Trade Reform in New Zealand: Unilateralism at Work*

In J. Bhagwati (ed.) *Relaxed Reciprocity: Historical and Modern Experience with Unilateral Trade Liberalization*, MIT Press, 1998.

Lewis Evans and **Martin Richardson**

Lewis Evans
Department of Commerce and Administration
Victoria University of Wellington
P.O. Box 600
Wellington
New Zealand

Martin Richardson
Department of Economics
University of Otago
P.O. Box 56
Dunedin
New Zealand

Outline

* We are grateful to Paul Wooding, Jagdish Bhagwati and Pravin Krishna for very helpful comments on earlier drafts of this paper. We thank both Paul Wooding and John Yeabsley for useful discussions of issues arising in the paper. We also thank Ganesh Nana for his ERP calculations in the JOANNA CGE model of the New Zealand economy.

I. *Introduction*

In the last two decades the New Zealand economy has been subject to an extremely extensive and far-reaching episode of liberalisation. Reforms have included institutional changes to the central bank, the way in which government departments organise and report their affairs, reforms of labour, capital and goods markets and even electoral reform. Amongst these reforms have been extensive liberalisations of New Zealand's international trading regime.

A central distinguishing characteristic of these reforms is that they have been largely unilateral. The aim of this paper is to consider the political forces behind these trade reforms with an eye towards explaining the political success of the unilateral approach. We seek to provide some answers to the following sorts of question. What were the vested interests behind New Zealand's starting point of very high protection and how did they succeed in getting it implemented? Why were reforms mooted – what happened such that the early status quo was no longer politically feasible? Why did the trade reforms succeed (in the sense of being put in place) and how did that implementation occur so as to overcome these special interests? Why unilateralism? Why has liberalisation not been complete (especially as it has been so dramatic: one might think that the final steps would be easier in some sense)? How important were multilateral and bilateral deals in affecting New Zealand's unilateral reforms? How, if at all, has New Zealand's multilateral position been affected by these reforms?

In considering these questions we look not only at the evolution of trade policy in New Zealand in recent decades but also focus on two important sectoral groups: manufacturing and agriculture. We discuss the involvement of these groups in the reform process and the *ex post* consequences for them of the reforms. Our approach to the political economy of unilateralism is organised around Bhagwati's 1988 framework of Ideas, Institutions and Interests. Finally, in order to get some idea of the political strength of various groups in New Zealand as reflected in trade policy, we use the methodology of Anderson (1996) to estimate effective rates of protection from a 22 sector CGE model of the New Zealand economy.

While our focus is on trying to understand direct trade reforms, many aspects of the entire reform process have had consequences for New Zealand's trading position. Accordingly, we shall start by outlining the major economic reforms that have occurred since the early 80's.

II. *The facts of the New Zealand experience*

A. *A timeline of economic reforms*

New Zealand (NZ) is a country about the size of Great Britain but with a population of only 3.5m or so. In 1995, GDP was a little under US$60b[1] (so per capita GDP was a little under US$17,000) and around 12% of this was generated in primary production, 20% in manufacturing and 60% in services. Exports amounted to 31% of GDP and raw and processed pastoral and wood products accounted for 70% of total merchandise exports (machinery, motor vehicles and mineral fuels accounted for almost 45% of total merchandise imports.) In sum, NZ is a small, open economy exporting mainly primary and processed primary products.

[1] The following data are taken from Evans *et al*: henceforth EGWT.

For a large part of its history since British settlement, NZ had relied on Great Britain as a destination for its agricultural exports. This was the source of NZ's very high standard of living: in the early 50's NZ had one of the 5 highest per capita incomes in the world. The relative decline of the NZ economy in the last 30 years has frequently been pinned on external factors such as the severity with which the oil shocks of the 70's hit the country and the accession of the U.K. to the EEC in 1973. However, EGWT note that NZ developed a comprehensive (and expensive) system of social legislation and became an increasingly regulated and publicly-owned economy.[2] They suggest that the focus on external factors as the source of NZ's woes caused policy-makers to overlook the need for greater internal flexibility so that by the late 70's/ early 80's NZ had extensive import controls, state ownership of assets, price and wage controls (including exchange rate and foreign ownership controls) and high debt.

In 1984 an election was called, triggering massive flight out of the NZ dollar[3]; so much so that the Reserve Bank ceased to convert NZ$ to foreign currency the day after the election leading to a constitutional crisis, "until the outgoing prime minister agreed to implement the instructions of the incoming government" (EGWT, p.5.) It was with the FX and constitutional crises as background that NZ's new Labour government launched its reform programme. Table 1 (adapted from EGWT Fig 2) presents the major components of the reforms.

(Table 1 here)

[2] Public largesse was a feature of all governments, regardless of political persuasion. After the 1972 election in which Labour ousted the previous National government, the outgoing National finance minister announced that Labour would be unable to keep its spending promises as, "I've spent the lot." As it turns out, this did not constrain Labour's behaviour anyway.

[3] Indeed, the government lost such quantities of reserves that it resorted to raiding the FX holdings of its overseas embassies.

B. *Economic performance since the reforms*

The performance of the NZ economy since the reforms were initiated has been well documented[4] so we will just summarise things very briefly here. After very high growth in 1984, NZ experienced real GDP growth of less than 2% in every year from 1985 to 1992 (including a fall of over 1% in 1991.) However, growth has picked up substantially to exceed 3.5% p.a. since 1993. Inflation has fallen dramatically from over 17% in 1986 to around 2% p.a. from 1991 to the present. Unemployment, historically very low in NZ, hit a high of nearly 11% in 1991 and now hovers at around 6% of the workforce while employment has risen about 15% since 1993. The government has operated a fiscal surplus since 1993 and used it, in large part, to retire public foreign debt. Gross government debt in 1991 was 60.5% of GDP, in 1995 it was only 50.9%.[5] Government *overseas* debt in 1993 was 35% of GDP, in 1996 it is 25%.

Based on casual observation, it seems that New Zealanders are still quite split about the effectiveness and desirability of reforms since 1980. Interestingly, however, the governments responsible for the major reforms (the Labour government of 1984 and the National government of 1990) were both subsequently re-elected (in 1987 and 1993 respectively) the former with an increased majority. One of the primary architects of the Labour government's reforms, Roger Douglas, fell out with the Prime Minister in 1987 and was sacked in 1988. (In an interesting parallel, the Finance Minister in charge during many of the subsequent reforms under the 1990 National government, Ruth Richardson,

[4] See, e.g., EGWT, Bollard *et al* (1996) and OECD (1996).

[5] OECD (1996).

was also sacked the year after the National government was re-elected in 1993.) It is frequently suggested that voter anger at the reforms was stimulated by the perception that the Labour government was hijacked by a small cabal of reformers who had kept their intentions hidden until they were in power.[6] Not only does the re-election of the Labour government in 1987 cast considerable doubt on this version of events[7] but Roger Douglas had himself, "advocated the case for radical reform some years earlier in a book…" (EGWT p.7). Furthermore, there had been academic opinion for many years that the NZ economy was over-regulated, particularly in the area of trade policy and many public officials, notably in Treasury, were well-versed in recent developments in microeconomic theory and had been drawing on this knowledge to develop alternative policy proposals.

C. *The evolution of trade policy in New Zealand*

1. *An overview*[8]

Any attempt to quantify the evolution of New Zealand's trade policy over the last 40 or 50 years is complicated by the extensive use of quantitative restrictions and (largely as a consequence of this) the wide disparity in levels of protection across sectors. What studies there have been of restrictions through the 1970s tend to be of selected industries only. So

[6] Jane Kelsey, an outspoken critic of the reforms, in describing the process of the reforms entitles the second chapter of her 1995 book "Capturing the political machine". Wallis (1997) also makes plain this interpretation even in his title: "Policy conspiracies and economic reform programs in advanced industrial democracies: the case of New Zealand."

[7] Another common argument is that electoral reforms - the introduction of a system of proportional representation for the 1996 election - were also triggered by this sense of capture of the policy-making process by unrepresentative interests.

[8] The material in this section draws heavily on Lattimore and Wooding (1996).

one study suggests that in the late 1950's the effective rate of protection of auto assembly was in excess of 2,400% and that for clothing was over 120%.[9] A more recent and frequently cited study of effective rates in 1982 found rates of 90% in textiles and over 50% in a number of other manufacturing industries.[10] The wide disparity in rates across sectors makes many indicators of "openness" quite misleading for New Zealand. So even in 1994, for example, while tariff revenues as a percentage of the total value of imports were only 3.4% in NZ, about the same as the OECD wide average, the average duty paid on dutiable lines was around 27%.[11]

Nevertheless, the general consensus on NZ trade policy through to the early 1980s can be summed up thus: "[u]p to 1984, New Zealand had probably the highest tariffs on manufactured goods of any OECD country, and was the only developed country to maintain a comprehensive system of quantitative controls".[12]

This contrasts with the following comment from the Office of the U.S. Trade Representative in 1997: "New Zealand's open trade and investment policy continues to be a bellwether for regional and global trade and investment liberalization" (USTR (1997 p.267).) Likewise, the WTO comments, "New Zealand has transformed its economy from among the most heavily protected and regulated into one of the most market-oriented and open in the world."[13] In 1996 the average applied tariff on all dutiable lines in NZ was

---

9 See Rayner and Lattimore (1991 p.66.)

10 Syntec, cited in Lattimore and Wooding (1996 p.335).

11 Ministry of Commerce (1994 p. 134).

12 OECD (1989 p.39).

13 WTO (1996). While the starting point for NZ in 1984 was a highly regulated economy, it has been pointed out that this was also the case for many other OECD countries. Similarly, many other countries have pursued liberalising policies in the last two decades but, nevertheless, NZ's reforms stand out in both their breadth and depth. See Henderson (1996).

only 10.3% (down from 27% only 2 years earlier and projected to fall to less than 6% by 2000) and the trade-weighted average applied tariff rate across all goods was 5.2%.[14]

The origins of protection in NZ have been traced back to the 1880's when a depression led to a switch in motivation for tariffs (and a general increase in the tariff level) from revenue to sectoral protection (arguably as a response to declining natural protection induced by falling ocean freight rates).[15] For our purposes, however, we note only that in 1938 a foreign exchange crisis, which dramatically reduced NZ's exchange reserves, led to blanket import licensing in NZ. Coverage fell over the next two decades but was restored to 100% in 1958. It gradually declined again until by the start of the 1970's around 30% of all imports were covered by licence requirements.

At the same time a rather haphazard pattern of tariffs emerged, motivated largely by import-substitution goals. Accordingly, most raw materials were imported duty-free, tariffs were modest on intermediates and generally high on finished goods: a pattern of cascading tariffs with correspondingly high effective rates of protection. Final goods were only protected, however, if a domestic industry existed[16] so nominal and effective rates of protection were widely dispersed across industries.

---

[14] Source: APEC Individual Action Plan: Tariff Summary for 1996, from Ministry of Commerce.

[15] Lattimore and Wooding, 1996, p.317.

[16] The existence of domestic industry was not exogenous, however! Roger Douglas cites the following from a TV manufacturer in NZ: "We would go to Japan and explain…that our government wanted us to assemble their TV sets in NZ…They said no one [else] assembles Japanese TV sets. 'Do you have cheaper labour?' they asked. 'Make your own tubes? Transistors? Anything?' 'No,' we said. 'We just have to make them in NZ; and because there are only a few of us permitted to do this, we make good money doing it.' …[T]he Japanese finally agreed to sell us the bits to assemble their sets in NZ. However, they explained this was very costly. They were making tens of thousands of sets a day and we only wanted parts for a few thousand a year. At great cost they contracted outside people to come in, take assembled sets apart, sort out all the pieces we needed and put them in boxes. They got engineers to write out all the instructions in English for reassembly, and shipped them on their way… on average they charged us for the parts 110% of the price of the finished goods… We then opened a factory, imported much machinery, paid the highest wages in the neighbourhood… and finally produced a TV set … at twice the imported price." (Alan Gibbs, quoted in Douglas (1993 pp.27-28).)

The importance to NZ of external trade was certainly understood in this period and the harmful consequences for exporting industries of high import restrictions was also recognised. However, the only responses to these observations were to introduce additional distortions aimed to "compensate" exporters for the harm done to them by import restrictions and to pursue a small degree of bilateral liberalisation with Australia in the form of the original NAFTA of 1966. This focus on exporters was also heightened in the 50's and 60's by the perceived possibility of British entry into the European Common Market and this stimulated a desire to promote greater diversification in NZ's export base. Accordingly, explicit export subsidies were introduced in the 1960's and by the late 1970's there were many forms of explicit assistance to exporters, primarily of nontraditional export products: export development expenditures were given tax write-offs; exporters were given greater access to import licences; and an incremental export subsidy scheme was introduced. It has been estimated that in 1982/3 the pre-tax subsidy equivalent of these incentives was over $400 million[17] or nearly 17% of the total value of NZ exports.

New Zealand's trade policies had been perceived for some time to have negative effects on resource allocation and these perceptions found a strong voice in a 1968 report on the NZ economy prepared by the World Bank. The first cautious steps to serious reform were taken in 1969 at the National Development Conference, which recommended, essentially, that protection of manufactures should be "tariffied". The government of the day announced its intention to do this over a period of five years but this triggered such a strong response from manufacturers that the proposal went to a committee that recommended more cautious implementation. In 1972 the government announced that it had decided to postpone the tariffication measures and, instead, announced significant

[17] Syntec Economic Services (1984, p.30)

increases in export incentives. Furthermore, in 1978 a new (and what was to become very generous) system of price supports for agricultural producers was introduced: supplementary minimum prices (SMPs).

From 1975-77 a Tariff Review Committee undertook a substantial review of NZ's tariff structure with a view to determining the, "level of tariff necessary to afford domestic producers a reasonable degree of protection." In their 1978 report they identified 11 industries where the appropriate level was considered "excessive" and special Industry Plans were developed for the restructuring of these industries by the Industries Development Commission (IDC).[18]

The first serious liberalisation of trade policy came in 1979 when the government announced a number of major changes to import licensing.[19,20] Consequently, import licensing for non-IDC industries rapidly disappeared: in 1986 it was announced that import licensing on all non-IDC industries would end in 1988. Finally, import licensing ended for all industries in 1992.

---

[18] The IDC formulated plans for 15 industries in all: textiles, motor vehicles, carpets, tyres, general rubber, shipbuilding, plastics, electronics, packing, wine, tobacco, writing instruments, fruit growing, eggs and milk.

[19] That there was some reluctance is evidenced by the Minister of Finance's comment, rejecting the idea that 40 years of import licensing should be scrapped, that, "I have no intention of letting efficient industries go to the wall for the sake of a theory" (cited in Lattimore and Wooding (1996 p.326).)

[20] First, manufacturers could be granted licences to importing components where the domestically-produced good had a, "manifestly excessive price, or quality problems compared with imports" or where use of the domestic product would harm exports of finished goods. Second, import licence tendering began. While initially small (being confined to only about 5% of the domestic market for certain consumer goods) many commentators have identified this as an important step in the ultimate dismantling of the whole licensing scheme, not least because it made visible the extraordinary premia that consumers were paying for many imports. Pickford (1987b) reports, for instance, that over 17% of the successful bids in the first 12 rounds of the scheme involved premia of over 50% of the underlying value of the licence. Interestingly, by 1984 this figure had fallen to less than 3%: this is indicative of the way in which the tender scheme was used to liberalise licensing. Increasing values of licences were put out to tender in successive rounds: 10% of the domestic market in 1984 increasing to 15% in 1985. If the premia paid remained low for a couple of rounds, or if total tenders were less than the amount of licenses available, this was used as an indication that licensing could be abolished on that product line.

In 1983 NAFTA was replaced by the far more comprehensive Closer Economic Relations (CER) free trade area (FTA) agreement with Australia. The original intention was to develop a full FTA by 1995 with export incentives for trans-Tasman trade removed by 1987, tariffs by 1988 and quotas by 1995. In fact this was all achieved some 5 years ahead of schedule, by the middle of 1990. The FTA has gone beyond many other bilateral agreements in also co-ordinating competition policies across the partners and removing anti-dumping measures – see Vautier and Lloyd (1997) for more details.

In 1985 the new Labour government announced its intentions of liberalising foreign trade more rapidly than the previous government had envisaged, through reductions of high tariffs on non-IDC industries.[21] In 1986 the government also announced its intention to convert all specific tariffs to *ad valorem* equivalents and in 1987 a Tariff Working Party was set up, pre-empting a planned major review of 1988.

This group recommended that tariffs should be reduced further and more uniformity introduced into the tariff system and, in December of that year, the government announced a plan for more radical tariff reform than initially envisaged in 1984. The "Swiss formula" of the GATT Tokyo Round was adopted to improve tariff uniformity and tariffs (including those less than 20%) were cut in half by 1992 with IDC industries included as their plans finished.

[21] Initially, all such tariffs (on goods that were also produced in NZ) above 25% were to be reduced by 5% in 1986 and by a further 10% in 1987 prior to a major review in 1988. Furthermore, tariff reductions on 500 product lines not made in NZ and not subject to import licensing were also introduced. Pickford (1986) notes that for most of these goods tariffs (some as high as 40%) were eliminated but for some the tariff was reduced to 5%, "because of obligations to give major trading partners a preferred trading position in those areas" (p.75).

In 1990 a schedule for further reductions beyond 1992 was announced but, with a new government, this was suspended and a more modest proposal slated.[22] Tariffs for the post-1996 era were reviewed again in 1994 and the consequences of this review are noted in Table 2. Furthermore, any tariff that was 5% or less on July 1 1996 will be removed by 1998. These tariff reductions are scheduled to occur in 4 annual approximately equal steps. Finally, the few remaining specific tariffs (most notably in some apparel lines) will be reduced in accordance with the schedule for their *ad valorem* equivalents except for the specific tariff on used autos.[23]

(Table 2 here)

So by the year 2000 there should only be four tariff rates applied in NZ: 0%, 5%, 10% and 15%. Finally, a further review in 1998 has been scheduled. "At that time the Government will determine how to move towards a zero end point under a unilateral domestic tariff reduction programme".[24]

What have been the consequences for NZ's trade performance of these liberalisations? New Zealand's export mix has altered substantially over the last few decades, both in terms of product lines and in terms of markets. There is much less reliance on both "traditional" export products (wool and meat) and "traditional" markets (particularly the U.K.) with increased diversification, both in terms of actual destinations and in terms of

[22] From 1992 general tariffs were cut by a third by 1996 with a maximum tariff of 14% (so any tariff no less than 21% in 1992 was cut to 14% by 1996.) This one-third reduction did not apply to certain of the "special" sectors (notably carpets, apparel, some textiles, footwear and motor vehicles) and also no tariff in excess of 5% in 1992 was to be reduced to less than 5% by 1996.

[23] This latter remains at NZ$1300 or $1500 (according to engine size) and is only incurred if it exceeds the dollar amount of the duty that would be paid if the auto were subject to the going *ad valorem* rate on new cars.

[24] Minister of Industry and Commerce, 16 December 1994.

the number of trading partners.[25] Of course, these trends have been occurring for some time and cannot be attributed solely to the reforms. But New Zealand enjoyed an export boom from 1991 to 1995 and, interestingly enough, it was characterised by an increasing volume and diversity of manufactured exports, in particular: from 1991 to 1995 non-food manufacturing export volumes grew by 11% p.a., on average.[26] A great deal of this growth comes from exports to Australia: almost one quarter of NZ's total manufactured exports (including primary food processing) go to Australia and the value of that trade nearly doubled from 1988 to 1994.[27]

Some empirical work suggests that there is a structural break in both the NZ merchandise export and import time-series around 1988/90 with real exports growing significantly faster in the 91/95 period (6.4%) than in the 67/89 period (4%).[28] Another study looking at the performance of NZ exporters by markets and by product categories measured against the performance of other exporters[29] found that, over the period 1970-85, the value of NZ's exports grew substantially less than the value of world trade overall. This was largely because of NZ's export commodity composition, which was concentrated on primary goods with slow-growing markets. Over the period 1985-93 NZ's overall

---

[25] In 1950 over 40% of the value of NZ's exports came from wool, nearly 16% from meat, 30% from dairy products and less than 14% from other goods (Rayner and Lattimore (1991 p.35).) In 1995 wool accounted for less than 7% of the total value of exports, meat for around 13% and dairy products for less than 14% with other goods constituting 66% of total exports (NZ Treasury (1996 p.35).) Similarly, while the U.K. took 66% of NZ's exports in 1950, the U.S. 10% and Australia only 3%, by 1995 Australia was the largest purchaser of NZ exports, taking over 20%, while Japan was second at nearly 17% (with the U.S. third at 10% still.) In 1995 only a little over 6% of NZs exports (by value) went to the U.K. (*supra* p.37).

[26] NZ Treasury (1996 p.22).

[27] Colgate (1995 p.15).

[28] Lattimore and Wooding (1996).

[29] Lattimore and McKeown (1995).

export growth was still slower than world trade growth (and the main reason was again the product mix) but the gap had narrowed dramatically.

2. *Focus on manufacturing*

The evolution of trade reform in New Zealand outlined above makes it clear that manufacturing has long been the focus of – and driving force behind – protective efforts. In this section we look more closely at the evolution of manufacturing protection in New Zealand and the position of manufacturers *re* the reforms. We then examine, in a little more detail than above, the consequences for manufacturers of the trade reforms.

As noted earlier, protection in New Zealand has long had a cascading pattern with high restrictions on imports of finished goods that competed with domestic products and very low or zero restrictions on raw materials and inputs or goods not produced domestically. This was a conscious import-substitution strategy predicated upon a belief that manufacturing was intrinsically valuable, a belief buttressed in later years by a desire to diversify NZ's export base. At the National Development Conference of 1969, for example, the Manufacturing Committee was, "directed to outline a national strategy for attaining the optimum growth of the manufacturing sector … with particular reference to the development of manufacturing activity that can contribute to a major breakthrough in exports."[30] The Committee stresses the belief that positive externalities are likely with manufacturing and goes on to recommend a number of measures the government should take in order to support manufacturing.

---

[30] NDC, 1969, Manufacturing Committee, Report of the Working Party on Industrial Policy, p.5.

This report may be the source of the subsequent understanding of manufacturers that their protection was "needs-based" (see below). Paragraph 101 of the report reads, "[t]he essential point is that where industry requires protection this is because it has higher unit costs and cannot market an equivalent product at the same price as a competing import" (*supra* p.21). Nevertheless, the Committee recommended that the *form* of protection should change from quantitative restrictions to tariffs for a number of reasons: (1) administrative simplicity (particularly in avoiding the decision of who gets licenses), (2) revenue, (3) international acceptability, (4) greater responsiveness to foreign supply changes and (5) greater ease of measurement of the costs of protection.

In discussion of this Committee's recommendations at the NDC plenary sessions, a number of the stronger recommendations concerning industrial policy and protection were referred to a select committee. These included the following:

> "212. That Government should proceed *with all practicable haste* to implement its announced policy of dismantling the import licensing system and replacing it with a policy of appropriate tariffs"
>
> "213. That Government be urged to continue the dismantling of the import licensing scheme *with all practicable speed*" (our italics.)

The select committee, which included the president of the Manufacturers' Federation, replaced these and other clauses with recommendation 209A which, while less enthusiastic about the speed with which tariffication should occur, was nevertheless clear in endorsing it. The final recommendation passed by the Conference was the following:

> "209A: The manufacturing sector should be accorded a level of protection sufficient to promote steady industrial development [and] increasing manufactured exports…This level of protection, however, should be such as to encourage competition efficiency and reasonable prices to other sectors and to consumers … It is accordingly recommended that the system of protection should be flexible, that import licensing should be replaced by tariffs … and that this transition should be carried out … within a reasonable time. It is recognised, however, that there are cases

> where other protective measures including import licensing may be more appropriate than a tariff."

By the time of the second NDC in March 1972, however, manufacturers had cold feet: "in the light of changed conditions they no longer see recommendation 209A as appropriate to maintain a level of confidence in the manufacturing sector…".[31] The review committee redrafted the recommendation (and expanded it from its original 127 words to a much-hedged and caveated 494 words in 4 parts with sections and subsections!) The thrust of the amended 209A is that tariffication is no longer the central point of the recommendation but simply an option to be considered in consultation with industry etc. etc. As noted earlier, this led to the shelving of plans for reforms of the licensing scheme. Interestingly, Federated Farmers of NZ, the Associated Chambers of Commerce of NZ, the NZ Retailers' Federation and the NZ Bureau of Importers and Exporters all made submissions to this new Committee supporting the current version of 209A (p.21). The changed stance of the manufacturers suggests that the Committee's findings, which essentially acceded to the wishes of the Manufacturers' Federation, did not stem from a national belief in the infant industry and externality arguments floated in favour of continued high assistance to manufacturing but rather from the political power of manufacturers as a group.

When the 1979 budget announced the first tendering of licenses, it was with the intent of not only introducing some foreign competition into consumer goods industries but also to get some sense, via the size of tender premia, of the magnitude of protection that was being afforded through the licensing system. Manufacturers continued to resist tariffication

[31] Quoted in the Introduction to the Review of 209A by the Committee on Industrial Policy, NDC 1972, p.9.

even as license tendering increased, until acquiescing to a gradual programme in 1984. The Treasury, in its background papers for the 1984 Economic Summit, notes that,

> "[i]n order to pursue the goals of assistance reform in activities outside those subject to industry plans, discussions were initiated last year [1983] with the NZ Manufacturers' Federation, aimed at developing arrangements for the gradual switch from import licensing to tariffs as the prime means of protection. … The motivation for [a rule suggesting that increases in license allocations for tender would depend positively on tender premia] is to ensure that a somewhat faster rate of adjustment to import competition is faced by the most highly assisted ("tall poppy") industries *as revealed by the size of tender premia*"[32] (our italics).

Despite this, it appears that manufacturers had a sense that the premia were to determine the "scientific tariff" needed by each industry, along the lines of the Manufacturing Committee Report at the NDC some ten years earlier! So the Manufacturers' Federation could write in their newsletter of May 1984 of their understanding that the, "tariff would be based on the needs of the particular industry provided those needs were not 'very high' (150-200 percent duty)".[33] The acquiescence of manufacturers in 1983 to the principle of tariffication and reform (the latter perhaps unknowingly!) was the beginning of the end as far as protection of manufacturing was concerned. The new Labour government of 1984 devalued the currency by 20% and explicitly argued that this, "devaluation has created conditions conducive to an acceleration of this assistance reform programme. In particular, the devaluation will produce an increase in the cost of imported goods (and thereby an increase in the level of protection) and an increase in export returns".[34]

[32] NZ Treasury (1984 pp.307-308).

[33] Cited in Lattimore and Wooding (1996 p.329).

[34] From the statement of the Minister of Trade and Industry to the Economic Summit in 1984 (p. 88).

The general lesson that emerges from this discussion is that the favoured position of manufacturers in NZ can be attributed in part to a general belief on the part of planners and policy-makers in the desirability of manufacturing *per se* and in part to the strength of manufacturers as a political group. One feature of protection in New Zealand that has survived all the reforms is a favouring of certain industries within the manufacturing sector. So in the 1994 Tariff review for 1996-2000 the Minister of Commerce and Industry noted, "[a]s in the past special consideration has been given to the textiles, apparel, footwear and automotive industries".[35] Before turning to political economy explanations of protection of manufacturing in NZ, however, it is instructive to look more closely at the consequences for the manufacturing sector of the general reforms to date. In light of the wide scope of NZ's reforms, however, the following caveat is instructive: "when contemplating likely results from past and present liberalizations, it is important to keep in mind that trade often plays a distant second fiddle to bigger macroeconomic issues."[36]

It is clear that the initial impact of the reforms on the manufacturing sector was strongly negative but, in recent years, perhaps as a consequence of other reforms (particularly to the transport industry and to labour markets in NZ), output and,

[35] Minister of Industry and Commerce, 16 December 1994.

[36] Levinsohn (1996).

particularly, exports have picked up.[37] Furthermore, exporting has become more significant in most product lines for all size firms as shown in Table 3.

(Table 3 here)

It would be of some interest to know the role played by both existing firms and new entrants into manufacturing in the recent export boom. Roberts *et al* (1996) report that only about a half of export growth in their micro-study of several export booms is attributable to incumbent exporters: the rest comes from non-exporters choosing to export. In the NZ case, one study of firm behaviour from 1987 to 1991 found that approximately half (1123 out of 2551) of the manufacturing firms surveyed who were exporters in 1987 (and still existed in 1991) were no longer exporters. Over the same period, only a small fraction (about 9%) of firms that sold only to the domestic market in 1987 had become exporters by 1991.[38]

The most significant sectors that continue to attract high protection are motor vehicles (assembly and component production) and textiles, clothing and footwear. Nevertheless, as protection of motor vehicles has declined, imports have increased and the sector has shrunk dramatically already. New Zealand has also experienced a large increase in imported used cars from Japan in recent years and this has also contributed to domestic production falling – by almost 50% in the last ten years. Employment in the assembly

---

[37] Hazledine and Murphy (1996) report that while the real output of resource-based manufacturing industries grew by some 22% in total from 1984 to 1992 (and employment there declined some 24%), overall manufacturing grew by less than 6% over that period (and employment declined by almost 21%.) This is somewhat misleading in that 1992 was a recession year: by 1995 unemployment had fallen from the 10.3% of 1992 to 6.3% and manufacturing increased from 16.7% of total employment to 18.2% (OECD (1996).) Nevertheless, manufacturing real GDP was over 15% lower in 1991 than in 1984 (Colgate (1996 p.7).) But exports of non-commodity manufactures grew by 3.5%, 9.4%, 19.4%, 12.7% and 20.7% in each of the years 1990 through 1994 (Colgate (1995 p.8).)

[38] Malcolm (1993 p.56). This survey is likely to underestimate the move into exporting for a number of reasons: it does not include new entrants; it is not clear if the export category refers to firms that *only* export as opposed to those with domestic sales as well; and it looks at 1991, a recession year.

industry at the beginning of 1997 was only 2,200 people with a little more than that employed in production of components.[39] Finally, in late 1997 the government announced that all tariffs on new and used auto imports would be abolished in the year 2000, falling from 15% in July of that year to zero in December. Table 4 shows the consequences of tariff reforms for the nominal tariff on imported, completely assembled autos in NZ and Table 5 provides some basic statistics for passenger cars in NZ.

(Tables 4 and 5 here)

In the TCF industries, employment is somewhat larger but has also declined following liberalisation. Around 31,000 people were employed in the apparel and textiles industries in 1985 and only about 20,000 in 1994.

The recent export boom in manufactures, discussed earlier, has surprised a number of commentators: NZ's comparative advantage clearly lies in primary products and one would anticipate that if trade liberalisation improves resource allocation then any export boom should come from the primary sector. That this has not been the case is probably due in part to the patchwork pattern of tariff compensation to agriculture in NZ, which attempted to lessen the export tax component of import restrictions. Furthermore, NZ's actual experience fits quite well with the thesis advanced by Olson (1987). He suggests that high protection of manufactures, "facilitate[s] collective action to collude and cartelize" (p.256) which in turn distorts resource allocation further and leads to greater inefficiencies. Accordingly, one would anticipate very low export ratios in such sectors. Liberalisation then induces an increase in exports of the protected sector. Our discussion of the evolution of the manufacturers' position in NZ certainly suggests that protection

[39] It should be noted that over 40% of the output of the components industry is exported so this employment is not totally dependent on the domestic assembly industry.

…

facilitated collusion on a political front and enabled manufacturers to wield surprising political power.

This discussion brings us to the political economy of protection of manufactures in NZ. Some efforts have been made to try and explain the pattern of assistance to manufacturing industries in terms of industry features. One study regressing industry *assistance* (trade protection as well as assorted subsidies and tax concessions) on industry characteristics in 1981/2 found that assistance was higher, *ceteris paribus*,

- the lower the skill level of workers (measured by educational achievement),
- the lower the industry's growth rate,
- the lower were transport costs (i.e. natural protection),
- the less important were exports and
- the higher the number of firms in the industry.[40]

Employment and labour-intensity were not found to be significant. This study omitted the motor vehicle assembly industry, for reasons of data problems, and is therefore likely to be influenced largely by the extremely high protection accorded to other industries such as textiles, apparel and footwear. Interestingly, however, they found that geographical concentration tended to *reduce* protection although it was concentration in non-urban areas that had this effect. This fits with a suggestion by John Yeabsley that high assistance to TCF industries might be attributable, in part, to the fact that they are relatively high employers of rural women and find a political voice through that.[41]

---

[40] Gibson and Lattimore (1991).

[41] In 1994 there were still some 800 plants in the apparel industry, for example, scattered through the country, and employing an average of 20 employees each (Ministry of Commerce, 1997). Accordingly, the results of Gibson and Lattimore may well be driven by the high protection accorded to this single very scattered sector.

The finding that protection increased with the number of firms in an industry runs counter to common arguments that pressure group formation and thus political effectiveness will be hampered by free-rider problems as the number of firms increases. Of course, these numbers are small anyway, in the NZ case (the authors report an average of 60 versus 164 in Australia) and may reflect the incentives for entry to protected industries. These incentives will be limited, however, by quotas as opposed to tariff protection.

Another more recent study looks at the pattern of plant exit in NZ manufacturing from 1986 to 1989.[42] Over this period, the effective rate of assistance for manufacturing declined from 39% to 19% and nearly 20% of their initial sample of around 4000 medium to large plants had exited by late 1989. The study attempts to explain exit with a range of plant, firm and industry characteristics, finding that exit was more likely

- by high-cost, larger and younger plants
- if the plant was owned by a firm that owned more than one plant
- if it was not foreign-owned
- the greater was the fall in the effective rate of assistance to the industry and
- the more significant was import licensing as an element of that assistance.

[42] Gibson and Harris (1996).

While interpretation of these results as consequences of trade liberalisation is a little doubtful,[43] they do suggest the unsurprising result that highly protected industries were also highly inefficient.

The study also notes that the exporters in the sample tend to have larger plants, have fewer plants per firm, use more specialised capital and be younger than the overall sample average. "With the exception of plant age, the characteristics of successful exporters are also the major characteristics of surviving plants" (p.19). A recent paper by Clerides *et al* (1996) examines the same episodes of export booms as Roberts *et al*, and suggests that there is a self-selection of efficient firms into exporting. This in turn suggests that, *ceteris paribus*, exit of non-exporters as in the NZ case will tend to be efficiency-improving.

All in all, these studies suggest that the pattern of protection of manufacturing in New Zealand had been motivated as much by "social policy" concerns as by anything else. This fits well with the persistence of protection for certain sectors through the reforms and might explain why NZ's unilateral reforms did not jump immediately to full free trade. Indeed, from the initial major reforms in the early 1980's, the current schedule is such that NZ will have taken over 2 decades to reach full free trade.

Another explanation that has been put forward for the persistence of sectoral protection is that when the Labour government of 1984 introduced sweeping reforms it essentially "outflanked" the National party, its main Opposition. In subsequent elections, and as a

[43] All other things equal one would anticipate, for example, that high-cost, young plants are more likely to exit in any sample and the interesting question is then how *trade* reform changes the nature of the exit decision. If trade liberalisation is adequately controlled for through the fall in ERAs then presumably one would like to know how this interacts with the other independent variables. If trade liberalisation is *not* captured by the fall in ERAs then to interpret these numbers as consequences of reforms solely because of the time period chosen one would also need to consider an earlier post-reform period as a control. Also, macroeconomic effects may have been present and these are not controlled for: in particular, real interest rates were very high and the economy was flat over this period.

backlash against the reforms mounted, National chose to "differentiate their product" by pledging their support for freer trade as a *practical* matter rather than an *ideological* one.[44] Accordingly, they had few qualms about continued protection for certain sectors and, indeed, could use the commitment to more gradual trade reform as evidence of their practicality.[45]

3. *Agriculture*

The negative consequences of import protection for exporters have long been recognised in New Zealand (this is evidenced in statements by agricultural representatives at the NDC in 1969 and also explains, in part, the cascading pattern of protection that evolved to the 1970s.) The political response to this, however, has typically been to offer additional interventions designed to offset these consequences rather than to question the initial protection itself.

This interpretation of assistance to primary producers as "tariff compensation" is widespread. Lattimore and Wooding (1996 p.319) note that the introduction of producer marketing boards with monopoly export rights in the 1930s was an explicit *quid pro quo* for increased protection of imports. Others have argued that attempts at trade "liberalisation" commencing around 1962, "can be characterized as an attempt to move closer to neutrality in trade intervention by the provision of compensation to exporters for the effects of import protection"[46] and that, "a stated justification of the supplementary

[44] This also fits with the comments of NZ negotiators following the conclusion of the Uruguay Round of the GATT, discussed below.

[45] This argument has been suggested to us by Paul Wooding.

[46] Lattimore and Rayner (1991 p.10).

minimum price (SMP) scheme [a price support scheme for certain agricultural products introduced in 1978] was to compensate farmers for cost excesses due to protection to the manufacturing industries".[47] Tariff compensation finds its most explicit official voice, however, in the Minister of Finance, the Rt. Hon. Robert Muldoon, in the 1982 Budget (p.10): "[t]he chief purpose of the export incentives is to compensate exporters for the high costs they face because of import protection."

Thus, quite ironically given its comparative advantage, New Zealand developed a system of high assistance to agriculture. EGWT (p.39) report that the effective rate of assistance to pastoral agriculture, looking at all forms of transfers, was in excess of 30% in much of the early part of the 1980s (largely due to SMP payments), reaching a peak of 120% in 1983. However, it has been argued that, apart from in 1983 (when the true effective rate of assistance was 25%) these payments did not fully compensate farmers for the losses incurred through import protection.[48]

The consequences of the reforms for agriculture have been dramatic. EGWT report that effective transfers to the sector were negative by 1990 and rationalisation has been extensive: farm land prices fell sharply with deregulation and the pattern of farming has changed – sheep numbers fell by 30% in the decade from 1985 to 1995, for example.

Interestingly, however, farmers as a group were big supporters (indeed leaders of the dominant farmer organisation were initiators) of the reform of the early-mid 1980s. To trace the origins of this it is helpful to expand analysis of the state of agriculture in the period leading up to the reforms.

[47] Chiao and Scobie (1990 p.1).

[48] Chiao and Scobie (1990).

From the middle of the 1970s to the onset of the reforms agricultural subsidies were, as we have mentioned, designed to compensate agriculture for the high levels of protection afforded manufacturing.[49] In part this stemmed from the deteriorating balance of payments and growing public debt.[50] Evidence for concern about export performance is revealed by the establishment of an export subsidy scheme for manufactures.[51] At the same time the subsidy schemes were designed to generate extra output (i.e. exports) from *agriculture* as well.[52] These incremental subsidies sought to produce extra output at a lower government budgetary cost than if the same intended output expansion was engendered by broad-based subsidies. Evans and Morgan (1983) report many of the subsidy schemes of the late 1970s and early 1980s resulted in user costs of capital inputs which, at the time of investment, were virtually zero, and in some cases negative. This subsidisation meant that the marginal rate of return to investment on farms was much higher than the average rate of return farmers were experiencing on their businesses as a whole. While it may have encouraged extra production it did not raise the profitability of farming *vis à vis* that of other industries. So farmers as a group came to perceive that their share of economic rents resulting from government management of the economy was less than that they would achieve in a much less centrally controlled economy.

---

[49] The extent of agricultural subsidies for the period 1979-97 is described by SONZA (1997, p.123-124). The subsidies took a wide variety of forms. Some were the outcome of mechanisms designed to smooth farmers' fluctuating incomes. These often took the form of low interest guaranteed loan facilities to finance producer boards' cost of carry in their activity of trading in markets (eg the wool market) in attempts to ameliorate the fluctuations in prices that faced farmers. Others were direct input (eg fertiliser) subsidies and output subsidies.

[50] Statistics New Zealand (1996, 359 and 564).

[51] The history of export incentives is described by Wooding (1987, 96-98).

[52] The widespread subsidisation of the 1970s and early 1980s separated economy-wide incentives guiding production and investment decisions from the country's terms of trade, that for meat and wool, have been declining since their relatively high level of 1972-3 (see SONZA (1997, pp.92-96)).

Farmers anticipated higher (average) rewards from comparative advantage in a deregulated economy. Just prior to the reforms, subsidies and regulation had reached the point where they were widely perceived as not sustainable. This, and the belief that in a fully de-regulated economy farming would achieve a higher income share, predisposed farmer support for the reforms and farmer special interest groups have broadly supported the reforms since their inception.

In 1985, the reform of agriculture started abruptly with the removal of subsidies. It was accompanied by plans for reform of other sectors, but was almost contemporaneous with de-regulation of the financial sector and the foreign exchange market. Significant state sector reform did not start until 1988 and labour market reform did not take place until 1991. With the exception of changes to the regulatory framework for natural resource use, the statutory monopoly of a number of producer boards remains the key unresolved source of statutory constraints on agriculture.[53] These boards' statutory powers include the right to levy producers, compulsory product purchase, the sole right of export, and the responsibility for the administration of quotas imposed by foreign countries. The effect of these boards on competitive supply, price signals and efficient provision of supply, marketing, contracting and transport services is under wide scrutiny and debate.

The general reform programme also included re-consideration of legislation controlling town and country development. The Resource Management Act of 1992 replaced all previous legislation and its goal was to a framework for sustainable use of resources. The focus of the Act is to promote sustainable land use while placing greater weight on effects

[53] There have been some changes. The deregulation of egg production and distribution and the Wool Board withdrawing from its buffer stock scheme are examples, but there has been little change in function or structure of the board encompassing the largest business: the New Zealand Dairy Board.

of actions, rather than actions themselves, and on property owners' rights to make decisions. Because the Resource Management Act replaces, rather than builds on, previous case law its introduction has injected uncertainty into planning and development procedures for agriculture. Local government authorities have the responsibility of administering the Act and they have adopted various positions on the trade-off between regulatory restriction and unfettered decision-making by owners; although they are constrained by the requirement that restrictions be justified by economic analysis. There is uncertainty about the enforceability of some local government positions and promulgated regulations. In many regions the new Act has provided more freedom to subdivide properties for various purposes, and it is sustaining a trend to smaller farms which really started in the mid 1980s as farmers sought to restructure their debt.

In the context of the other planned reforms, the rapid de-regulation of the financial (including foreign exchange) sectors and fully funding of the government budget deficit resulted in a period of very high interest rates and real exchange rate in 1985. In conjunction with the simultaneous removal of agricultural subsidies the profitability of farming was vastly reduced and agriculture retrenched. The decline in farm land prices in the 1985-88 period was as much as 50 per cent in real terms. Restructuring was not smoothed by government-sponsored transitional arrangements, and a number of farmers were bankrupted. Others retained ownership by selling portions of their farms.

Agriculture has changed and diversified. Its commodities now account for less than 50 per cent of total exports, and there has been much change in operation and the product mix. Meat and wool farms have borne the brunt of change. The decline in sheep numbers and expansion of forestry reflect the low terms of trade for sheep products and reversion from the high levels of capital stock resulting from the pre-reform policy of encouraging extra production with scant regard for international product price signals.[54] It also reflects the relative profitability of sheep and forestry, in part engendered by world prices and in part by the exceptional tax treatment of forestry.

Although diversification into deer farming and horticulture and wine production started in the 1970s and early 1980s, it has been consolidated since that time. Indeed, horticultural export growth has accounted for much of the growth in agricultural value added and exports broadly defined. The strong growth of tourism in the 1990s has made it a major foreign exchange earner, and it has been associated with changes to farms to meet tourism demands.

The changed operation of farms reflects the need for individual farmers to manage their own risk rather than rely on government programmes, and benefits associated with contracting directly with customers for specific products. Their larger size, permitting specialisation of labour and better access to capital markets, may entail corporate farms having advantages over the family farm in both these areas. Although they are few in number, there are now more public corporations in farming than in 1984.

Industries supplying inputs to agriculture have followed agriculture's cycle. In particular, the meat packing industry, which was once heavily regulated, has had to undergo major restructuring since entry became open in the early 1980s, as sheep numbers have declined, and in response to demands for value-added meat products rather than meat as a commodity. The restructuring has carried with it a number of bankruptcies resulting in significant losses to shareholders and farmers. The industry still has excess capacity,

---

[54] Sheep numbers fell by 30 percent between 1985 and 1995. Between 1960 and 1990 the peak level of new production forest plantings was in 1985. Following the changed tax treatment of forestry (in 1991) and the lower relative profitability of sheep farming, forestry planting jumped to almost twice this peak by 1995 (Statistics New Zealand (1996, 396)).

particularly under the current more flexible terms of employment, and is likely to remain volatile for some time to come.

Rural New Zealand is continuing to change rapidly in the directions already indicated. It is affected by factors which include ancillary industries' adjustments, the major change to the regulation of resource use and the continuing expansion of tourism. It is more diversified and has a continuing decline in the importance of traditional farming operations and products. Agriculture's contribution to GDP and exports have grown since the onset of the reforms. But between 1991 and 1996 pastoral farming's share of exports fell from 46% to 43%, and between 1994 and 1997 the contribution of farming to GDP fell from 6.2% to 4.9%.[55] Philpott (1994) estimates that during the 10 years since 1984 agricultural and horticultural GDP grew by 6.4 per cent per annum, and total factor productivity by 7.7 per cent, much of it attributable to horticulture. He suggests that the average labour productivity of agriculture has increased more rapidly than in manufacturing over the reform period. Finally, between 1979-81 and 1996 producer subsidy equivalents, expressed as a percentage of the value of agricultural output averaged across all OECD countries increased from 29% to 36%.[56] For New Zealand the percentage decreased from 18% to 3% in the mid-1980s and it has remained at this low level.

With this background we return again to the political economy of New Zealand's agricultural reform. The abrupt reduction in profitability of farming in the mid-1980s did not change the pro-deregulation stance of leaders of New Zealand's farming interest groups. Their response was not to change their commitment to de-regulation, consequent

[55] SONZA (1997, 120-122).

[56] See SONZA (1997, 123). Producer subsidy equivalents indicate the value of transfers from domestic consumers and taxpayers to farmers, as measured by the difference between domestic and world prices.

to the plight of farmers, but rather it was to regard the costs as transitional and to speed up the process of reform by promoting further de-regulation of other sectors of the economy. In particular, they have been firm advocates of reducing border protection and government expenditure. They have held this position throughout the 1986-97 period despite some reverses in interest group membership; but without the formation of competing farmer-representative organisations.[57] It may be that the current distribution of rents is regarded as being as much to farmers' advantage as could be expected under further regulation and subsidies, especially given the increased international pressure, under the GATT agreement of the Uruguay Round, for other countries to de-regulate their agriculture. Indeed, NZ's unilateral stance towards agricultural subsidies offers this country's agriculture a prominent exemplary leadership role that may aid gaining access to markets.

III. *The political economy of New Zealand's unilateral trade reforms*

There has been in the New Zealand experience a remarkable change in the direction and coalition of interest group pressures. In addition to agricultural interest groups, manufacturers have also advocated government expenditure reductions during the 1990s. Their position reflects these groups' perception that the lower this expenditure the less pressure that monetary policy will place on interest rates and concomitantly on the exchange rate: *ergo*, lower government expenditure leads to a lower exchange rate. It is not the argument about this linkage that is remarkable; rather it is that farmers and

[57] It must be noted that New Zealand farmer organisations are also very active in reacting to land use regulations brought down under the Resource Management Act 1992, and to managing issues arising under the Occupational Health and Safety in Employment Act 1992. The former Act, in particular, has most significant implications for farming.

manufacturers have joined in forces in their advocacy of a point of view. It reflects the long-held view of farming leaders about border protection and consequent domestic costs and the fact that exporting is now so important to manufacturing that the goals of its representative group have become aligned with many of those of farming. Prior to the 1990s, with manufacturing under a protective, umbrella the interests of the two groups were quite different. It may be that the coalition of interests will be strong enough to preserve New Zealand's low and declining border protection, thus making this aspect of the reforms more sustainable.

Political interest group influence has changed in other ways. In the mid-1980s the New Zealand Business Roundtable (NZBR) established a secretariat that has continued to finance and conduct studies across a wide spectrum of economic and social policy areas. The reports have not had a sectoral point of view but have typically argued for policies that entail an open and competitive economy with reduced government.[58] They have been influential, partly as a consequence of their frequently employing academics (often US academics) to author their studies. Such a grouping did not exist prior to 1984 and the concordance of its views with many of the common policies of farmer and manufacturer organisations yields a consensus about the direction of the economy from the business sector that will continue to advocate low levels of border protection in NZ.

Before turning to specific issues in the political economy of NZ's unilateral trade reforms we should stress again that no aspect of NZ's economic reforms can be analysed in isolation. We argue below, for example, that an important (perhaps the *most* important)

[58] Membership of the NZBR is for CEOs by invitation. The NZBR represents most of the large NZ business interests drawn from all parts of the business sector. The focus is, "the general economy rather than particular sectors or industries" (NZBR Statement of Purpose.)

motivation for unilateral trade reforms was in providing credibility to the reform process itself.

A. *Ideas*

1. Perceptions of NZ's performance and the need for change

As NZ's trade liberalisation was, in many respects, just another facet of general economic liberalisation so the causes of and motivations for the latter apply equally to the former. Thus general dissatisfaction with the hands-on economic management style of the outgoing National government, for instance, may have been as important a motivator in trade liberalisation as any other factor. However, we have noted already that criticism of NZ's trade policy regime, both from within and from external commentators, had been around for some decades and had been growing. So the 1968 World Bank report on the NZ economy was quite explicit in its criticism of NZ's reliance on high protection in general and QRs in particular: "[t]he most important single measure which can help make NZ manufacturing internationally competitive is its gradual exposure to competition from imports. This requires a removal of quantitative import restrictions and a reliance on [temporary] tariff protection [which] … should be gradually reduced."[59] This criticism was also echoed in IMF and OECD reports through the years.

2. Alternatives

An important question that needs to be answered is *why* NZ chose to reform its economy in such an extensive fashion and in such a short time period. That some drastic change should occur was almost inevitable (but see Kelsey (1995, Chap. 14) for a dissenting view)

[59] IBRD 1968, p.14.

…

but it is not obvious why such a *broad* programme of reforms should have been initiated. When the Labour party took government in 1957, for instance, they also faced deteriorating FX reserves but responded by imposing 100% import licensing.

The difference probably lies in the coincidence of economic and constitutional crises and in the fact that the incoming government had (at least, some of its key members had) a coherent and already-articulated philosophy of economic management. Furthermore, the outgoing government had been characterised by a general policy of extreme interventionism in the economy and there were no clear signs that it had been at all effective. Accordingly there was a strong sense of dissatisfaction with the idea that activist government policy could be a panacea for all – or any – ills. Indeed, it's been suggested that the overwhelming support for the Labour government of 1984 was less an endorsement of their reform package (which was largely unannounced in their campaigning) than a rejection of what went before.[60]

As far as trade policy is concerned, the timing of these crises was such that real alternatives to unilateral liberalisation were few. We have argued that it had been clear since the late 60's that trade reform was needed in NZ, but neither multilateralism nor bilateralism were immediate enough to be attractive to the reformers. Speed of reform was highly emphasised by the Labour reformers.[61] GATT was between rounds with the Tokyo Round having left many unsettled issues and the direction of the U.S. was uncertain – while encouraging a further round of GATT talks it also passed the Trade and Tariff Act of

[60] In fact, de-regulation was proposed and did find political favour in that election. The New Zealand Party, formed only months before the election, gained a remarkable 12.6% of the vote on a de-regulatory platform.

[61] Roger Douglas elevates speed to the status of a Principle of successful Reform in *Unfinished Business*: "Speed is essential. It is almost impossible to go too fast" (p.222).

1984 granting presidential authority to negotiate bilateral deals. Multilateralism through the GATT could not be initiated by NZ and the delay involved in negotiating reciprocity for domestic reforms, if it could be done at all, would have been too great. Indeed, there was explicit recognition in Treasury that NZ was too small a player to have any effects on the policies of other countries, be they trade policies or any other form of industry assistance.

The main bilateral option available was in trade with Australia and, indeed, the pace of this was accelerated, as we have noted, but in tandem with unilateral liberalisation.

3. *The role of individuals*

Antagonists and protagonists alike attribute the reforms to a, "conjunction of personalities, economics, politics and the prevailing ideology" (Kelsey (1995, p.353)) and it is inevitable that personalities must be involved to some extent in a country with the population the size of Toronto. Roger Douglas' role in initiating and leading the institution of the reforms, along with key advisers and other members of parliament, is clearly significant and is well documented elsewhere.[62] Nevertheless, EGWT suggest that this aspect of the reforms has been overstressed. It is certainly the case that the initial enthusiasm for reform was coincident with Labour party principles (as witnessed by subsequent comments of the then-prime minister, David Lange, who remarked in 1989 that, "I apologise … for nothing of what we did to begin with …in the course of about three years we changed from being a country run like a Polish shipyard into one that could

[62] See, for example, Bollard (1994).

be internationally competitive".[63] Both those in favour of and those against the reforms also acknowledge a growing consensus amongst academics – and awareness amongst key public servants – that the NZ economy was over-regulated and that liberalisation to some degree was inevitable. As already suggested, this consensus did not just spring up overnight but had been foreshadowed many years earlier. The notion, then, that the reforms were somehow an aberration or purely a product of personalities seems difficult to maintain.

Surprisingly, particularly in contrast to the experience in Australia where it was a strong factor in promoting reform, explicit academic criticism of NZ's trade policy continued to be muted.[64] The infant-industry argument was generally accepted as a valid theoretical rationale for protection and, as we have seen, there was a strong belief in the external benefits of manufacturing. Even at the Economic Summit of 1984 when manufacturers themselves were facing up to the reality of life with import competition, the submission of a leading academic economist, while decrying the particularly high levels of protection in certain sectors, wrote,

> "[t]here are strong arguments for a continuing level of uniform protection – arguments which in our view stem largely from:
>
> (i) Pessimism about the future growth in overseas demand for traditional agricultural export products.
>
> (ii) The high NZ propensity to import such that faster export led growth tends to be frustrated by the spill over into imports.
>
> … There is in fact an optimal level of protection justified by the need to ensure an industrial structure which produces the highest GDP or standard of living possible".[65]

---

[63] Kelsey (1995, p.38).

[64] An exception had been Wilfred Candler (professor of agricultural economics at Massey University) who many years earlier in 1963 had published an unsigned article in *The Economist* entitled "How to Progress Backward."

[65] Economic Summit Conference (1984 p.535).

More significant were the opinions of key policy advisers, particularly in the Treasury, as we discuss next.

B. *Institutions*

1. Domestic political institutions

The structure of NZ's political system is such that opportunities for far-reaching reforms are more easily taken than in many other systems. New Zealand operates a Westminster-style Parliament but with a single House. Accordingly, there is no upper body to overrule decisions made by the elected Parliament. There is no single written constitutional document and there are no provincial or state legislatures. Further, until 1996 the electoral system was a FPP or first-past-the-post system in which every Member of Parliament was a local representative of some geographical constituency. Parliament was (and still is, though to a lesser extent with the introduction of proportional representation in 1996) dominated by two parties, Labour and National. Party loyalty has traditionally been very strong with the effect that government has effectively been by Cabinet. Accordingly, a small group of like-minded individuals can effect rapid and far-reaching change with less opposition than might be encountered in a more pluralistic system.

One very significant counter to this, however, is that the Government is elected for only three years at a time. As such it has severe restraints on its ability to enact unpopular policies if they are not broadly supported. This time constraint provided an incentive for rapid reform and, in consequence, an inducement for *packages* of reforms: in the context of significant reforms there was simply not time to rely only on bilateralism.

2. The role of domestic policy advisors

The main institutions here are the NZ Treasury and, to a lesser extent, the Reserve Bank of New Zealand. There were other institutions engaged in public debate but with far less influence – the NZ Planning Council, for instance, issued occasional papers and reports until its demise in 1991 – but Treasury has been the main source of economic policy advice to the NZ government for some decades. Treasury in New Zealand serves a role which in many other countries is found in a Finance Department as well as a Treasury: it is the main source of economic analysis, briefing and advice to government. As an advisory body it tends to stay out of open public debate, a feature which has led many critics to view it as pushing a "secret agenda" and as somehow bypassing the democratic process. So critics have perceived its "strategy" as seeking, "to impart information and bring important interests on board, not to consult them about the nature and direction of change."[66]

It has been well-documented (see EGWT, for example) that a number of Treasury officials had received postgraduate training in the U.S. and were well-versed in developments in microeconomic theory, particularly concerning public choice, contracting issues, the economics of information and so forth. In fact, Treasury was one of the most important conduits of such developments to New Zealand given the relative non-involvement of academics in the policy debate at the time and the positions taken by those that *were* prepared to debate the reforms.

The Treasury put together an influential briefing document for the incoming Labour government entitled *Economic Management* and the coincidence of its views on reform with those of Roger Douglas gave added impetus to the Labour Party's commitment to

[66] Kelsey (1995) p.34.

…

reform. The Treasury position had evolved over a number of decades as their views increasingly came into conflict with those of the National government of the 70's and early 80's.[67]

3. *International institutions*

We have already noted the impact of reports on the NZ economy by institutions such as the World Bank, the IMF and the OECD. It should also be noted that NZ's trade policy had been affected frequently by relations with major trading partners. Tariffs on autos have never been totally eliminated, for instance, and one reason has been British pressure to maintain a tariff preference on UK cars. Another example was the U.S. response to NZ export subsidies in the late 70's/early 80's when NZ was persuaded to sign the GATT code on countervailing duties. The proximate cause of this was a threat by the U.S. to remove an injury test in evaluating U.S. firms' complaints about subsidised exports from NZ.[68]

The role of Closer Economic Relations with Australia (CER), particularly as far as trade reform was concerned, is an interesting but difficult one. Clearly CER was important in that it provided the first breath of competition to NZ's domestic industries. Furthermore, Lloyd (1996) has suggested that CER provided a valuable "demonstration effect" on both sides of the Tasman, showing that trade liberalisation did not lead to the end of the world as we know it and thus reassuring policy-makers and voters alike that further liberalisation was also unlikely to be catastrophic. It is interesting to note that overall CER progress has slowed since 1990 or so and that the main reason seems to be

---

[67] Bollard (1994) p.90.

[68] See Lattimore and Wooding (1996) p.329.

…

Australian reluctance to go much further. Lloyd writes, "[i]n the 1992 negotiations the New Zealand government was anxious to see the Agreement extended [principally to capital flows and services.] … Australia saw the agreements as a free trade agreement which had almost been completed."[69]

At a theoretical level, it has also been suggested (Richardson (1993)) that FTAs might lead, endogenously, to declining external tariffs in a political economy setting. However, NZ officials have suggested that CER was more an epiphenomenon of general liberalisation rather than a cause (as already suggested it is certainly true that progress under CER was rapidly overtaken by other developments.)

Disentangling the effects of CER from those of unilateral liberalisation is an impossible task. Australia has become NZ's largest trading partner and is particularly important as a destination for manufacturing exports but how much of this would have occurred in the absence of CER is hard to know. While lower Australian trade barriers are a factor in NZ's manufacturing export boom so are resource reallocation effects of NZ's unilateral reforms. Further, suppose the extent of the liberalisation under CER would have occurred even in the absence of each country's unilateral reforms. Then clearly it reduced the cost of unilateralism to New Zealand by eliminating tariffs on the only country that New Zealand might have had any bargaining power over at all.

A question of some interest from the trade policy perspective is what consequences, if any, NZs liberalisations have had for its role in multilateral negotiation fora – both the GATT and regional bodies such as APEC (of which NZ is a vociferous supporter although Lloyd suggests that this may be from fears of trade diversion should world trade become

---

[69] Lloyd (1995) p.274.

…

dominated by aggressive blocs.[70] *A priori* one would anticipate that it has had very little effect given that NZ is a small player in these settings. Furthermore, NZ threw its insubstantial weight in the GATT negotiations in with the Cairns group of primary exporters and that may have diluted its voice even further. As noted earlier, it is possible that NZ trade negotiators have been assisted by the reforms in that they can take a position of "leadership" as a consequence.

To the extent that NZ has some market power in certain product lines (wool, butter, some horticultural exports) NZ's increased efficiency might reduce world prices and thus increase the costs of protection in other countries. As in Richardson (1993) and Coates and Ludema (1996), a unilateral tariff reduction by one country harms import-competing producers in another and, if their political efforts are the source of protection, this may reduce protection in other countries as well.

However, even where NZ is a big exporter, it is unimaginable that these effects could occur. In the dairy industry, for example,[71] NZ exports 90% of its production but this still amounts to less than 2% of international output.[72] The NZ Dairy Board is a statutory export monopoly; even so, it is only the 9th largest dairy company in the world. NZ exported 151 tonnes of butter to the U.S. in 1994 when U.S. consumption was around half a million tonnes and NZ butter exports to the EC are less than 4% of European consumption.

---

[70] Lloyd (1996, p.18).

[71] The following figures are taken from WTO (1996).

[72] As a percentage of total *trade* in dairy products, however, NZ is a more significant participant in world markets, accounting for approximately 25% of world trade. The largest exporter is the EU at about 45%.

A much more credible mechanism by which NZ reforms could influence the policies of trading partners is *via* Lloyd's "demonstration effect" mentioned earlier. So the reforms have given increased weight to the NZ experience internationally: unilateral liberalisation has led to an *increase* in exports and removal of assistance to agriculture has led to increased diversification, rationalisation and productivity in the agrarian sector. Furthermore, the NZ experience has been highly publicised internationally.[73]

New Zealand is also active in seeking bilateral deals. "In fact, New Zealand is willing to explore fresh bilateral and sub-regional free trade options with any of its significant trading partners".[74] Of course, given the extent of its unilateral liberalisation any such deals would impose little further obligation on NZ.

One further institution we have not yet discussed in any depth is the GATT and its current incarnation, the WTO.[75] As noted, NZ's reforms have been pursued unilaterally. Nevertheless, it is a signatory of GATT and an active participant in GATT negotiations (and has recently taken a case to the WTO regarding a dispute over the EC's refusal to allow spreadable butter in NZ's butter quota.) But its unilateral liberalisations have (generally) gone well beyond its obligations under the Uruguay Round agreements. With the exception of transport equipment (93%) and textiles (99.9%), 100% of tariff lines are

[73] The Economist magazine in a leader on October 19, 1996, explicitly recognised that the attention paid in the magazine to NZ, "a tiny country of only 3.5m people [roughly the same size as] Albania or Uruguay" was disproportionate to its size. "The answer, quite simply, is that the country merits it. Over the past decade or so, New Zealand has embraced more of the free market reforms that this newspaper espouses than any other industrial country".

[74] Minister for International Trade April 29 1997.

[75] Given the explicit commitment of recent NZ governments to freer trade, remarks of the NZ Minister for Trade Negotiations on the completion of the Uruguay Round which suggested that New Zealand had "gotten away with something" in not having to make "concessions" beyond those already undertaken unilaterally were surprising. While his remarks reflect more his own personal position than that of his government, his perception that this was needed to sell the agreement politically does suggest a remaining mercantilism in the electorate.
…

bound and half of these are duty-free.[76] The import-weighted average bound tariff rate in 1996 was 10.8% while the average applied tariff rate was only 5.2%. Moreover, these figures are somewhat skewed by the existence of high tariffs on a few product lines, as noted earlier.

C. *Interests*

1. ERP study

We have noted the interests that drove trade protection in NZ but what are the interests that have been best *served* by NZ's protection pattern? To answer this question we have estimated effective rates of protection across broad sectors of the NZ economy. It has long been known that the standard definition of the effective rate of protection – the percentage change in domestic value added induced by the protective structure – is not meaningful in general equilibrium (Ethier (1977)): it tells us nothing about the pattern of production, resource flows or sectoral returns except under very stringent conditions. Accordingly, we employ an alternative definition advocated by Anderson (1996) which proposes that effective protection for industry j is measured by the level of a uniform tariff on all imports that yields the same return to a specific factor in sector j as does the existing protective structure. Its intended interpretation is that it indicates the power of the specific sector to elicit rents at the expense of society at large, and thus the political power of that sector. We accept Anderson's argument that the term "distributional effective protection" (DERP) may be substituted for "effective protection" (ERP) to best describe his concept. These measures are given by

$$DERP^{j} \ldots (1/d) - 1$$

and

$$ERP^{j} \ldots \frac{t_j - \quad \alpha_{ij} t_i}{1 - \quad \alpha_{ij}}$$

where $d \ldots \{d : \pi^{j}((p^{1}/d), w^{0}) = \pi^{j}(p^{0}, w^{0})\}$

t_i is the *ad valorem* tariff applied to imports of *j*,

p^k is the distorted (k=0) or free trade (k=1) output and intermediate input price vector,

w^0 is the primary input price vector,

$\pi^j(.,.)$ is the j[th] industry's profit function and

α_{ij} is the cost share of intermediate *i* in industry *j*.

Under very special conditions DERP and ERP yield the same outcomes.[77] We report both measures for the NZ economy in 1990-91.

To calculate the uniform tariffs that are equivalent to the tariffs that were in place in New Zealand in 1990 (DERP) we use a computable general equilibrium model, JOANNA, that is a member of the stable of models that have been constructed by the Research Project in Economic Planning at Victoria University (see Wells and Easton (1986, pp.182-237)). JOANNA is a 22-sector model of the Johansen type (Dixon *et al* (1982)). Its variables are expressed and solved for as percentage changes in which form the model is linear. The version of JOANNA we have used is based upon Statistics New Zealand's inter-industry study of 1991.

The model has profit (utility) maximising producers (consumers) that admit substitution between labour, capital and intermediate inputs (8 consumption goods) and

---

[76] Source: NZ APEC individual action plan 1997. We are grateful to officials at the BIEP group of the Ministry of Commerce for providing this information.

the allocation or division of aggregate intermediate goods across industries is determined by fixed coefficient input-output relationships. It incorporates downward sloping export demand curves and imperfect substitution between domestically produced goods and their imported equivalents. We employ the static short run version of JOANNA and in it government consumption and total and government investment are exogenously specified. The short run is taken to be sufficiently long for investment to occur, but without additions to useable capital stock. Total investment is allocated across sectors in the manner that equates expected rates of returns (determined by the current rates of return and the ratio of desired to current capital stocks in each sector). The endogenous contemporaneous rates of return are calculated as the rent to immobile capital – the gross revenue of sector j less the cost of material inputs and labour.

JOANNA determines prices relative to a numeraire that is world prices in New Zealand dollars. The closure of the model requires exogenously specifying certain variables and we choose the closure that most closely corresponds to microeconomic trade models: trade balance and employment are fixed and the nominal wage is endogenous.

The term "equivalent tariffs" encompasses two tariff measures. Two are required to recognise that whereas for those industries that face border protection in the form of tariffs the statutory tariff rate is the appropriate measure, this is not the case for imports subject to quotas. For these, equivalent tariffs were constructed as the difference between the landed cost of an import and its production cost in New Zealand. Quotas were of negligible importance in the period of our analysis.

---

[77] These are (a) non-joint outputs, (b) distortion of all intermediate goods prices and (c) fixed coefficients (Anderson *op cit* p.7).

The model was used to calculate the DERP figures of Table 6 and the data of the model were used to produce that Table's ERP data.

(Table 6 here)

The industry-specific uniform tariffs (DERPs) in Table 6 are obtained from running the model for each sector. In running the model for sector j (j=1, … ,22) the (otherwise endogenous) rent of sector j is held constant in the move from the existing tariff structure to one with a uniform tariff. The exogenous variables are:

- industry capital-use
- aggregate real investment spending
- real investment in industries *min*, *egw*, *own*, *pub*
- real government consumption spending
- nominal exchange rate (numeraire)
- trade balance and aggregate labour employed (wages endogenous)

The unreported element in Table 6 (communications) occurs because, starting with a zero tariff, as the tariff increases the change in the rental price of this sector never falls to zero over any relevant range of tariff settings. In consequence, there is no uniform tariff that preserves the *status quo* in their rental price: that is, there is no solution to the model that maintains the same rental price of capital of these industries for this closure.[78]

The data of Table 6 pertain to a period that preceded the further reductions in border protection that we have noted. Nevertheless, they indicate the broad picture that one would expect from our preceding discussion. The CGE model can be closed in various ways. Closures that substituted for fixing the trade balance and aggregate employment that we experimented with included holding constant nominal wages and the trade balance and fixing real household consumption and aggregate employment. These two also gave the

[78] Anderson (1996, p.10) notes that when protection is negative a solution may not exist.

same key picture of Table 6 and, indeed, levels of effective protection (DERP) for textiles and fabricated metals that were close to those reported in that Table.

The measures DERP and ERP are quite different. Apart from identifying the same two sectors (textiles and fabricated metals) that stood out in the level of protection that they enjoyed, the DERP and ERP outcomes are not highly correlated measures.[79] Anderson (1996, 24-5) foretold this outcome and provides an example of it. The lack of correlation is indicative of the departures of the model from the requirements for an exact correspondence. In particular, the fixed coefficient requirement may be particularly stringent given that the tariff tableau is not from exactly the same year as the data of the model.

Of the two measures we feel comfortable giving only DERP an explicit interpretation. It is the uniform tariff that would give the industry the same rent as it enjoys under the existing structure: it has no immediate welfare connotations.[80] The extraordinarily high DERP for textiles (both relative to other sectors and in absolute terms) fits with our earlier discussion of the industry and supports the conclusion that it is a sector with disproportionately great political clout. The size of this sector is very small, however it is measured, and hence the aggregate excess rent of textiles is small. One possibility is that the sector carries political power because it is labour intensive. In fact, the data of Table 6 indicate that, on the basis of the labour capital ratio, it ranks the third most labour intensive

[79] So comparing the ranking of sectors by ERP and DERP, for instance, yields a Spearman's rho statistic of –0.015, which is insignificantly different from zero i.e. no correlation between the two sets of rankings.

[80] Anderson suggests a rationale for the use of DERP by referring to the seminal work of Grossman and Helpman (1994) in which the rents accruing to a specific factor represent the amount a lobby group is willing to pay to the tariff-setting authority to obtain protection. Accordingly, if welfare is monotonically decreasing in the uniform tariff on all imports then the DERP can be thought of as representing the welfare loss a policy-maker is willing to incur in order to protect a particular sector. This story is not watertight, however, as there is no monotonic mapping from the *actual* welfare loss of a particular sectoral tariff to the welfare loss of the DERP.

industry. When this is combined with the likelihood that the labour in this sector is probably less skilled than that of the "Private Services" industry, and that it is likely to have a much larger proportion of females than the "Building" industry (these being the two industries that are more labour intensive than textiles), this result buttresses strongly our earlier conjecture that protection in that sector flows from political responses to areas of less skilled labour. The other noticeably high DERP is fabricated metals. This reflects the protection of the vehicle assembly industry, but it is interesting that transport equipment itself comes in only fourth in this list with a rent-maintaining uniform tariff not much greater than that of four or five other sectors.

D. Other factors

1. Timing: the foreign exchange and constitutional crisis of 1984

We have already noted that NZ's reforms of recent years were initiated by the Labour government of 1984 that took power with a backdrop of a foreign exchange crisis and a consequent constitutional showdown with the outgoing government. The importance of this, which has been discussed at length elsewhere,[81] lies in the opportunity for change that it presented. That that opportunity was taken so enthusiastically is perhaps surprising but one of the key elements explaining the success of NZ's liberalisation emphasised by the reformers was its comprehensiveness, as we discuss next.

2. *Trade reform as a subset of general reforms*

We have stressed throughout this chapter that NZ's trade reforms cannot be considered in isolation from the other reforms that were occurring in the economy at the same time. One reason that opponents were overruled is that the reforms were extensive and affected every sector. This was quite deliberate on the part of the reformers and was justified not only as a means of making reforms *feasible* (in "buying off" groups who suffered from one set of reforms but gained from others[82]) but also in gaining *credibility* for the reforms (by bringing all NZers into the reform process and thus making reversals more difficult and by selling each piece of the reform as an essential part of the overall package.[83])

---

[81] See, for example, Bollard (1994).

[82] "Large packages [of reforms] provide the flexibility to ensure that losses suffered by any one group are offset by gains for the same group in another area": Roger Douglas, quoted in EGWT (1996 p.8).

[83] We do not have space here to discuss the broad package of reforms in full detail beyond that we have already mentioned and what is listed in Table One. The interested reader is referred to EGWT for a much more comprehensive discussion of aspects of New Zealand's economic reforms other than in trade.

To what extent is there any evidence of this *quid pro quo* in the reform package and was it perceived differently by the reformers and sectoral interests?[84] We have seen in our discussion of agriculture that farmers very explicitly requested the dismantling of industrial protection as their price for the removal of assistance to agriculture. One could argue that farmers *did* take a broad view of the reforms, an argument buttressed by their continuing support even after the initial very dire consequences for agriculture in the early- to mid-1980s.

The business sector, however, was rather more divided over the reforms. While the Business Roundtable was supportive of general reform (and, again, took the broader view that deregulation was in their overall interests despite the effects of reduced assistance on particular sectors), the Manufacturers Federation only came to support the reforms grudgingly when they were already pretty much a fact of economic life. Nevertheless, the *quid pro quo* was again explicit here as evidenced in our earlier quotation from the Minister of Trade and Industry's statement to the 1984 Economic Summit that the 20% devaluation was protection enough. It has also been suggested[85] that the reform of monetary policy to provide the greater certainty of a low-inflation environment was part of the benefits put to business interests by the reformers.

As noted earlier, there is also some suggestion that manufacturers did not understand the ultimate goals of the initial trade liberalisations, thinking that the auctioning of import

[84] Jagdish Bhagwati raised this question and suggests that while a reforming government might see the "big picture" in which the immediate consequences for a particular sector are offset by other reforms, sectoral interests might take a more narrow view, focussing on the direct "impact effect" of changes specific to their sector.

[85] We are grateful to Paul Wooding for raising this argument.

licences was intended to find premia to be used to determine the appropriate tariff to apply to each industry. This may also explain their conversion, albeit limited, to the reforms.

It is reasonable to surmise that, along with those of many commentators, farmers' and manufacturers' expectations of the adjustment period and the costs of adjustment were awry. That there was a major place for manufacturing in the new environment was largely unforeseen and it meant that the longer adjustment than many anticipated reinforced manufacturers' expectations that they would lose from the reforms. The persistent high real exchange rate was also not anticipated by farmer lobby groups. By the realisation of this, however, key reforms were in place and reforms in the rest of the economy were being implemented. Thus there was always the expectation of a fall in interest rates and the real exchange rate and this expectation affected farmer groups' positions. The expansion of manufacturing exports meant that manufacturers' initial expectations about the long-term impact of the reform on them had, in hindsight, been overly pessimistic. The reverse was the case for farmers. We note that there is now a concordance of interest between farmers and manufacturers, resulting from the dependence of both on exporting, that has not been present before in NZ's history. This adds credibility to the existing low barriers to entry.

One group that appears to have been "left out" by reformers was organised labour. Recalling that a Labour government began the reforms, it was always the case that the interests of labour would be considered heavily but it was argued that the real wage of workers would be increased through price reductions and price stability stemming from economic liberalisation. It was out of consideration for their traditional support base in organised unions that the Labour government did not move quickly on labour market reform (something the reformers subsequently regretted) and substantial deregulation did not occur until the National government of 1990 brought in the Employment Contracts Act of 1991. Also, early in the restructuring of the public service redundancy packages were significantly more generous than are generally the case under current arrangements and this affected the position of the influential public service unions.

Returning to trade reform, we argue that unilateralism can only be completely understood as a piece of the patchwork that made the reforms a coherent whole, as the reforms were explicitly intertwined, both politically and economically. One important aspect of unilateral trade liberalisation for NZ was that it facilitated the light-handed regulation regime that has characterised NZ competition law since 1986 (EGWT pp.31-38). Unilateral reduction of border protection was essential because it was an important part of the broader programme to allow open entry into NZ markets and therefore make possible a regime of only light regulation. The argument here is that open entry and contestability render heavy-handed competition law regulation unnecessary. If such access (to the *NZ* market) was negotiated on a bilateral basis and so depended on inter-country negotiations then openness would be rather more limited[86] as the provision of preferential access in a bilateral deal implies that protection against non-members remains. This would make a policy of light regulation unsatisfactory as a means of ensuring competitive outcomes. Thus, unilateral trade reforms can be viewed as being necessary in providing *credibility* for the competition policy reforms: if the former had been negotiated on a bilateral basis then their necessarily more limited nature – and the possibility of their reversal – would have rendered the light-regulation regime less effective and so less

[86] One can also argue that, as bilateral deals make liberalisation contingent on the actions of partner countries, by implication they involve the necessity of reversal if a partner reneges. So to the extent that such deals are sustained by the threat of punishment (as in many theoretical analyses of such agreements in supergame settings), the possibility of reversal of liberalisation occurs. For New Zealand countervailing threats would not have been credible in any setting. In any event, retaliation is not an issue in unilateral reforms, obviously.
…

believable. Farmers would have been less sanguine about the removal of their subsidies had they thought that lower border protection was to be negotiated rather than simply implemented.

Conclusions

At least two possible political economy perspectives on the reforms might be drawn from the literature on political support functions and that on competing lobby groups:

First, one might argue that the incoming Labour government of 1984, as a consequence of its personalities, perhaps, placed different weights on various aspects of social welfare than did its predecessors; in particular it stressed the welfare of consumers more highly than earlier producer-captured governments.

Second, one might also argue that the NZ economy had become sufficiently ossified through the creation of rent-seeking opportunities that such rents were declining through general economic decline. Accordingly, pressure groups might have recognised the desirability of "starting again" rather than simply nullifying each other's directly unproductive political lobbying activity with consequent deadweight losses.

Our interpretation of the evidence is that there is some truth in both of these positions. However, the distinguishing feature of the incoming government in 1984 was less its difference in goals and more its different perception (however constructed) of the means to achieve those goals. The history of trade policy in New Zealand shows a long and abiding belief in the use of trade policy both as a tool of social policy and as a means of fostering industrial development and the Labour government of 1984 dissented from both of these views. It perceived instead that these goals could be more effectively pursued in a growing economy and focused on achieving them indirectly through economic liberalisation.

In this it was aided by sectoral interests that perceived the futility of their mutual efforts. As we have noted, farmers' representatives, in particular, were active in promoting reform even when the immediate impacts of the reforms were sharply negative for them. Manufacturers were far more reluctant initially but, *ex post*, have recognised that their best interests are served by continued support for economic liberalism.

We conclude by summarising our answers to the questions with which we began.

- *What were the vested interests behind New Zealand's starting point of very high protection and how did they succeed in getting it implemented?* Crudely, manufacturers. They succeeded because of a general sympathy towards economic arguments that stressed the importance of industrialisation – infant industry arguments and claims of a declining terms of trade – and because industrial policy was also used as a tool of social policy, in particular, to protect employment in the politically-sensitive industries of textiles and auto assembly.
- *Why were reforms mooted – what happened such that the early status quo was no longer politically feasible?* General reforms in 1984, of which trade policy was a subset, were triggered by twin crises – economic and constitutional – and by a government with a new policy agenda. There was also recognition that the existing pattern of protection and protection-compensation was largely self-defeating but resulted in substantial resource misallocation and poor marginal incentives.
- *Why did the trade reforms succeed (in the sense of being put in place) and how did that implementation occur so as to overcome these special interests?* They succeeded in that they were part of a much larger package which, in turn, succeeded

for a number of reasons: political institutions, speed, scope, even-handedness. This last feature was critical in overcoming special interests in that the reforms affected all parties and could be sold by noting that losses from one reform would be offset by gains from others. Exempting certain special interests would have been politically difficult given this commitment to breadth of coverage.

- *Why unilateralism in trade reform?* Partly it was because border policy was just another interventionist instrument to be liberalised in keeping with the general reformist philosophy. Partly it was in the interests of speed. Partly, however, it was because of an explicit recognition by policy advisers (i.e. Treasury officials) that NZ is too small in international markets and policy fora to rely on multilateral bargaining as an effective means of liberalisation. Also, we have argued that unilateralism was important – even essential – in giving credibility to competition policy reforms by the very fact that the trade reforms were both extensive and not dependent on international negotiations.
- *Why has liberalisation not been complete (especially as it has been so dramatic: one might think that the final steps would be easier in some sense)?* Because of the social policy aspect of trade policy in textiles and autos and because of efforts by recent governments to "distinguish" their reforms from those of previous policy-makers as driven by practicality, not ideology.
- *How important were multilateral and bilateral deals in affecting New Zealand's unilateral reforms?* Of limited importance in the sense that NZ was committed to unilateral reforms anyway and CER was incidental to these. However, the market access consequences of CER may have affected the sustainability of the reforms in contributing towards an increase in manufactured exports and thereby to the

commitment of manufacturers to the reforms. Further, the existence and extent of CER reduced the costs of unilateralism by "removing" the only significant trading partner country against which NZ had any bargaining power.

- *How, if at all, has New Zealand's multilateral position been affected by these reforms?* It is our perception that it has been almost totally unaffected. New Zealand is still committed to multilateral fora, particularly APEC, and the loss of "bargaining chips" through unilateral reforms is insignificant, given New Zealand's size. Furthermore, the reforms have enabled New Zealand negotiators to take the "moral high ground" in bilateral and multilateral negotiations.

References

Anderson, James E., 1996, "Effective Protection Redux", NBER Working Paper 5854. Cambridge, MA.

Bhagwati, Jagdish, 1988, Protectionism, MIT Press, Cambridge, MA.

Bollard, Alan, 1992, New Zealand: economic reforms 1984-1991, International Center for Economic Growth, San Francisco, CA.

Bollard, Alan, 1994, New Zealand. In John Williamson (ed.), The political economy of policy reform. Institute for International Economics, Washington DC.

Chiao, Y-S. and G. Scobie, 1990, The cost to agriculture of import protection in NZ. Working Paper No. 90/2, Department of Economics, University of Waikato, Hamilton NZ.

Clerides, S., S. Lach and J. Tybout, 1996, Is "learning-by-exporting" important? Mimeo, World Bank, Washington DC.

Coates, D. and R. Ludema, 1996, Unilateral tariff reduction as leadership in trade negotiations. Mimeo, Georgetown University, Washington DC.

Colgate, P., 1995, Trade in manufactured goods. NZIER Working Paper 95/12, NZ Institute of Economic Research, Wellington.

Dixon, P., B.R. Parmenter, J. Sutton, and D.P. Vincent, 1982, ORANI; A Multisectoral Model of the Australian Economy, North Holland, Amsterdam.

Douglas, Roger, Unfinished Business, Random House NZ Ltd., Auckland.

Duncan, I., R. Lattimore and A. Bollard, 1992, Dismantling the barriers: tariff policy in New Zealand, NZIER Research Monograph #57, NZIER, Wellington.

Economic Summit Conference, 1984, Proceedings and Conference Papers, Government Printer, Wellington.

The Economist, 1996, October 19. London

Ethier, W. J., 1977, The theory of effective protection in general equilibrium, effective-rate analogues of nominal rates. Canadian Journal of Economics.

Evans, L. and Morgan, G., 1983, "The User Cost of Capital and its Application to New Zealand Agriculture," New Zealand Economic Papers 17, 17-24.

Evans, L., A. Grimes and B. Wilkinson with D. Teece, 1996, New Zealand's economic reforms: 1984-95. Victoria Economic Commentaries 1:1996, Victoria University of Wellington, Wellington.

Gibson, J. and R. Lattimore, 1991, Causes of the pattern of manufacturing industry assistance in NZ, 1981/82. New Zealand Economic Papers 25 (1), 100-122

Gibson, J. and R. Harris, 1996, Trade liberalisation and plant exit in NZ manufacturing. Review of Economics and Statistics, forthcoming.

Grossman, G. and E. Helpman, 1994, Protection for sale. American Economic Review 84, 833-850.

Hazledine, T. and A. Murphy, 1996, Manufacturing Industries. In A. Bollard, R. Lattimore and B. Silverstone (eds.) A study of economic reform: the case of New Zealand, North-Holland, Amsterdam.

Henderson, David, 1996, Economic Reform: New Zealand in an International Perspective, NZ Business Roundtable, Wellington.

Kelsey, J., 1995, The New Zealand experiment: a world model for structural adjustment?, Auckland University Press and Bridget Williams Books, Auckland.

Lattimore, R. and P. McKeown, 1995, NZ's international trade performance pre and post deregulation: 1970-1985 and 1985-1993. AERU Research Report No. 231, Lincoln University, Canterbury NZ.

Lattimore, R. and P. Wooding, 1996, International Trade. In A. Bollard, R. Lattimore and B. Silverstone (eds.) A study of economic reform: the case of New Zealand, North-Holland, Amsterdam.

Levinsohn, James, 1996, Firm heterogeneity, jobs, and international trade: evidence from Chile. Mimeo, Department of Economics, University of Michigan, Ann Arbor, MI.

Lloyd, P. J., 1995, The future of trans-Tasman Closer Economic Relations. Agenda 2#3, 267-280.

Lloyd, P., 1996, Unilateral and regional trade policies of the CER countries, paper presented to IEA Roundtable Conference on International Trade Policy and the Pacific Rim, July 1996, Sydney.

Malcolm, G., 1993, Business dynamics in NZ 1987-1991: entry, growth and decline in the business sector. NZIER Research Monograph 61, New Zealand Institute for Economic Research, Wellington NZ.

Ministry of Commerce, 1994, Review of post-1996 Tariff Policy, Wellington.

National Development Conference, 1969, Second Plenary Session proceedings, Government Printer, Wellington.

National Development Conference, 1969, Report of the Working Party on Industrial Policy, Manufacturing Committee, NDC 4/1 Manufacturing, Government Printer, Wellington.

National Development Conference, 1969, Overseas Markets and Exporting Committee, NDC 13 Markets, Government Printer, Wellington.

National Development Council, 1972, Report of the Committee on Industrial Policy: Review of Recommendation 209A, Government Printer, Wellington.

New Zealand Planning Council, 1978, "New Zealand's Economic Trends and Policies" Report No. 1 of the Economic Monitoring Group of the NZPC, Wellington.

New Zealand Treasury, 1984, Economic Management, NZ Treasury, Wellington.

New Zealand Treasury, 1996, New Zealand: Economic and Financial Overview, NZ Treasury, Wellington.

OECD, 1989, OECD economic surveys: New Zealand 1988/89, OECD, Paris.

OECD, 1996, OECD economic surveys: New Zealand 1996, OECD, Paris.

Olson, Mancur, 1987, Economic nationalism and economic progress. The World Economy 10 (3) 241-264.

Pickford, Michael, 1987a, Measuring the welfare effects of the tariff cuts of 19th December 1985, New Zealand Economic Papers 21, 75-82.

Pickford, Michael, 1987b, Industry inefficiency, monopoly and import liberalization in New Zealand – an assessment of the static welfare effects. Economic Record 63, 162-74.

Rayner, A. and R. Lattimore, New Zealand, in Papageorgiu, D., M. Michaely and A. Choksi (eds.), 1991, Liberalizing foreign trade Vol. 6, Blackwell.

Richardson, M., 1993, Endogenous protection and trade diversion. Journal of International Economics 34, 309-324.

Roberts, Mark, Theresa Sullivan and Jim Tybout, 1996, Micro-foundations of export booms. Mimeo, World Bank, Washington DC.

SONZA, 1997, Situation and Outlook for New Zealand Agriculture, New Zealand Ministry of Agriculture, Wellington.

Statistics New Zealand, 1996, The New Zealand Official Yearbook, Wellington.

Syntec Economic Services, 1984, The structure of industry assistance in New Zealand: an exploratory analysis. Study commissioned by NZ Government.

United States Trade Representative, 1997, 1997 National Trade Estimate Report on Foreign Trade Barriers, United States Trade Representative, Washington D.C.

Vautier, Kerrin M. and Peter J. Lloyd, 1997, International Trade and Competition Policy: CER, APEC and the WTO, Institute of Policy Studies, Wellington.

Wallis, Joseph L., 1997, Policy conspiracies and economic reform programs in advanced industrial democracies: the case of New Zealand. UNE Working Papers in Economics No. 38, University of New England, Armidale.

Wells, Graeme, and Brian Easton, 1986, Economy Wide Models of New Zealand, New Zealand Institute of Economic Research, Wellington.

Wooding, Paul, 1987, "Liberalising the International Trade Regime", Ch.5 of Economic Liberalisation in New Zealand, Alan Bollard and Robert Buckle (eds.), Allen and Unwin.

World Trade Organization, 1996, Trade Policy Review report on New Zealand, WTO, Geneva.

	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Trade	CER	SMPs abolished		5% across-the-board tariff cut	Tariff Working Party Export subsidies cease			Full CER FTA						
			Import licensing removed											
		Tariff reductions												
Other goods market		Price freeze lifted		Commerce Act										
		Agricultural subsidies removed												
Financial markets	20% devaluation	NZ$ floated												
Monetary policy							Reserve Bank Act							
Public sector				GST					Social welfare cuts		Fiscal Responsibility Act			
				Privatisations										
				Corporatisations							Health reforms			
Labour markets			Wage freeze lifted					Employment Contracts Act						
Political														PR introduced

Table 1: a simplified chronology of reforms

Tariff in 1996	Tariff in 2000
Under 15%	5%*
15% to 20%	10%
Over 20%	15%**

* except for motor vehicle components which will only fall to 10%.

** Auto tariffs will be 15% in July 2000 but cut to 0% in December 2000

Table 2: Tariff reform schedule 1996-2000

Source: Ministry of Commerce.

	Year	Primary food processing	Textiles	Wood products	Paper products	Chemical	Basic metals
Large firms	**1982**	88.2	41.5	12.2	17	16.4	39.9
	1994	65.2	53.2	26.6	16.8	18.1	75
Small and medium firms	**1982**	19	16.2	5.5	7.3	30.2	11.5
	1994	25.4	31.3	5.4	16.7	34.7	22.4

Table 3: Exports as % of total sales by value

Source: Colgate (1995) pp.4-5.

1/1/89	**1/1/90**	**1/7/93**	**1/7/94**	**1/7/95**	**1/7/96**	**1/7/97**	**1/7/98**	**1/7/99**	**1/7/00**	**1/12/00**
45%	35%	32.5%	30%	27.5%	25%	22.5%	20%	17.5%	15%	0%

Table 4: Nominal tariff on new autos
Source: Border, Industry and Environmental Policy group, Ministry of Commerce

	Nominal tariff on new imports	Used imports	New imports	NZ sales of new cars	NZ production of cars
1988	50%	21,325	11,875	71,372	49,473
1996	25%	117,025	42,860	65,065	29,727

Table 5: Some auto industry data

Industry	Rent (return to capital) $m	% of total	Capital Stock $m	% of total	Gross Output $m	% of total	GDP $m	% of total	Employment 000 FTEs	% of total	DERP %	ERP %
Agriculture	1479	4.52	32625	9.55	9081	5.96	4142	5.65	123.5	9.58	0.62	-0.47
Fishing	83	0.25	536	0.16	586	0.38	214	0.29	4.3	0.33	4.68	-3.88
Forestry/Logging	1538	4.70	1308	0.38	2380	1.56	1652	2.25	6.4	0.50	5.51	-0.57
Mining	555	1.69	4737	1.39	1392	0.91	844	1.15	5.5	0.43	-7.16	-0.63
Food/Bev./Tob.	1085	3.31	10918	3.20	12856	8.43	3694	5.04	58.3	4.52	0.76	19.51
Textiles	133	0.41	2363	0.69	2799	1.84	773	1.05	31.6	2.45	36.58	47.15
Wood&Products	349	1.07	2266	0.66	2087	1.37	821	1.12	17.7	1.38	2.47	9.76
Paper	720	2.20	5914	1.73	4635	3.04	1814	2.47	32.5	2.52	3.09	7.46
Chemicals	761	2.33	7516	2.20	4231	2.78	1492	2.04	19.4	1.50	8.02	13.19
Non-metallics	104	0.32	1454	0.43	1180	0.77	356	0.49	7.0	0.54	-2.53	13.78
Basic Metals	167	0.51	4039	1.18	1903	1.25	457	0.62	7.5	0.58	6.81	5.27
Fab. Metals	680	2.08	6055	1.77	7876	5.17	2410	3.29	65.3	5.06	12.18	21.65
Other Manuf.	32	0.10	329	0.10	291	0.19	94	0.13	3.6	0.28	-2.53	35.56
Ele/Wtr/Gas	1471	4.49	29996	8.78	4276	2.81	2027	2.76	12.0	0.93	2.93	-0.50
Buildings	946	2.89	4186	1.23	11976	7.86	3136	4.28	91.5	7.10	3.39	-8.75
Trade & Hotels	3750	11.45	21538	6.31	25796	16.92	10835	14.78	241.9	18.75	2.44	-3.22
Transport	1076	3.29	18597	5.45	7226	4.74	3440	4.69	59.0	4.57	6.95	-2.08
Communications	1009	3.08	6941	2.03	3014	1.98	2233	3.05	33.5	2.60	-	-0.67
Finance	5180	15.82	28410	8.32	16910	11.09	10146	13.84	131.7	10.20	0.27	-0.65
Own Dwellings	4312	13.17	90288	26.44	6783	4.45	5048	6.89	0.0	0.00	5.03	-0.63
Private Services	868	2.65	4509	1.32	5706	3.74	2851	3.89	98.1	7.60	5.61	-2.72
Public Services	6447	19.69	56951	16.68	19454	12.76	14820	20.22	239.8	18.59	5.73	-0.60
TOTAL	32746	100.00	341476	100.00	152438	100.00	73298	100.00	1290.2	100.00		

Table 6: 1990 Input-output base data: DERP and ERP

Table 6: 1990 Input-output base data: DERP and ERP