss the benefits for New Zealand. More effective trade policy requires more resources put into the process of domestic debate and understanding as 'consensus' building. How will the 'opening out' be handled? Where will those resources come from? If an element of the private sector is to become involved how will impartiality and security of information and advice be persevered?
- The role of the trade bureaucracy and the private sector, and the nature of the interaction between the two, will also possibly have to change. The private sector will have to shoulder more of the work associated with trade policy analysis and development, while the committed professionals in the bureaucracy will have to be more forthcoming in allowing private sector access to the thinking and strategies being used to advance policy objectives. How does New Zealand develop a new 'system' and a degree of regular process that will promote long-term relationship building between the private sector, informed researchers, political decision makers and trade policy negotiators?
- The effect of MMP and the heightened flows of electronically available information mean that domestic consensus is more difficult to achieve. In addition to any enhanced process, as

discussed above, more fact-based information needs to be put before members of parliament and the public to illustrate why the approaches selected as policy have been taken. Is there a role for a sole trade ministry to provide local focus and also co-ordinate the more complex domestic trade environment? From a wider view point, the design of agencies is typically done by trying to reap economies of scale and scope. This would suggest that the new environment may call for consideration of which of the links are the stronger. Is it the overlap with the skills and experience associated with political international relations (which would support a single generalist representational group, such as MFAT), or the need to have a strong domestic connection from which to forge the ongoing consensus (which might imply a Ministry of Trade, or even a wider body with local commercial functions, such as the previous Department of Trade and Industry)?

- To achieve the sort of access and professionalism sought for New Zealand trade policy purposes demands both focus on relevant topics and additional resource commitment. It is possible that better use of technology and innovation would produce productivity gains to contribute to effective trade policy management. This includes use of leveraging and making hard decisions about the allocation of resources, as discussed by Williamson (1999). Will our system be robust enough to make the hard focus decisions and generate the resource commitment required?

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Index

additional resource commitment 228

Agricultural Adjustment Act..165

agricultural trade ....
3, 4, 17, 24, 42, 65, 66, 69, 72, 97, 139, 140, 166, 167, 168, 171, 172, 175, 176, 178, 188, 189, 191, 210, 214

Aimer, Bandicci and Karp 219

AMS..186

Anderson and Smith...........40, 41

Annecy Round..........................164

Anti-Dumping Code...............166

APEC ....
4, 5, 8, 15, 24, 53, 54, 56, 57, 63, 81, 82, 192, 193, 194, 195, 196, 197, 198, 199, 200, 201, 202, 203, 204, 205, 206, 207, 208, 210, 212, 223, 230, 231

Baldwin 34, 166, 229

Bareme.................................48, 84

Boston 221, 229, 234

Boston, Levine, McLeay and Roberts 220

British market..............................
4, 7, 8, 24, 80, 83, 84, 85, 87, 90, 93, 94, 101, 102, 103, 104, 105, 107, 110, 111, 112, 113, 114, 115, 117, 122, 128, 131

Cairns Group ....
7, 8, 13, 24, 53, 81, 153, 163, 172, 176, 177, 178, 179, 180, 181, 182, 183, 184, 189, 190, 191, 212, 230, 233

CAP..................................107, 166

capacity building.................20, 21

capacity development model...224

Carey..................................16, 174

CER ....
4, 5, 7, 8, 9, 13, 24, 44, 51, 52, 56, 58, 81, 127, 137, 138, 140, 141, 142, 143, 144, 145, 146, 147, 148, 149, 151, 152, 169, 170, 172, 189, 191, 210, 214, 229

Chandler...............39, 55, 230, 235

clothing and textiles sector.......................................10, 188

CNN..224

coalitions 178, 179, 220

Coasian 'buy, rather than make' approach 222

Coates 91, 92

commoditisation..........68, 69, 216

complexity......24, 26, 76, 168, 226

composition of world trade 65, 72, 214

consensus ....
2, 3, 5, 6, 7, 8, 10, 26, 53, 71, 74, 76, 103, 118, 126, 139, 142, 144, 151, 152, 161, 174, 175, 176, 177, 189, 190, 195, 199, 202, 203, 210, 220, 227
- domestic consensus 8, 12, 75, 141, 161, 202, 226
- international consensus...6, 11

consensus' 8

credible alternative 208

Crocombe, Enright, & Porter .. 39
Department of Trade and Industry 143, 228
Dillon Round 165, 166
Doha 19, 165
Dollar 27, 230
Dutch disease 83
early harvest 218
East 32
economies of scale 27, 39, 71, 75, 189, 210, 228
EEC 7, 24, 46, 49, 50, 80, 81, 101, 102, 104, 105, 107, 108, 109, 110, 111, 112, 113, 114, 115, 118, 119, 121, 122, 123, 124, 125, 130, 131, 137, 150, 166, 167, 212, 216, 233
Engel's law 66
Evans and Richardson 28
FAO 16, 189
Farmers' Union 91
Fauriol 32, 231
Federated Farmers 91, 177
Forbes 91, 92
Forrester Research 69
free trade agreement with the USA 5
FRST 222, 223
GATS 156, 185, 186
GATT 8, 17, 24, 50, 51, 52, 58, 65, 67, 73, 81, 101, 102, 119, 130, 132, 135, 136, 137, 153, 154, 155, 156, 157, 164, 165, 166, 167, 168, 169, 170, 171, 172, 174,
GATT (cont.) 175, 176, 177, 179, 180, 181, 184, 185, 186, 187, 189, 190, 212, 217, 218, 230, 232, 234
GATT 'club' 217
GDP 42, 55, 62, 63, 65, 127, 177, 225
Geneva Round 165
globalisation 54, 59, 60, 65, 69, 206, 232
Grant 40, 67, 231
gravity models 40, 41, 60, 61
Gresham 31, 34, 231
Habeeb 34, 35, 36, 37, 54, 70, 102, 118, 137, 151, 179, 209, 226, 231
Hannah and Williamson 40
Harland 221
Hawke 48, 192, 199, 203, 219, 231, 232
Heckscher-Ohlin 38
Helliwell 40, 41, 232
Henderson 32, 232
Hirschman 156
Hoekman and Kostecki 156, 157, 159, 186
Hunt 220, 232
Imperial Preference 88
innovation 17, 43, 77, 169, 211, 228, 235
International Dairy Agreement 50, 174
internet 5
ITO 51, 155, 156, 165
James 28, 232

Jane Kelsey 28
John Pryde 177
Josling 16, 22, 174
Kennedy Round 165, 166, 168
Krugman 38, 39, 40, 41, 54, 55, 232
Lasswell and Kaplan 35
Lattimore and Hawke 48, 49, 50, 83, 101
localisation 59, 60, 69
long-term research 221
Mancur Olson 27
Martin, Pallot and Walsh 221
McCallum 40, 41, 232
McRobie 219, 233
MFAT 11, 202, 203, 228
MFN 51, 102, 135, 154, 180, 187, 189
Mike Moore 177, 181, 194
Ministry of Trade 228
Mixed Member Proportional system 219
Mowat 85, 86, 92
MTM project 16
Muldoon 4, 16, 17, 134, 137, 140, 141, 143, 144, 151, 174
multinational companies 68
NAFTA 9, 10, 24, 46, 51, 56, 57, 58, 59, 81, 131, 132, 133, 134, 135, 136, 137, 139, 140, 143, 144, 145, 149, 150, 170, 214
Nash and Takacs 58
negotiating framework 37
New Zealand trade diversification 46
NGOs 74, 197, 219
OECD 16, 22, 52, 55, 66, 127, 130, 134, 135, 140, 148, 174, 215, 217, 233
open regionalism 7, 13, 14, 52, 59, 138, 152, 193, 203, 208
opening out 76, 227
openness ratio 65
Ottawa Conference 4, 6, 7, 8, 14, 23, 80, 88, 89, 91, 92, 99, 100, 101, 103, 104, 108, 124, 153
Oxley ....vii, 179, 180, 181, 183, 184, 233
Pacific Rim 208
Panagariya 59
Penrose 156
policy taker 10, 11, 70, 136, 151, 196, 197, 200, 209
political economy of trade 27
Pomfert 154
Porter ..39, 230, 231, 233, 234, 235
private sector 11, 76, 199, 208, 227
productivity gains 77, 228
protection in industrialised nations 65
PSE 16, 174
quantity of information 75, 224, 225
Rae and Nixon 187

raising all boats 15
regional liberalisation 208
research back-up..................... 224
Ross 175
Rothstein.................................. 33
Ruggman 40, 234
Scobie 40, 234
Scott........................ vii, 221, 234
Sheepowners' Association....... 91
small country ....
3, 10, 23, 52, 71, 102, 110, 136, 155, 158, 159, 162, 189, 196, 200, 201, 206, 209, 210, 227
Small State definition........... 32
Smoot-Hawley tariff package . 97
sole trade ministry.................. 228
spatial dimension of trade....... 38
specialisation................................
................75, 133, 159, 160, 225
standardisation 59, 68
Sundakov and Yeabsley 221
Takayama and Judge 38
tariffication 175
tariffs on agricultural products...
.... 66
tariffs on industrial products .. 66
technology ....
5, 25, 26, 45, 55, 59, 60, 70, 75, 77, 83, 103, 129, 219, 224, 228
Teece.................................39, 235
Tirole 36, 235
Tokyo Round................................
136, 137, 139, 165, 166, 168, 170, 173, 174, 184
Torquay Round 164
trade bureaucracy ....
.......................76, 141, 169, 227
trade in industrial manufactures
.... 67
trading profile 216
TRIPs 156, 185, 187
UK accession into Europe.......... 4
Uruguay Round ....
4, 7, 8, 10, 16, 17, 18, 24, 43, 49, 50, 52, 53, 81, 96, 103, 119, 122, 123, 124, 155, 156, 165, 168, 170, 171, 172, 175, 176, 178, 180, 181, 183, 185, 187, 188, 189, 190, 191, 194, 198, 206, 230, 234
Uruguay Round Agreement ... 50
Vowles.............................219, 235
wartime guaranteed prices...... 84
Went 28, 235
Williamson 27, 228, 231, 235
WTO ....
8, 19, 53, 54, 67, 73, 74, 82, 104, 153, 155, 156, 157, 158, 159, 161, 163, 164, 165, 181, 185, 187, 189, 195, 197, 198, 200, 212, 217, 218, 219, 230, 232
Yetton, Craig, Davis and Hilmer
.... 40