Strengthening trans-Tasman economic relations

A JOINT STUDY · DISCUSSION DRAFT · September 2012

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Australian Productivity Commission

The Australian Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies in the long term interest of the Australian community. www.pc.gov.au

New Zealand Productivity Commission

The New Zealand Productivity Commission was established in April 2011 and is an independent crown entity with a dedicated focus on productivity. The Commission carries out in-depth analysis and research on inquiry topics selected by the Government with the aim of providing independent, well-informed and accessible advice that leads to the best possible improvement in the wellbeing of New Zealanders. www.productivity.govt.nz

Opportunity for further comment

You are invited to examine this discussion draft and provide written comment to the Commissions. For further information see 'Make a submission' on the joint website listed below.

Written comments should reach the Commissions by Thursday, 18 October 2012.

The final report will be prepared after comments have been received and discussions with interested parties have been held.

Website

www.transtasman-review.pc.gov.au

www.transtasman-review.productivity.govt.nz

Commissioners

For the purposes of this study and discussion draft, the Commissioners are:

Gary Banks AO	Chairman, Australian Productivity Commission
Murray Sherwin CNZM	Chair, New Zealand Productivity Commission
Jonathan Coppel	Australian Productivity Commission
Dr Graham Scott	New Zealand Productivity Commission

Terms of reference

Impacts and Benefits of Further Economic Integration of the Australian and New Zealand Economies — Joint Scoping Study by the Productivity Commissions of Australia and New Zealand

Purpose of the study:

The Governments of Australia and New Zealand are firmly committed to strong economic relations between Australia and New Zealand, including boosting productivity through reducing the regulatory burden on business, increasing competition and encouraging closer economic cooperation, and to strengthening those relations further. The two countries have a long history of working together through the *Australia New Zealand Closer Economic Relations Trade Agreement* which first came into effect on 1 January 1983 and has involved successive rounds of integration of the Australia and New Zealand economies. This has been highly beneficial to both countries.

At their annual leaders meeting, the Prime Ministers of Australia and New Zealand agreed that, to promote further reform and economic integration, the Productivity Commissions of each country would conduct a joint study on the options for further reforms that would enhance increased economic integration and improve economic outcomes. The Commissions' final report should be completed by 1 December 2012 in order to inform the next meeting of leaders, expected to take place in early 2013.

With 2013 marking 30 years of the operation of the Closer Economic Relations Trade Agreement, the Commissions' report will help advise the Australian and New Zealand Governments on next steps in economic integration.

The report should identify specific areas for further potential reform, the ways in which they might be best achieved, the likely impacts of potential reforms, any significant transition and adjustment costs that could be incurred and the time scale over which impacts are likely to accrue.

Scope of report

The Commissions' report to leaders should provide analysis on:

- potential areas of further economic reform and integration, including identification of the areas of reform where benefits are likely to be most significant, with particular focus on critical issues for business like investment and productivity
- the economic impacts and benefits of reform
- any significant transition and adjustment costs that could be incurred
- identification of reform where joint net benefits are highest
- the means by which they might be best actioned
- the likely time paths over which benefits are expected to accrue.

Methodology

The Commissions should provide an explanation of the methodology and assumptions used in its analysis. The Commissions should also provide guidance concerning the sensitivity of results to the assumptions used and bring to leaders' attention any limitations or weaknesses in approaches to reform evaluation.

Consultation and timing

In the course of preparing the report, the Commissions should consult and hold public hearings as appropriate. While these consultations would inform the Commissions' assessment, responsibility for the final report would rest with the two Productivity Commissions.

The Commissions should produce both a draft and a final report. The Commissions' final report should be submitted to leaders, through the Treasurer of Australia and the Minister of Finance of New Zealand, by 1 December 2012. The reports will be published.

Contents

Additional material referred to in the chapters but not reproduced in this report will become available on the joint study website:

www.transtasman-review.pc.gov.au

www.transtasman-review.productivity.govt.nz

Draft supplementary papers:

A: Trade in goods

B: Transport services

C: Foreign direct investment

D: Cross border movement of people

E: Economy-wide modelling of economic integration

Abbreviations

AANZFTA	ASEAN-Australia-New Zealand Free Trade Agreement
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACTU	Australian Council of Trade Unions
ANZCERTA	Australia New Zealand Closer Economic Relations Trade Agreement
ANZEA	Australia New Zealand Economic Analysis model
ANZLF	Australia New Zealand Leadership Forum
ANZSOG	Australia and New Zealand School of Government
ANZTPA	Australia New Zealand Therapeutic Products Agency
APRA	Australian Prudential Regulation Authority
ASA	Air Services Agreement
ASEAN	Association of Southeast Asian Nations
ASIC	Australian Securities and Investments Commission
BIE	Bureau of Industry Economics
BITRE	Bureau of Infrastructure, Transport and Regional Economics
CER	Closer Economic Relations
COAG	Council of Australian Governments
EU	European Union
FDI	Foreign Direct Investment
FSANZ	Food Standards Australia New Zealand
GDP	Gross Domestic Product
GTAP	Global Trade Analysis Project model
IAC	Industries Assistance Commission
IC	Industry Commission
JAS-ANZ	Joint Accreditation System of Australia-New Zealand

MFN	Most Favoured Nation
NZCC	New Zealand Commerce Commission
NZCTU	New Zealand Council of Trade Unions
NZ PC	New Zealand Productivity Commission
NZS	New Zealand Superannuation
OECD	Organisation for Economic Cooperation and Development
PC	(Australian) Productivity Commission
PMC	Passenger Movement Charge
PTA	Preferential Trade Agreement
RBA	Reserve Bank of Australia
RBNZ	Reserve Bank of New Zealand
RIA	Regulatory Impact Assessment
RoO	Rules of Origin
SAM	Single Aviation Market
SCV	Special Category Visa
SEM	Single Economic Market
TCF	Textiles, Clothing and Footwear
TTCBS	Trans-Tasman Council on Banking Supervision
TTMRA	Trans-Tasman Mutual Recognition Arrangement
TTOIG	Trans-Tasman Outcomes Implementation Group
TTTA	Trans-Tasman Travel Arrangement
WTO	World Trade Organisation

Glossary

Agglomeration economies	A decrease in costs arising from the co-location of firms and/or people. For example both employers and labour benefit from markets with more potential employees and jobs. Cities form and grow to exploit economies of agglomeration.
Air service agreement (ASA)	An agreement between governments regulating international air services between the two countries. The agreement sets out the terms and conditions under which airlines can fly.
Airline designation	An airline is designated under an air services agreement if it meets certain provisions intended to restrict the benefits of the agreement to the airlines of the signatory countries.
At the border barriers	Measures that create transaction costs at the border. These commonly include tariffs, customs duties, biosecurity measures, and taxes and other levies on goods.
Australia New Zealand Economic Analysis (ANZEA) model	A global general equilibrium model derived from the GTAP model (see below) and database. It is simpler than the GTAP model. It is used to illustrate the economic implications (such as changes in prices, output and economic welfare) of integration.
Behind the border barriers	Barriers to trade that operate inside a country, including: costs of complying with domestic regulation such as labelling requirements; or restrictions on foreign companies' operations and investment.
Benchmarking	Identification and analysis of policies and processes that are leading practice in order for jurisdictions or organisations to learn from one another.
Between the border barriers	Barriers that increase the transaction costs necessary for moving a good or service between two particular borders. These barriers relate mostly to transport costs and may

	include regulations that protect shipping or air services from competition.
Cabotage	In the context of air services and shipping, cabotage refers to the reservation of a country's domestic trade — that is trade directly between domestic ports — for operators from that country.
Deadweight loss	The loss in economic efficiency (or reduced community wellbeing) caused by a distortion in the market. For example, a tax results in a deadweight loss due to a reduction in consumption and output relative to the tax-free situation.
Economies of scale	A decrease in the cost of production per unit of output as the volume of production increases.
Franked dividend	Payments by a company to shareholders on which the company has already paid tax. These payments carry imputation (also known as franking) credits.
Freedoms of the air	The basis of rights exchanged in air services negotiations, allowing designated airlines to fly to, from, beyond and between bilateral partners and other countries.
Global Trade Analysis Project (GTAP) model	A global computable general equilibrium model based on assumptions of perfect competition and constant returns to scale. The model can be used to analyse the economic effects of policy changes.
Imputation credit	A credit received by shareholders for the tax that has already been paid on their dividends by the issuing company. Also known as franking credits.
Liner shipping	A shipping service that provides carriage for general cargo, in regularly scheduled services, between specified ports. Liners typically transport goods in modular containers.
Māori terms	*Hapū*: kinship group, clan, tribe, or subtribe (section of a large kinship group). *Mana*: prestige, authority, control, power, influence, status, spiritual power, charisma; as well as jurisdiction, mandate, or freedom. *Marae*: courtyard – the open area in front of the *wharenui*

	(meeting house) where formal greetings and discussions take place. Often also used to include the complex of buildings around the *marae*. *Tino rangatiratanga*: self-determination. *Tohunga*: a skilled person, chosen expert or priest. A person chosen as a leader in a particular field. *Whānau*: extended family or family group.
Most favoured nation (MFN) status	Allows the recipient country to receive trade advantages no less than those received by the 'most favoured' trading partner. This ensures that no country receives preferential treatment.
Mutual recognition	Recognising compliance with another jurisdiction's laws or regulations. For example, under mutual recognition, if a product meets sale requirements in one jurisdiction it can be sold in the other jurisdiction without needing to meet that jurisdiction's regulatory requirements.
National treatment	Foreign goods, services and factors are granted the same treatment under government provisions as those of domestic goods, services and factors. Departures from national treatment discriminate against foreign suppliers.
Occupational licensing	A system which controls entry and standards of practice within a particular occupation to those that meet a set of requirements or guidelines.
Preferential Trade Agreement (PTA)	PTAs are agreements to lower (not necessarily eliminate) tariffs and other barriers to trade, among the countries party to the agreement. PTAs usually include clauses that affect trade in goods and services, as well as investment.
Prudential regulation	Regulation on the operations of deposit-taking institutions such as banks, superannuation funds and other financial organisations, including insurance. Prudential regulations are designed to manage risks in the financial system, including ensuring the safety of depositor funds and the stability of the financial system.
Quantitative restrictions	Limits on the physical amounts of particular commodities that can be imported by a country.

Ratemaking agreements	International liner shipping agreements that include agreement to set or manage freight rates on a route and/or to limit capacity in order to raise rates above what they would be in the absence of the agreement.
Regulatory harmonisation	Alignment of differing regulations across jurisdictions. Regulatory harmonisation does not necessarily mean regulations need to be identical in each jurisdiction, but should be consistent or compatible to the extent that they do not result in barriers to trade, investment or labour mobility. Harmonisation is a more integrated method of regulatory coordination than mutual recognition, which recognises compliance across jurisdictions.
Rules of Origin (RoO)	Rules of Origin are used to define where a product was made and determine whether it qualifies for preferential treatment in the context of a PTA.
Sensitive land	Land of a particular type, such as farm land, that exceeds a particular area threshold, as detailed in New Zealand's *Overseas Investment Act 2005*.
Seventh freedom rights	The right given to a designated airline to carry freight and passengers between two countries by an airline of a third country on a route with no connection in its home country.
Trade creation	A trade increase between partners in a PTA as a result of a preferential lowering of trade barriers.
Trade diversion	A decrease in imports between a PTA partner and third countries. This occurs when a tariff preference induces a PTA country to shift imports from a low cost third country supplier to a higher cost supplier from its PTA partner.
Transaction costs	The costs involved in exchange, such as transport costs, taxes, costs of regulatory compliance, and administrative costs.

Overview

Key points

- The Australian and New Zealand economies have become closely integrated in many areas, beyond what would seem possible with any third country. This has been facilitated by institutional, legal and cultural similarities, as well as geographic proximity.
- Closer Economic Relations (CER) initiatives have contributed significantly to trans-Tasman integration over the past 30 years. Tariffs and quantitative restrictions have been eliminated on virtually all goods traded between the two countries; people move freely between them; and the CER agenda has expanded into new areas, such as services trade and behind-the-border regulatory barriers.
- The Commissions' assessment is that CER has produced benefits overall for Australia and New Zealand, notwithstanding limitations in the empirical evidence.
- While much has been achieved, barriers to further integration remain and new issues will emerge. Addressing them is becoming more challenging, however, as the focus shifts to more complex areas, including many involving the regulation of services.
- To ensure that integration policies make the biggest contribution to both economies, future CER initiatives should continue to be: outward looking; take account of linkages with other agreements; and complement domestic policy improvement.
- A 'direction of travel' has been characterised by Prime Ministers in terms of a seamless market in which people and businesses can have a 'domestic-like' experience in either country.
  - How far Australia and New Zealand go in this direction should emerge from good public policy processes focused on the achievement of net benefits along the way.
- This scoping study identifies some 20 policy initiatives to promote integration that could yield joint net benefits.
  - Most of these address regulatory barriers to services trade and commercial presence, and some remaining impediments to integration in goods, capital and labour markets.
  - There is also some untapped potential for each government to cooperate with and learn from the other in policy development and service delivery.
- Current governance approaches for CER are informal and flexible, and they appear to have been reasonably effective thus far. With a view to the challenges of the future agenda, this scoping study identifies some opportunities for improvement.
- A number of the policy areas potentially yielding joint net benefits will require more detailed consideration, including after the study is completed.

Overview

Next year marks the 30th anniversary of the historic Closer Economic Relations (CER) agreement between Australia and New Zealand. The close relationship between the two countries goes back much further, with people moving freely across the Tasman since colonial times. Integration has increased over the past three decades, with trade, investment and people movements yielding benefits for both countries.

With some 480 000 New Zealand-born people now living in Australia and around 65 000 Australian-born people living in New Zealand, personal ties are extensive and deep. Commercially, Australia is New Zealand's largest export market and more than half of its foreign direct investment comes from Australia. As Australia's economy is over seven times the size of New Zealand's, the commercial significance of New Zealand for Australia is smaller but nonetheless important. New Zealand is a major market for Australia's manufactured exports and Australians held investments in New Zealand worth around A$74 billion in 2010. The two countries have similar political, legal and economic institutions, as well as language and culture, leading to a relationship that the two Prime Ministers have recently described as being 'like no other' (Key 2011) and as 'family' (Gillard 2011a).

Against this backdrop, in March the Prime Ministers requested that the two Productivity Commissions jointly conduct a 'scoping study' to identify further initiatives to strengthen the trans-Tasman economic relationship and improve economic outcomes for both countries. The Commissions were asked to identify reforms where joint net benefits would be highest and how they might best be actioned, noting any significant transition and adjustment costs that could be incurred.

Given that this is a scoping study, the Commissions have looked into a wide range of issues, which has inevitably limited the depth of analysis in some. As a result, a number of areas will need more detailed consideration. At this point, all the findings in this discussion draft are preliminary and will be refined or amended in the light of public feedback.

What has been achieved?

The genesis of the CER goes back to a meeting of Prime Ministers Fraser and Muldoon in Wellington in 1980, when it was agreed that, as the Australian Prime Minister expressed it:

> If the two countries can cooperate more closely in their own trading relationship, with each concentrating on what it can do best, it will help both countries to grow stronger and to compete in wider markets. We agreed in Wellington that any closer economic relationship must be outward-looking…

The early years of CER saw major changes. Notably, tariffs and quantitative restrictions on virtually all goods traded between the two countries were eliminated by 1990, five years ahead of schedule. The CER agenda was then extended from its initial focus on merchandise trade to cover trade in services, as well as business regulation, taxation and government procurement. Provision was also made for greater cooperation between government agencies and engagement of New Zealand officials in meetings of the Council of Australian Governments (COAG). By 2004, these extensions were encompassed in the ambition of creating a 'single economic market' in which businesses, consumers and investors could operate 'seamlessly' across the Tasman.

In general, increased economic integration, by expanding the size of the market, enables countries to capture scale advantages and specialise in things they do relatively well. Consumers benefit from lower prices and more choice, as lower priced imports take the place of more costly domestically-produced goods and services within more competitive market settings. There is also increased transfer of knowledge. Wider labour mobility opens up opportunities for people to develop and apply their skills and earn higher rewards for their efforts, and can facilitate adjustment to structural shocks and cyclical developments.

Promoting integration between two economies, however, may come at the expense of exchange and integration with other countries. For example, recent empirical studies indicate that the CER has resulted in 'trade diversion' — the switching of imports from lower-cost third country suppliers. However, the analysis is not definitive, and any such diversion effects are likely to have been largely eliminated by general tariff reductions, such that little preferential margin remains.

Further, CER appears to have helped to change opinions about trade protection for manufacturing and thereby paved the way for unilateral reductions in tariffs generally, particularly in New Zealand. In this way, CER bilateral trade arrangements, unlike many other preferential agreements, may have acted more

as a ‘building block’ than ‘stumbling block’ in the pursuit of wider reform and economic integration.

Overall, there is sufficient evidence to conclude that CER has produced benefits for both Australia and New Zealand, even though there is uncertainty about the magnitudes.

Key themes in further integration

‘Closer’, but still politically separate

Geographic proximity and commonalities between the two countries have enabled governments to pursue forms and areas of economic integration beyond what would seem possible with any third country. However, the steps along the way have been taken on the basis of an understanding of the national interests of both countries. After all, Australia and New Zealand are separate countries: political union is clearly not a live option and this in turn rules out some higher forms of integration. In particular, proposals for a monetary union would take integration to the point where it started to generate net costs. Following the recent euro area experience, such proposals have little support today.

The political autonomy of the two countries has implications for the way the Commissions have interpreted ‘joint net benefits’. Policy initiatives are supported that would provide net benefits overall, and for each country separately. In cases where a policy initiative would provide net benefits in aggregate, but would also likely involve a net cost for one country, the Commissions will merely report the results, for possible consideration by governments as part of a wider package of actions.

Deeper integration requires careful assessment

Implementing agreements to reduce barriers ‘behind the border’ — typically regulatory in nature — is more complicated than reducing tariffs and other barriers to merchandise trade. In some cases, work programs have taken many years. For example, the first consultation paper on the idea of establishing a joint therapeutic products agency was released in 2000, yet the new agency itself is not due to be operational until 2016. In other areas — such as a mooted merger of stock exchanges and the integration of banking supervision and competition policy regimes — deeper integration has not been achieved.

In contrast, for some areas such as in business law reform, there is an ambitious agenda and progress has been made. Some existing initiatives may also need to be revisited as circumstances change. However, as advances are made, new integration opportunities have become less obvious, and judgments will require well executed public policy analysis.

The 'direction of travel' matters more than the destination

The benefits and costs of policy initiatives for integration will alter as technology, preferences and a host of other factors change. This means that the end point — in terms of the extent of bilateral economic integration that provides the largest net benefits — cannot be specified in advance. It will evolve with changing circumstances. It can be thought of as a moving target and one that should naturally emerge from good public policy processes focused on the achievement of net benefits.

A broad indication of the 'direction of travel' for integration has nevertheless been offered by a number of principles endorsed by Prime Ministers in 2009. While the principles were developed mainly in the context of integrating business regulation, the Commissions consider they are also useful for shaping the economic relationship more broadly. They point to a single economic market characterised by features such as:

- substantively the same regulatory outcomes in both countries achieved in the most efficient manner
- regulated occupations operating seamlessly between each country
- both governments seeking to achieve economies of scale in regulatory design and implementation
- products or services supplied in one jurisdiction being able to be supplied in the other.

Importantly, the Prime Ministers specified that in moving towards a single economic market, policy initiatives along the way would need to pass a cost–benefit test.

The bigger regional picture is important

It is important that CER remain outward-oriented, and not become too narrowly focused on the bilateral relationship. The risk of this was recognised by the original

architects of CER. It was understood that bilateral agreements should not get in the way of either country securing beneficial wider integration opportunities.

Multilateral efforts to promote trade liberalisation have lost momentum, which has reinforced the need to consider trans-Tasman integration in a regional as well as global context. That means generally avoiding actions that would impede trade or investment with other countries and extending trans-Tasman initiatives to reap further gains from broader integration through regional and multilateral fora.

Looking ahead, the trans-Tasman economic agenda needs to provide a good 'fit' with the broader challenges and opportunities presented by the 'Asian century' in particular. Asia accounts for one third of global GDP, double what it was 50 years ago. This shift in the locus of economic activity globally is expected to continue. The rise of Asia presents important opportunities for both countries — with benefits that potentially greatly outweigh those on offer through further trans-Tasman integration, significant though these may be. The best way for the two governments to position their economies to benefit from the 'Asian Century' will be to enhance their productivity and competitiveness.

Domestic policy has trans-Tasman effects too

Closer economic integration is one source of productivity gains. Most gains, however, will come from domestic policy and regulatory reforms. Further policy actions by each country to increase national income can also bring benefits to the other country through trade and investment. For example, for every 1 percent expansion in Australia's economy, New Zealand's exports are estimated to increase by 0.2 percent and its economy to expand by nearly 0.1 percent.

Domestic productivity improvements that are encouraged by good policy in one economy will often place competitive pressures on the other. Greater openness to trade and in capital and labour markets by one party can expose rigidities that impede adjustment and thus put pressure on the other government to address these.

Good process matters

Advancing the integration agenda along these lines will require good policy processes — both for selecting those initiatives that are likely to generate the largest net benefits and for avoiding any that would be costly or too difficult to implement. The study sets out an approach to guide this endeavour, building on established foundations and seeking to ensure that developments in the bilateral

relationship are informed by the needs and constraints of each country in a wider regional setting.

In order to make the biggest contribution to both economies, CER initiatives should: continue to be outward looking; not impede opportunities for profitable exchange with other trading partners; take account of linkages with other agreements; and complement initiatives to enhance domestic policy. Analysis of integration policy initiatives need to take into account the indirect as well as direct costs and benefits, be proportionate to the importance of the issue being addressed, and be publicly available.

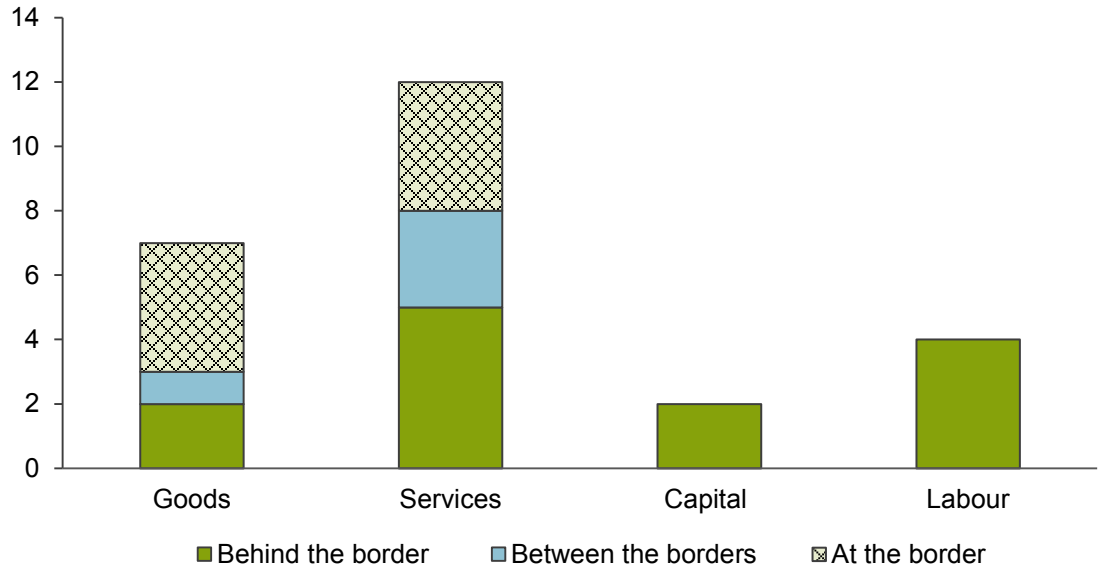
Scoping the future CER agenda

In canvassing potential opportunities to strengthen trans-Tasman economic ties, the study employs a framework based on what the European Union has termed the 'four freedoms' — relating to trade in goods and services, and in the movement of capital and labour. This framework can be extended to also encompass knowledge transfers and the integration or interaction of government functions.

Government policy can hinder or facilitate a closer economic relationship between Australia and New Zealand. The study focuses on areas where there are unnecessary impediments to integration — created either intentionally or unintentionally. They may arise between the borders of Australia and New Zealand (typically affecting international transport costs); at the border of one or both countries (for example, tariffs and quarantine restrictions); and behind their borders.

The last category refers to situations where countries take different approaches to domestic regulations which may add to the cost of doing business across the countries. Often, this arises because foreign providers are not afforded national treatment; that is, they are not treated as if they were domestic firms. The figure shows that, of the 20 areas and issues that the study has focused on, most involve impediments to trade in services. Regulations behind the border — particularly the absence of national treatment — loom particularly large.

Figure 1 **Where are the areas for reform?[a]**



[a] Areas substantially affected by the draft recommendations identified in chapter 4. Some recommendations are likely to affect more than one area.

The Commissions' proposals fall into three categories: 'unfinished business', to which both Governments have committed and which should be completed as soon as possible; potentially worthwhile new CER initiatives on the basis of available evidence; and some areas that warrant further, more detailed investigation.

The tables at the end of this overview list the Commissions' preliminary proposals and indicate where they are dealt with in the report. Some of the more significant proposals are presented below.

'First freedom': trade in goods

The main remaining impediment to merchandise trade between Australia and New Zealand is the cost of CER 'rules of origin'. Waiving these for all items for which tariffs are at 5 percent or less — where rules of origin are unnecessary — would reduce compliance and administrative costs for a significant proportion of trans-Tasman trade. Building on this reform, each country could reduce those tariffs that exceed 5 percent down to that level by, say 2015, improving the productivity performance of each economy and eliminating the need for costly rules of origin.

‘Second freedom’: trade in services

Reducing transport and telecommunication costs would facilitate trade across the Tasman. While the trans-Tasman air route is already quite competitive, two remaining regulatory barriers to competition could usefully be removed. In relation to shipping, ocean carriers’ exemptions from key parts of competition regulation are no longer necessary and there would be gains from removing them. In regulating coastal shipping, Australia has followed a different path to New Zealand. A future review of the changes to Australia’s coastal shipping regulation should learn from the New Zealand experience in assessing what is in the best interests of the Australian economy.

In telecommunications, any move towards a more integrated market raises complicated issues. While the regulatory frameworks across the Tasman seem reasonably aligned, there are some significant differences in places that require closer examination. The two governments have announced that they will respond to the findings of a joint departmental investigation into options to reduce trans-Tasman roaming charges.

‘Third freedom’: capital flows

The three main areas of interest here are foreign direct investment (FDI), taxation and banking.

The two Governments should proceed to implement the investment protocol they signed last year which increased the thresholds for screening of trans-Tasman investment. There would be mutual benefits from extending this protocol to lessen the remaining ownership restrictions in ‘sensitive’ areas, given the closeness of the two countries.

An issue of greater concern to most business participants is that companies are not allowed imputation credits on trans-Tasman investment, so that company income is taxed twice if it crosses the Tasman. The fact that this has been debated for more than 20 years, however, is a sign of the complexities and judgments involved in addressing the matter. Mutual recognition of imputation credits could expand investment across the Tasman and bring some efficiency gains. But this would involve sizeable fiscal losses as well as transfers of income between the two countries, which may or may not cancel out. This draft highlights the key determinants of these calculations, on which public comment will be sought.

In relation to banking, the two countries have adopted different approaches to prudential supervision. This is an area of regulation that is evolving rapidly, with an existing trans-Tasman forum well placed to assess integration opportunities.

'Fourth freedom': people movements

There are opportunities to reduce the costs and complications of (short term) trans-Tasman travel through wider implementation of SmartGate arrangements at the border, and development of a trans-Tasman tourist visa for foreigners visiting both countries.

In relation to the long-term movement of people, issues arise because while the two countries have long permitted virtually free movement across the Tasman, social security and tax systems can create incentives that distort migration choices. Current provisions to deal with these possibilities have placed some 'trans-Tasman citizens' in anomalous situations. The study contains some ideas for ameliorating this situation, but information gaps and the complexities and interconnections with wider national policy issues to do with migration and citizenship, mean that a more detailed assessment is needed.

Government services and benchmarking

There is considerable cooperation between the public sectors in Australia and New Zealand. This has developed organically as opportunities have emerged, and can improve regulatory outcomes and reduce the cost of providing government services. The two governments should ensure that government agencies consider opportunities for additional cooperation on a case-by-case basis. Additional use of performance benchmarking could identify scope for improved service delivery and enhance diffusion of best practice across the Tasman.

Making it happen

The areas identified for further policy action vary in their relative significance, complexity and timescales (see summary list in tables below). All proposals are preliminary at this stage and some will in any case require more in-depth examination than is practical in a scoping study. Assessing priorities and sequencing policy actions will be important to the ultimate outcomes. The Commissions' final report should assist governments in these respects, but effective ongoing 'management' of the agenda will be crucial.

Current governance approaches for CER are informal and flexible, and they appear to have been reasonably effective thus far. With a view to the challenges of the future agenda, however, there are opportunities for improvements through:

- clearer leadership and oversight arrangements
- requiring new regulatory proposals to account for trans-Tasman implications, where relevant
- arrangements to facilitate more joint action in the quest for greater and better regional and multilateral integration
- formal five-yearly public reviews of CER's direction and achievements.

Next steps

The preliminary recommendations and findings in this 'discussion draft' are being made available to interested parties and the general public for consideration and response. Further submissions are welcomed, and roundtables and other consultations will be held in coming weeks. The Commissions' final report will be submitted to the two Prime Ministers by 1 December and will inform the leaders' meeting scheduled for early 2013.

Table 1 **'Unfinished business'**

	Proposed initiative	*Rationale*	*Potential joint net benefits*	*Time scale for implementation*
DR 4.1	Complete identified business law initiatives	Parts of the business law reform program are behind schedule. Delivering the program on time will reduce compliance costs, deepen markets and increase competition.	**	Short term
DR 4.2	Share knowledge and lessons in developing efficient and effective occupational licensing systems	This would encourage occupational licensing systems that facilitate the efficient movement of labour within and across the two countries.	**	Short term
DR 4.3	Implement the trans-Tasman agreement on portability of retirement savings	Trans-Tasman portability of retirement savings may increase labour mobility and strengthen New Zealand's KiwiSaver scheme.	*	Short term
DR 4.4	Advance the Australia New Zealand Therapeutic Products Agency and review lessons from this experience	A single trans-Tasman regulator could reduce costs of regulation and increase technical capability. It would also provide useful lessons for other areas of potential harmonisation.	**	Short term
DR 4.5	Implement the CER Investment Protocol as soon as practicable	The Protocol has been signed but not enacted. It should serve to reduce administrative costs for government and compliance costs for firms, and improve capital allocation.	*	Short term

Table 2 **Proposed initiatives**

	Proposed initiative	*Rationale*	*Potential joint net benefits*	*Time scale for implementation*
		Trade in Goods		
DR 4.6	Abolish CER 'Rules of Origin' for all items with tariffs at 5 percent or less	Savings in administrative and compliance costs for government and business and improved resource allocation.	**	Short term
DR 4.6	Reduce remaining tariffs to 5 percent, which would allow CER Rules of Origin to be abolished	Improved resource allocation and lower prices for consumers.	**	Longer term
DR 4.7	Continue to develop common systems and processes for quarantine and biosecurity, where cost effective	Benefits through sharing of information and resources.	*	Ongoing

	Proposed initiative	*Rationale*	*Potential joint net benefits*	*Time scale for implementation*
		Trade in Services		
DR 4.8	Work towards removing remaining restrictions on a single trans-Tasman aviation market	Maintain competitive pressure in the trans-Tasman air services market.	*	Short term
DR 4.9	Work towards further broader liberalisation of air services policy	Enhanced competition, lower airfares, and an expanded range of services.	**	Longer term
DR 4.10	Reconfigure the Passenger Movement Charge in Australia as a genuine user charge for border services. Review border passenger charges in New Zealand	Increased transparency, and potentially more equitable.	*	Short term
DR 4.11	Remove competition exemptions for international sea freight ratemaking agreements	Increased competition and potentially lower costs for businesses, without reducing service reliability.	*	Short term
DR 4.12	Evaluate Australia's restrictions on competition in coastal shipping within a broad cost–benefit framework, and drawing on New Zealand's experience	Net benefits for the wider economy, while also helping trans-Tasman integration by reducing shipping costs.	**	Longer term
DR 4.13	Develop integrated data collection, monitoring and benchmarking of ports' performance	Identify opportunities to improve performance of ports and facilitate the diffusion of good practice.	**	Short term
		Capital Flows		
DR 4.14	Expand scope of the Investment Protocol by lessening remaining restrictions on bilateral FDI	Reduced cost and uncertainty for trans-Tasman investment, while encouraging freer capital movement.	**	Short term
		People Mobility		
DR 4.15	Progress roll out of SmartGate and associated systems where cost effective	Extending availability of SmartGate would simplify customs and immigration checks for a larger number of eligible travellers.	*	Short term

	Proposed initiative	*Rationale*	*Potential joint net benefits*	*Time scale for implementation*
DR 4.16	Scope a 'trans-Tasman tourist visa' for foreigners visiting both countries	Reduced costs for obtaining visas may encourage some foreign travellers to visit both countries on a trip.	*	Short term
DR 4.17	Make information on eligibility for social supports readily available to New Zealand citizens planning to reside in Australia	Better information would help New Zealanders contemplating a move to Australia understand the current provisions and plan accordingly.	*	Short term
DR 4.18	Finalise consideration of alternative potential pathways to Australian permanent residence and citizenship for New Zealand citizens	May help address the issues faced by a small but growing number of New Zealand citizens in relation to their access to certain welfare supports.	**	Short term
		Government Services		
DR 4.19	Ensure government agencies consider opportunities for trans-Tasman coordination on a case-by-case basis	Greater coordination may reduce costs, encourage knowledge transfer, and increase technical capability.	*	Ongoing
DR 4.20	Develop further joint performance benchmarking initiatives	Benchmarking can help identify opportunities for improvement and facilitate the diffusion of good practice.	**	Ongoing
		Governance		
DR 5.1	Establish a clearer leadership and oversight role for CER, building on existing governance arrangements and the annual meeting of Prime Ministers	Such a role would help to maintain momentum of the CER agenda, while providing greater continuity, cohesion and foresight.	**	Short term
DR 5.2	Require significant new or modified regulatory proposals to account for trans-Tasman implications, where relevant	There may be opportunities to design changes in a way that lowers transaction costs for businesses operating across the Tasman.	*	Ongoing
DR 5.3	Consider how to facilitate joint action in regional and multilateral fora	There may be cases where the two countries can exert greater leverage in international rule making and standard setting through a 'single voice'.	*	Ongoing

	Proposed initiative	*Rationale*	*Potential joint net benefits*	*Time scale for implementation*
DR 5.4	Undertake five yearly public reviews of CER	Provides an opportunity to take stock of what is achieved and learnt, and to ensure that the agenda remains relevant and forward looking.	**	Ongoing

Table 3 **Policy areas requiring further investigation**

Section	*Area*	*Issues to resolve*
4.1	Single application and examination process for patents	This should deliver cost savings. However, it could reduce access to technology in New Zealand if it increases the number of joint patents that are filed.
4.4	Trans-Tasman telecommunications market	Deficiencies or differences in regulation could reduce competition and discourage trans-Tasman commercial activity. Assessing the significance of these differences will determine whether their removal could deliver net benefits.
4.5	Mutual recognition of dividend imputation / franking credits	While this would remove the double taxation of distributed company income and associated distortions, the economy wide and distributional effects are complex and require further assessment.
4.5	Trans-Tasman money transfer fees	Lower fees would reduce business costs. The issue is whether current fees reflect costs, regulation, or market power. Analysing this issue will determine whether a policy change could deliver net benefits.
4.6	Australia's social security access limitations	Limited access to some safety net payments may be creating hardship for a small but growing number of New Zealand citizens residing in Australia. Establishing how extensive this issue is will help in developing an appropriate policy response.
4.6	New Zealand's universal flat rate age pension scheme	Return migration of New Zealand citizens and 'retirement' migration of Australian citizens may create some fiscal risks. Establishing how significant these issues are will help in developing an appropriate policy response.

1 Introduction

Australia and New Zealand have distinct national identities and physical environments. However, they are also both former British colonies, sharing much history and common endeavour. In the late 19th century they contemplated political union. While this did not eventuate, they continue to have much in common, including in culture, institutions and values. And the two countries are close geographically — Sydney being closer to Auckland than Perth. These factors have enabled them to develop a closer relationship than could be expected with any other country.

The Australian and New Zealand Governments have helped foster closer economic relations over a long period by reducing barriers to trade and investment, and facilitating free movement of people. In 1983, the Australia New Zealand Closer Economic Relations Trade Agreement (CER agreement) was signed and the economic integration agenda has continued to evolve since then. The purpose of this scoping study is to advise the Australian and New Zealand Governments on future directions and priorities for further strengthening trans-Tasman economic relations.

Key features of the Australian and New Zealand economies are outlined in table 1.1.

1.1 What have the Commissions been asked to do?

At their annual leaders' meeting in January 2012, the Prime Ministers of Australia and New Zealand agreed that the Productivity Commissions of each country would jointly conduct a scoping study on strengthening trans-Tasman economic relations. The study is to identify reforms that would boost productivity, increase competitiveness and drive deeper economic integration between the two countries. The Commissions were asked to provide analysis on:

- potential areas of further economic reform and integration, including identification of the areas of reform where benefits are likely to be most significant, with particular focus on critical issues for business, such as investment and productivity

Table 1.1 **Australia and New Zealand — country profiles**[a]

Australia		*New Zealand*	
Land area	7 692 000 km^2		268 000 km^2
Population & 3 largest cities			
Australia	22 324 000	New Zealand	4 405 000
Sydney	4 610 000	Auckland	1 377 000
Melbourne	4 170 000	Wellington	393 000
Brisbane	2 150 000	Christchurch	381 000
Political system			
Federation of states (6 states and 2 mainland territories) with the Parliament of Australia and most state parliaments being bicameral.		Unitary state with a unicameral parliament.	
Economic structure			
GDP (US$ billion)	1 486.5		161.9
GDP PPP (US$ billion):	914.5		122.2
GDP per person PPP (US$)	40 234		27 668
Contribution to GDP (%)			
Services	80		79
Manufacturing	9		14
Mining	8		1
Agriculture, forestry & fishing	3		6
Exports			
Goods & services exports (US$ billions)	324.8		46.5
Goods & services exports (% GDP)	22		29
Key goods exports (US$ billions)			
Iron ore & concentrates	66.8	Milk powder, butter & cheese	9.0
Coal	48.7	Meat	4.3
Gold	15.7	Logs, wood & wood articles	2.5
Services exports (US$ billions)	52.1		10.1
Trans-Tasman goods trade			
Trans-Tasman trade (% total trade)	3		23
Foreign direct investment (FDI)			
FDI stock in country (US$ billions)	528.0		76.2
FDI stock abroad (US$ billions)	352.7		19.5
Government sector			
Government expenditure (% GDP)	37		42

a Data are for 2011 (population data are for June 2011; FDI data are for December 2011), except for government expenditure as a proportion of GDP and trans-Tasman trade data, which are 2009 data. **GDP**: gross domestic product. **PPP** purchasing power parity.

Sources: IMF (2012); OECD (2011); RBA (2012); RBNZ (2012); UN Comtrade database (2012); various Australian Bureau of Statistics and Statistics New Zealand publications.

- the economic impacts and benefits of reform
- any significant transition and adjustment costs that could be incurred
- identification of reform where joint net benefits are highest
- the means by which reforms might be best actioned
- the likely time paths over which benefits are expected to accrue.

The terms of reference are included in the preface to this discussion draft.

The timing of the study is noteworthy in at least two respects. First, it occurs in the lead up to the 30th anniversary of the CER agreement. This anniversary provides an opportunity to take stock of what has been achieved, what remains to be done and to consider how developments in our region should influence further trans-Tasman integration. In particular, it is important to ensure that it acts as a 'building block' to broader integration in what is becoming known as the 'Asian century' (Henry 2012).

Second, as this study is taking place, much of Europe is going through an economic crisis. While this crisis has complex causes, one strand relates to the failure of economic integration to fully deliver on its promise (despite some evident successes). While this should not distract our countries from recognising the potential benefits of further integration, it does provide a reminder that integration initiatives need to be built on sound economic principles and institutions.

1.2 Strengthening economic relations

Government efforts to strengthen economic relations with other countries are commonly referred to as economic integration initiatives. A higher degree of integration could be expected to result in increased trade, and flows of capital and labour. Prices for goods, services and factors of production will tend to converge in two countries that are highly integrated as the costs of exchange (or 'transaction costs') are lowered.

What should the policy objective be?

Increased economic integration expands the extent of markets, enabling countries to capture greater scale advantages and specialise in those things they do relatively efficiently. Resources ultimately shift to these activities and lower priced imports take the place of more costly domestically-produced goods and services. This is a dynamic process that encourages competition and innovation.

Consumers benefit from lower prices and greater choice. The integration of labour markets — a prominent feature of the trans-Tasman relationship — opens up opportunities for people to develop and apply their skills and earn higher wages.

Government efforts to promote economic integration can achieve these types of benefits, but there are also potential costs. Aligning regulations can be complicated, administratively costly and politically difficult, and can sometimes produce results that are not a good fit for local circumstances. Achieving greater specialisation can bring significant benefits, but it can also involve adjustment costs. Moreover, where integration is pursued bilaterally, the focus of this study, there is a risk that it will be at the expense of productive exchanges with other countries. Higher levels of integration, such as through a monetary union, carry their own risks, as demonstrated by the recent European experience.

Accordingly, rather than promoting economic integration to the maximum extent possible, the policy objective should be to maximise the 'net benefits' from integration, as implied by the terms of reference for this study.

What role for governments?

In market economies such as Australia and New Zealand, firms make their own decisions about whether to export to, or source inputs from, other countries. Likewise, individuals make independent purchasing decisions, often choosing between domestic and imported goods and services. Individuals can also decide whether to move to another country to work. Accordingly, the main way that governments can promote integration with other economies is by making it easier and less costly to exchange goods, services and capital, and for labour to move internationally in response to economic opportunities. Governments can also have a more direct role in pursuing worthwhile opportunities to integrate government functions.

Governments can promote economic integration in a variety of ways. For example, they can:

- lower or remove tariffs and other measures that deliberately favour domestic production over imports
- remove regulatory barriers to competition, thereby encouraging greater market participation by both foreign and domestic firms
- align so-called 'behind-the-border' regulations more closely with those of other countries (for example, aligning product safety regulations) to allow firms to

export without going to the expense of tailoring manufacturing production to comply with country-specific regulations

- pursue higher levels of integration still, by adopting common monetary or fiscal policies.

However, while governments directly influence the environment in which firms and individuals operate, they are not the sole driver of economic integration. Geography, institutional and social/cultural factors, and the everyday operation of markets are also important. Markets can reduce transaction costs in many ways, including through innovation in communications, transport and logistics. For example, market-driven processes saw the costs of ocean freight fall by 80 percent (in real terms) between 1930 and 2000. This contributed to an uplift in trade and greater economic integration around the world. Costs of passenger air transport and international communications have fallen even further (OECD 2007).

Accordingly, economic integration should be seen as something that governments can choose to promote or inhibit, through actions that reduce or increase transaction costs for firms and individuals.

1.3 The Commissions' approach

The Commissions have been guided by their terms of reference and the 'scoping' nature of the study, while meeting the requirements of the enabling legislation for each organisation (*Productivity Commission Act 1998 (Cwlth)*; *New Zealand Productivity Commission Act 2010*).

Accordingly, the Commissions' approach centres on identifying opportunities for the Australian and New Zealand Governments to lower the costs of exchange in ways that generate net benefits. Often these opportunities involve modifying existing policies that either deliberately or inadvertently make transaction costs higher than they need to be.

Doing this has involved four main tasks:

- First, gleaning insights from the 30 year experience with CER to help guide the future integration agenda — being cognisant of the economic challenges and opportunities that lie ahead for Australia and New Zealand.
- Second, addressing unfinished business — those CER initiatives to which both governments have committed, but have not yet completed. Issues here include how to overcome delays to worthwhile reforms and identifying any measures that should not proceed.

- Third, identifying new integration initiatives that have the potential to generate net benefits across the two countries. There are many potential initiatives, spanning the traditional four economic freedoms (as set out in the Treaty of Rome 1957) — freedom of exchange of goods, services, capital and labour — and also freedom of knowledge exchange. To make this task tractable within the context of a scoping study, filtering criteria have been used to identify those options likely to have the most potential. In some cases, sufficient evidence has been obtained to make specific recommendations. In other cases, areas have been identified that offer potential net benefits, but further work would be needed to identify the best way forward. 'Directions of travel' have also been identified for the economic relationship over the longer term.
- Finally, as with all areas of public policy, implementation is important. The Commissions have considered institutional and governance arrangements for managing the trans-Tasman economic relationship and what changes might be warranted to advance the future agenda.

1.4 Conduct of the study

The study was announced at a meeting of the Prime Ministers of Australia and New Zealand, with the terms of reference being received on 14 March 2012. The two Chairmen and Commissioners from each organisation are leading the study, supported by a cross-Commission team.

The study was advertised in national and metropolitan newspapers in both countries, and promoted on the Commissions' websites as well as on a joint study website. The Commissions have engaged widely with stakeholders, drawing on input from participants through visits, roundtable discussions and written submissions (appendix A). The Commissions released an issues paper in April 2012, and received 60 submissions prior to the release of this discussion draft.

Quantitative modelling has also been undertaken to provide insights relevant to various parts of the study. Economy-wide modelling has been used to illustrate the wider effects of economic integration.

The findings and recommendations in this discussion draft are preliminary. The draft is being made available to interested parties and the general public for their consideration and response. Further submissions are invited, and roundtables and workshops on specific issues will be held in coming months. The Commissions will then prepare their final report to the two Prime Ministers, which is to be submitted by 1 December 2012. The final report will inform the leaders' meeting scheduled for early 2013.

The Commissions are grateful to participants in this study for meeting with Commissioners and staff, participating in roundtables, making written submissions and providing other information.

1.5 Structure of the discussion draft

Chapter 2 defines economic integration and discusses the benefits and costs of government efforts to promote it. The chapter also develops a framework to guide the development of trans-Tasman integration.

Chapter 3 examines the history of CER and what has been achieved in terms of reduced barriers to exchange, increased trade and factor flows, and economic benefits to the people of both countries. Some insights relevant to the future integration agenda are drawn from this history.

Chapter 4 examines opportunities for further trans-Tasman integration in goods, services, capital and labour markets, and in government services and knowledge flows. This chapter contains the bulk of the draft recommendations.

Chapter 5 looks at the current approaches to leading and implementing CER initiatives and examines whether improvements could be made for the future agenda.

Much of the detailed work undertaken for this study will be documented in supporting papers that will be published on the study website following the release of this discussion draft. These draft supplementary papers cover:

- A: Trade in goods
- B. Transport services
- C: Foreign direct investment
- D: Cross border movement of people
- E: Economy-wide modelling of economic integration.

2 Framework for trans-Tasman integration

Key points

- Economic integration is about the freedom of exchange, and the consequential flows of goods, services, capital, technology, knowledge and people. Enabling further integration of markets often involves removing or lowering barriers or distortions created by government policy. These barriers can be intended (for example, tariffs, restrictions on the level of foreign direct ownership in some sectors) or unintended (for example, compliance cost barriers where business regulations are not well aligned).
- Policies to encourage closer economic integration can improve the productivity of the Australian and New Zealand economies. Some policy initiatives can, however, impose net costs.
- Given the already close economic relations that exist between the two countries, the key question for this study is which opportunities for further integration can make the biggest addition to the wellbeing of the Australian and New Zealand communities.
- The Commissions' approach is to propose policy initiatives that provide net benefits for both countries, even where the distribution of the benefits may favour one country. However, in the event that a policy initiative provides joint net benefits in aggregate, but has a net cost for one country, the results are reported for possible consideration by governments as part of a wider package of actions.
- The joint net benefits from further integration will be increased if the policy initiatives are outward looking, generally focusing on initiatives that do not impede profitable exchange with other trading partners; take account of linkages with other agreements; and are consistent with domestic policy improvement. Analysis of integration policy initiatives should take into account both direct and indirect costs and benefits, should be proportionate to the importance of the issue being considered, and be publicly available.
- How far trans-Tasman integration ultimately goes in the direction of a 'seamless economy' is difficult to prescribe in advance. It should naturally emerge from good public policy processes focussed on the achievement of net benefits along the way.
- Given its significance to both economies and common objectives in many areas, the services sector is likely to be a key part of the future integration agenda.

Australia and New Zealand are closely integrated, both economically and socially. With more than 40 000 flights across the Tasman each year and around 480 000 New Zealand-born people living in Australia, and around 65 000 Australian-born people living in New Zealand, the personal ties are extensive and deep. Commercially, Australia is New Zealand's single largest export market and more than half of foreign direct investment in New Zealand comes from Australia. As Australia's economy is over seven times the size of New Zealand's, the commercial significance of New Zealand for Australia is smaller but nonetheless important. New Zealand is a significant market for Australia's manufactured exports and Australians held investments in New Zealand worth around A$74 billion in 2010. There is considerable cooperation between government agencies. The two countries have similar political, legal and economic institutions, and share the same language and culture, leading to a relationship that New Zealand's Prime Minister describes as being 'like no other' (Key 2011) and Australia's Prime Minister describes as 'family' (Gillard 2011a).

While it is people and businesses that effectively make integration happen, governments provide the framework within which their actions can take place. In the case of Australia and New Zealand, this framework consists of a large number of agreements and a commitment to a single economic market agenda. Although the 'ditch' is a natural impediment to trans-Tasman integration, falling transport costs and new communication technologies are reducing its significance.

Given the already close economic relations that exist between the two countries, the key question for this study is which opportunities for further integration would be likely to make the biggest addition to the wellbeing of the Australian and New Zealand communities.

This chapter describes the benefits from economic integration in general and from further integrating the Australian and New Zealand economies in particular. There may also be costs that need to be accounted for or managed. Finally, the chapter sets out a conceptual framework that would help to ensure that policy initiatives to promote further integration maximise the *net* benefits — the difference between benefits and costs — that closer integration can bring.

2.1 Economic integration and the role of government

Defining integration

'Economic integration' is about the freedom of exchange among countries and economies, and the consequential flows of goods, services, capital, technology, knowledge and people. All else equal, such integration expands as transaction costs are reduced (box 2.1).

The motivation for economic integration is that it allows countries to benefit from the gains from trade in products and from the mobility of production factors; these gains include benefits from specialisation and economies of scale.

Markets themselves reduce transaction costs in a myriad of ways — including through innovation in communications, transport and logistics, through information and insurance markets, by adapting institutions including firm structures (such as multinationals), and through agglomeration.

How governments influence integration

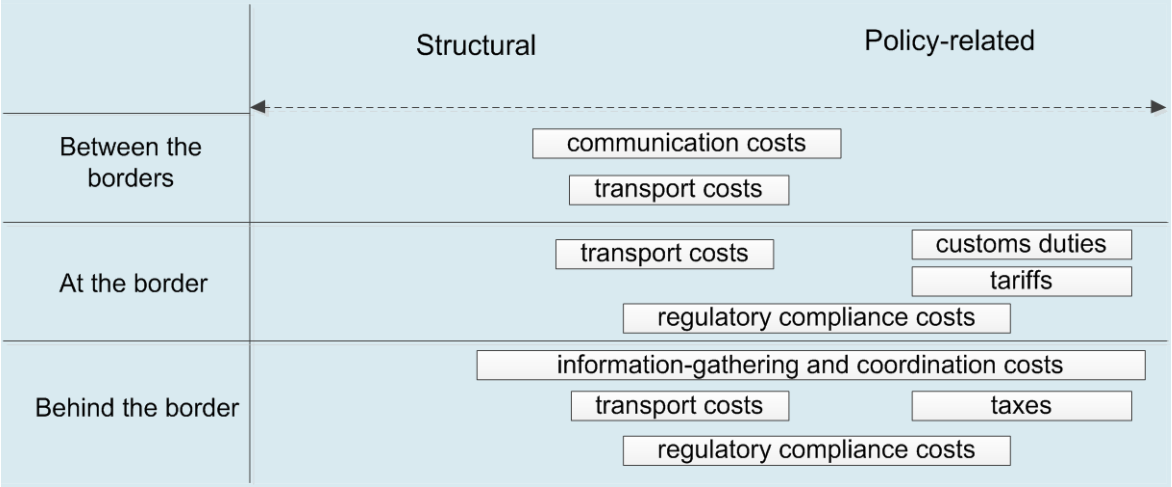
Government policies influence transaction costs, thereby facilitating or hindering economic integration. Governments can intervene between the borders of two countries through mechanisms that affect transport costs; at the border, by imposing barriers such as tariffs; and behind the border through, for example, consumer protection and food safety regulations, which affect market access by foreign producers. Table 2.1 provides more examples of where such barriers might affect the movement of goods, services, capital and labour. There may also be impediments to knowledge transfers and to productive interactions between government organisations and services.

Box 2.1 Transaction costs: why borders matter

In the context of economic integration between countries, transaction costs refer to those costs which are incurred in trade, or the movement of resources across borders. They include a variety of costs ranging from transport costs and regulatory compliance, through to information-gathering and co-ordination costs.

Transaction costs can be classified according to their causes — being either policy-related or structural — and where they occur relative to a particular border. The figure below is illustrative, allocating a selection of transaction costs according to whether they are structural or policy-related.

Figure **Transaction costs: types and determinants**



The extent of transaction costs required to facilitate trade across a border has been referred to as the 'thickness' of a border. Thinner borders enable closer economic integration. However, borders also allow regulatory systems to be tailored to the characteristics of particular economies and their citizens' preferences, while providing valuable competitive and learning effects which improve the quality of those systems over time. Thus while governments may want to reduce some transaction costs to facilitate economic integration, they may also wish to preserve the benefits of borders — such as providing tailored regulatory systems. Accordingly, governments are more likely to be able to reduce the thickness of borders with those countries with which they have more compatible institutions and governance.

While policy-related transactions costs, such as tariffs, can be addressed directly by changing government policy, structural transaction costs resulting from geography and technology can only be influenced indirectly. For example, governments can influence transport costs by ensuring that transport and infrastructure markets function well and efficiently, free from any distortions.

Source: World Bank 2009.

Table 2.1 **Organising framework, with illustrative impediments**

Type of exchange	*Point at which impediment occurs*			
	Between-the-borders regulation	*At-the-border regulation*	*Behind-the-border regulation*	
			Lack of national treatment	*Other*
Goods	Maritime and air transport costs	Tariffs and non-tariff barriers	Bias in government procurement	Consumer law
Services				
Mode 1: Cross-border trade	Post and tele-communications costs		Bias in government procurement	
Mode 2: Consumption abroad	Transport costs	Migration laws		
Mode 3: Commercial presence		Foreign investment laws	Ownership requirements	Impediments to establishment and operations
Mode 4: Movement of persons	Transport costs	Migration laws	Eligibility for government programs	Occupational licensing
Capital		Screening of foreign investment	Ownership requirements	Prudential regulation
Labour	Transport costs	Migration laws	Eligibility for government programs	Occupational licensing

Government actions can affect transaction costs in three ways.

- First, governments can reduce transaction costs by providing the institutional and legal platforms required for well-functioning markets, including the rule of law (to enforce contracts) and a robust system of property rights. These platforms can extend across national borders. The linking of different countries' trading regimes for reducing greenhouse gas emissions — discussed in chapter 4 — is an example.
- Second, some government policies, whether deliberately or inadvertently, increase transaction costs, consequently impeding exchange and distorting economic activity. Such policies — for example, tariffs and other trade barriers — unambiguously reduce efficiency and community wellbeing.
- The third situation is more complex. This is one in which governments intervene to correct 'market failures'. Their intervention may increase transaction costs faced by some domestic and foreign businesses and impede cross-border trade. However, if these interventions are efficiently implemented

to address a clearly specified problem such as pollution, they will enhance community wellbeing even though they may reduce trade. But if the transaction costs are unnecessarily high — say, because of poorly designed intervention — they may impede trade that could have benefited both countries.

Only case-by-case analysis can reveal whether reducing transaction costs has net benefits. Box 2.2 provides a hypothetical example.

Box 2.2 Product safety standards that increase transaction costs: improved wellbeing or a barrier to integration?

Suppose that two countries have different product safety standards for electrical products, and that exporters from the country with less stringent standards (A) have to re-design products for export to the other country (B). This is an additional transaction cost that may impede exports from A to B. But is this inefficient?

One way to remove the cost of re-designing the product for different markets would be for the two countries to harmonise their safety standards at the more stringent level of country B. But this will increase the prices that domestic customers in country A will have to pay for electrical products. They will benefit from a higher level of safety, but the cost may be higher than they would otherwise be willing to pay. Another approach would be mutual recognition, which would enable producers in country A to export to B without re-designing their products. But this may mean that consumers in B will now be exposed to products with lower safety standards than they were previously willing to accept.

Whether to implement harmonisation or mutual recognition in cases such as this depends on factors such as the extent of differences in attitudes and preferences; the number of firms operating in both jurisdictions; and the size of additional transaction costs.

The challenge for policy makers is to ensure that transaction costs are not excessive, and do not unduly impede the movement of goods, services, labour and capital across borders — what the European Union has called the 'four freedoms'. Under these conditions, the benefits of international trade are more likely to be achieved. Countries are able to specialise in producing those goods and services in which they have a comparative advantage, firms can reap scale economies in production; and there is increased dynamism as local industries are no longer sheltered from international competitors. Knowledge is transferred more freely across borders, and capital and labour move to higher valued uses.

These benefits, however, are associated with broader economic integration in general. This study is about bilateral integration between Australia and New Zealand. What are the potential benefits and costs of a policy focus on closer

integration between Australia and New Zealand — relative to wider international integration?

2.2 What are the potential impacts of trans-Tasman economic integration?

This section sets out the potential benefits of bilateral integration and then the potential costs, to provide a framework for assessing policy initiatives.

There are significant potential benefits

Specialisation and economies of scale

In small economies, it is difficult to achieve scale economies by supplying only domestic markets. A free international trading environment helps to overcome this problem by accessing markets overseas. As Alesina and Spolaore point out, abstracting from distance, when there is free international trade, 'the benefits of large country size fade away' (2005, p. 13), at least in relation to traded goods. When trade or other barriers are still present, negotiating better market access in specific countries — particularly ones that are larger — becomes a means to specialise production, expand market size and achieve economies of scale.

There is considerably less trade across the Tasman in services than in goods (chapter 3). Even though only part of the services sector is amenable to cross-border trade, recent technological advances have made more services tradeable. For example, lower communication costs are making remote medical consultations feasible. This type of technological change, combined with the completion of much of the policy agenda for integrating the goods sector, indicates that the services sector should be a natural focus of the future integration agenda.

Increased competition

The relatively small size of some markets in Australia, and even more so in New Zealand, means that many industries are characterised by a small number of competitors. As the Chair of the New Zealand Commerce Commission observed:

> Being a small economy, New Zealand businesses understandably face challenges in acquiring the scale to operate efficiently and compete effectively, especially in global

> markets. The level of aggregation that may be tolerated in New Zealand markets is therefore higher than in some larger economies. (Berry 2011)

To the extent that integration between Australia and New Zealand increases market size, it may also increase the number of competitors in markets and reduce the barriers to potential entrants. The consequent strengthening of competitive pressures can encourage firms to be more efficient and innovative.

Scale and government services

Cooperation between governments can also generate economies of scale and so reduce the cost of delivered services. Food Standards Australia New Zealand (FSANZ) and the proposed Australia New Zealand Therapeutic Products Agency (ANZTPA) are examples of the two governments jointly providing a regulatory service.

The New Zealand regulatory impact statement on the ANZTPA (2002, p. 6) observed that:

> … The economies of scale and removal of duplication that would result from regulating jointly with Australia would lower overall administrative and compliance costs. The actual impact on New Zealand would depend on how the costs were shared between the two countries in the longer term, but the overall compliance costs for New Zealand industry would be lower in a joint scheme.

Achieving such integration can involve considerable re-design of systems when values and preferences differ between countries — as the history of ANZTPA seems to illustrate (chapter 3) — and so opportunities for joint provision need to be selected carefully.

Labour market mobility

Since the 19th century, people mobility has been an important feature of the trans-Tasman relationship. Having few restrictions on the movement of people between countries — as currently applies under CER — allows labour to be allocated to its most productive use and to acquire new skills. Labour mobility can improve productivity in both the home and host countries. The prospect of better employment opportunities abroad may encourage more people to pursue education, which can contribute to raising productivity. Trans-Tasman labour flows are often seen as having helped to address short-term imbalances in the Australian and New Zealand labour markets (PC 2010a).

The overall economic effects of migration depend on a complex set of factors. The Australian Commission (PC 2006a) identified seven ways in which immigration and population growth might be linked to productivity and income per person growth, including through effects on sectoral reallocation of economic activity; the supply of labour; scale economies and competition; taxation, and government expenditure on services and transfer payments. Some contribute positively and some negatively, and the overall outcome is an empirical matter.

Knowledge transfers

Knowledge is a key source of innovation. The pathways through which knowledge can be transferred between Australia and New Zealand include:

- business linkages, such as through 'learning through exporting' and through foreign direct investment (FDI). Foreign investment often brings with it new technology, some of which may be passed on to local firms, and new skills for local workers, which they take with them when they move to other employment. Knowledge transfer might be further enhanced if foreign firms find it more attractive to secure a foothold in a larger, integrated, Australia-New Zealand market. Chapter 4 discusses whether restrictions on FDI between Australia and New Zealand should be relaxed
- integration within the government sector, as illustrated by the Australia and New Zealand School of Government (ANZSOG), which was established in 2002 by the Australian, State and New Zealand Governments and a consortium of universities and business schools on both sides of the Tasman. It provides Masters and leadership programs for public servants, and funding for research relating to public administration, with a trans-Tasman focus. Collaboration between government funding of research projects is another example
- cross appointments of senior staff
- education exports, where students travel across the Tasman to study.

Knowledge transfer can happen in policy areas as well. A clearly superior policy approach in one jurisdiction might be adopted by others, particularly if there is transparent assessment and evaluation of costs and benefits of proposed and present policies, and benchmarking of different approaches. Chapter 3 describes cases where policy knowledge has travelled across the Tasman.

Promoting good domestic policy

Domestic policies that increase the productivity of industries in one economy's traded goods sector increase pressures on industries in the other economy to increase their productivity, in order to remain competitive (box 2.3). Greater openness to trade and factor flows can expose rigidities that impede structural adjustment and thus puts pressure on governments to address them. The process of negotiating integration agreements between countries offers an opportunity to identify and leverage such initiatives. It may reduce domestic concern over reform, by making it a quid pro quo for improved market access in partner countries (PC 2010a). The negotiation process also provides opportunities to identify best practices to improve regulation and policy development processes.

Box 2.3 **Modelling trans-Tasman effects of productivity improvements**

Productivity improvements in one country (country A) affect output in its trading partner (country B) through various mechanisms.

- They increase the relative competitiveness of country A, expanding its global market share and output, and decrease that of country B, decreasing its output.
- They increase returns to factors of production and incomes in country A, which increases demand for imports from country B and its aggregate output.
- An increase in returns in country A causes factors to shift from country B to country A. This contributes to increasing aggregate output in country A and decreasing it in country B.

The net effect of these mechanisms on country B is an empirical matter, which depends on the nature and extent of its connections with other economies.

The ANZEA model (box 2.9) is used to illustrate the effects of domestic policy initiatives in Australia and New Zealand. The two illustrative simulations consist of a 1 percent improvement in the productivity of all factor inputs in each economy, which translates into a 1 percent increase in GDP.

Productivity improvements in New Zealand are estimated to have very little effect on Australia. There is a small substitution in favour of New Zealand sourced production in both Australia and New Zealand as a result of reduced production costs in New Zealand (in particular, in agriculture and food processing). This is compensated by an increase in New Zealand's demand for Australian exports, which are required for additional construction and investment activity.

Somewhat larger effects are at work when productivity improves in Australia. An increase in Australian income and consumption leads to an increase in Australia's demands for New Zealand exports, most notably food and other manufactured products. This partly offsets the export contraction that New Zealand firms experience in other foreign markets as a result of increased Australian competitiveness.

Benefits for consumers

Integration can encourage greater specialisation, exploitation of economies of scale, competition, mobility and better government services than would otherwise have been possible. To the extent that trans-Tasman integration does these things, consumers receive a wider range of price and quality offerings.

There are also potential costs

Policies to encourage bilateral integration, while bringing potential benefits, can give rise to costs that should be taken into account.

Trade diversion

Trade agreements that give partner countries favourable market access relative to non-member countries can lead to 'trade diversion'. This means that more profitable exchanges with non-members can be crowded out by the induced expansion of exchange among members, possibly to the extent that national incomes in the member countries decline, despite gains to producers.

This issue is most commonly raised in the context of preferential tariffs on merchandise trade. Preferential easing of other cost-raising barriers at the border (such as screening of foreign direct investment or quarantine procedures), where this could be done without compromising legitimate government objectives, would reduce costs on the exporting partner countries and could reduce prices for the importing partner. Prices could, however, be lower if unnecessary barriers were removed for all trading partners (box 2.4).

Many remaining barriers to trade in services and factor flows lie behind the border. In certain cases, these impediments will arise because foreign firms and individuals are treated differently from locals (for example, schemes that give preference to local suppliers). Gains will flow to those foreign suppliers that are given preferential access to the local protected market. The local economy will gain from any increase in competition that lowers prices. Moreover, in this case, there would be no diversion from suppliers in non-partner countries, but there would be crowding out of local suppliers by lower-cost suppliers in the partner country that are given preferred access. Once again, the price could be lower still if the local preference were removed from all imports that met the required quality standard.

Box 2.4 **Preferential easing of barriers at the border**

A preferential tariff provides the equivalent of an export subsidy to exporters in partner countries, as it increases their competitiveness relative to exporters in the rest of the world. If the resulting exports from partners simply replace lower cost ones from elsewhere (trade diversion) then the country giving the preferential treatment is worse off — total imports are unchanged but it has foregone tariff revenue to the benefit of exporters in partner countries. With reciprocity of preferential tariffs, each country could be worse off even though their exporters would be better off.

For a country to benefit from giving a tariff preference, it is necessary (but not sufficient) for domestic prices of the import to decrease. In this case there will be benefits from the additional lower-priced imports (trade creation), but there will still be trade diversion losses from the replacement of lower-cost third-party goods with higher-cost partner-country goods. Thus, even in this more favourable circumstance, it is unclear whether on balance giving a tariff preference yields national gains. It is more likely to be so when partner country exporters are low-cost producers by world standards and their export supply is responsive to price changes.

Where barriers at the border impose real costs on foreigners (such as screening of foreign direct investment capital or unnecessary quarantine procedures), preferential easing of requirements or expeditious processing (without compromising legitimate domestic policy objectives) would reduce costs for exporters in the partner country and generate gains to the importing country to the extent the domestic price fell. An expansion of exports from the partner would crowd out exports from third-party suppliers, but this diversion would not impose a cost on the importing country. That said, prices could be lower still if purely protective barriers were removed for imports from all countries.

Behind-the-border barriers will often simply reflect different ways of doing business compared with other countries, or different ways of addressing local circumstances and preferences. An agreement to harmonise regulations to reduce the costs of those businesses operating across partner countries would inevitably require some change in regulations in one or both countries. Such changes could inadvertently increase the cost of regulation for other trade-exposed businesses, reducing their international competitiveness and exports, and increasing imports. In other words, in this case, the diversion potentially crowds out partner-country exports to the rest of the world.

Implementation costs

Policy measures to encourage integration typically require governments and the private sector to incur implementation costs. Most of the initiatives discussed in

chapter 4 would require negotiation, re-designing or setting up systems and training people to use these systems.

For example, a memorandum of understanding was signed in August 2009, setting out both countries' intention to align the standards used in business reporting. The New Zealand standard business reporting program has 'not been pursued at this stage for fiscal reasons' (TTOIG 2012, p. 9).

Fiscal costs of labour mobility

Trans-Tasman migration has implications for government expenditure on services (such as education and health) and transfer payments (such as social security). It also affects taxation revenue. While migration can lead to more efficient allocation of labour, open access to taxpayer funded resources when there are uneven people flows can be a drain on budgetary resources in the recipient country. There can also be pressures on the other country if, for example, emigrants return home when they become eligible for pensions, having worked and paid taxes in the other country. Chapter 4 considers options for balancing these opposing pressures.

Trans-Tasman versus local preferences

In the case of regulation, integration usually involves some degree of acceptance by each country of the regulatory settings of the other. As pointed out earlier, the gains from harmonising regulatory processes might be reduced if the agreed uniform regulations, standards, or policy settings differ from what communities would otherwise choose. It is possible that people in the two countries might prefer different trade-offs between costs and regulatory outcomes. The slow progress towards establishing ANZTPA is an example of a situation in which jurisdictions have disagreed about where this trade-off is best set.

Potential risks for domestic policy

While a bilateral agreement can become a platform for encouraging further domestic policy improvements, focusing on trans-Tasman initiatives could divert attention from the domestic policy agenda. Ai Group noted that it:

> … supports closer economic relations where the objective is to reduce the costs of doing business across the Tasman. However, Australia needs to consider resolving impediments to mutual recognition in the domestic Council of Australian Governments (COAG) context before embarking on this in a trans-Tasman context. Careful cost benefit analysis also needs to be undertaken of any reforms to ensure that net

> economic benefits are achieved and maximised and there are benefits to both parties. (sub. 38, p. 3)

And while economic integration provides opportunities to transfer policy knowledge across the Tasman, both countries also need to be receptive to better practices elsewhere. Federated Farmers of New Zealand noted that:

> There is a perception in some quarters within New Zealand that adopting Australian policy, legislation, and institutions would in itself close the income gap between the two countries. Federated Farmers disagrees …
>
> The Federation believes that New Zealand should adopt the best possible policy, legislation and institutions regardless of where they originate, whether it be New Zealand, Australia, the UK, the US, or the rest of the world. (sub. 33, pp. 5–6)

There can be a risk that finalising an agreement becomes an end in itself, even if changes to domestic regulation negotiated to secure agreement do not benefit one of the countries. For example, changes to the duration of copyrights and other intellectual property provisions negotiated as part of the Australia United States Free Trade Agreement (AUSFTA) have reduced the likelihood of an appropriate balance between supplier and user interests in Australia's intellectual property system (PC 2010a, pp. 165–7).

Chapter 3 includes a discussion on the relationship between the implementation of CER and the domestic policy agendas in Australia and New Zealand.

Adjustment costs

Integration may bring structural adjustment and distributional effects as production methods and patterns change. This can happen whether integration is driven by market pressures or policy. For example, by increasing the scope for specialisation, integration can impact directly on an industry's workers and owners. It can also indirectly affect the wider community (box 2.5).

The transition costs of change are normally less long-lived than are the benefits from moving resources to more productive uses. Nevertheless, adjustment costs can be concentrated in particular industries or regions. Costs that might be small at a national level can be substantial for particular sectors or communities.

Box 2.5 **Economic integration and 'hollowing out'**

'Hollowing out' typically refers to the costs borne by a community when changes in economic activity lead to the loss of valuable capabilities in that community.

Changes in economic activity are driven by many forces. Two that commonly lead to the relocation of economic activity between countries have different implications:

- If economic change were driven solely by increasing specialisation, then it might be expected that economic integration would enable further specialisation by both countries. Both countries would typically benefit in this scenario (after adjustment costs).
- If economic change were driven solely by agglomeration economies, the country better able to exploit those (for example, because it started out larger) could accumulate economic activities with increasing returns to scale, leaving the smaller country to 'specialise' in less productive activities – with constant returns to scale. Both capital and labour may then shift to the larger country, seeking higher returns. The majority of benefits would accrue to the larger country – and the gap between the two countries would widen over time.

The 'hollowing out' concern most relevant to this study is that agglomeration economies combined with economic integration might lead to a net flow of higher-return economic activity from New Zealand to Australia, leaving lower-return activities behind. While this is a legitimate concern, a number of observations can be made.

First, agglomeration diseconomies exist alongside agglomeration economies; for example, congestion and high land prices in cities. The preferred location for economic activities is dependent on the balance between these forces – and is different for each activity. Also, the siting of some activities is determined by the location of immobile inputs; for example, minerals and agricultural land.

Second, economic changes in Australia and New Zealand are being driven by many factors. Global forces such as technological change and changes in the relative scarcity of resources are also important. Outcomes reflect the interaction of all these forces, and their individual effects are difficult to disentangle.

Third, economic integration is a means by which small countries can participate in and benefit from the wider and deeper markets of larger countries.

While integration carries some risks, policy in small countries can best address these by enhancing the adaptability of communities within a productive and open economy, while targeting adjustment support to directly affected individuals or communities.

Source: (Krugman, 1991); (McCann 2008); (Becker, Glaeser and Murphy 1999); (Garcilazo, Martins and Tompson, 2010).

Where it appears likely that a policy will generate significant adjustment costs, governments can respond by:

- relying on generally-available adjustment measures (such as government provided job search services and the social security safety net)
- accompanying the policy change with specific adjustment assistance measures (for example, financial compensation to those most affected)
- modifying the policy to reduce adjustment costs, to allow people to plan for change (for example, phasing it in)
- considering the case for modifying a policy following its initial implementation.

To improve on generally available adjustment measures, specific measures need to be targeted, involve an equitable sharing of their financing costs, interact efficiently with other programs and policies, and be transparent and subject to appropriate accountability mechanisms (PC 2001).

2.3 How *much* trans-Tasman integration?

The benefits and costs of policy initiatives for integration will alter as technology, preferences and a host of other factors change. This means that the end point — in terms of the extent of bilateral economic integration that provides the largest net benefits — will itself evolve with changing circumstances. It can be thought of as a moving target that should naturally emerge from good public policy processes focused on the achievement of net benefits.

This conclusion is consistent with the seven principles for the Single Economic Market (SEM) that Prime Ministers announced in 2009 (box 2.6). New Zealand's Minister of Commerce explained that:

> … the single economic market vision is not an articulated grand outcome but one built on principles that should govern our approach and accelerate the construction of key regulatory outcomes that will deliver a low-cost, innovative, and more seamless trans-Tasman operating environment for businesses (Power 2009).

While the first six SEM principles were developed in the context of business regulation, the Commissions consider that they also provide a 'direction of travel' for future CER initiatives more generally.

Box 2.6 **Single Economic Market Principles**

1. Persons in Australia or New Zealand should not have to engage in the same process or provide the same information twice.
2. Measures should deliver substantively the same regulatory outcomes in both countries in the most efficient manner.
3. Regulated occupations should operate seamlessly between each country.
4. Both Governments should seek to achieve economies of scale and scope in regulatory design and implementation.
5. Products and services supplied in one jurisdiction should be able to be supplied in the other.
6. The two countries should seek to strengthen joint capability to influence international policy design.
7. Outcomes should seek to optimise net trans-Tasman benefit.

Source: Rudd and Key 2009.

The seventh principle — to optimise net trans-Tasman benefit — provides an over-arching test for the other six. It conveys that the other principles in box 2.6 should not be interpreted strictly as objectives to be achieved in an absolute sense. For example, it is unlikely to be consistent with optimising net trans-Tasman benefit for persons in Australia and New Zealand *never* to have to engage in the same process or provide the same information twice. Individuals who earn income in both countries, for instance, are likely to have to fill in tax returns in both countries unless their tax systems are harmonised. Nevertheless, policy initiatives that reduce duplication of form filling and information provision are likely to be part of the single market agenda, where net benefits can be demonstrated.

Building on the seventh SEM principle, the Commissions have sought to identify initiatives that would make the biggest addition to the wellbeing of the Australian and New Zealand communities.

2.4 Identifying the most promising initiatives

Selecting initiatives for analysis

There are many areas in the economy where opportunities for moving towards an SEM could be explored — tariffs, transport costs, migration laws, consumer protection and government procurement are just a sample (table 2.1). And for

each of these areas, there are many possible impediments to integration, and many options for addressing each impediment.

The Commissions have focused their effort on initiatives that seemed most likely, ex ante, to offer joint net benefits. They have then had to consider how much analysis to undertake in each of these areas, to test whether the expectations can be borne out. There is no formula for doing this. To inform judgments about which areas might yield the largest joint net benefits, the Commissions used a set of filtering criteria, similar to ones that have been used in other broad scoping studies (box 2.7).

Box 2.7 **Filtering criteria for integration initiatives**

- Width of reach (the number of entities and/or value of activity affected by a barrier).
- Depth of reach (the extent to which entities are affected and/or the compliance and other costs of the current arrangements).
- Information from previous reviews, from submissions to the study, and from the Commissions' engagement program, about whether the issue is critical for stakeholders.
- Barriers that, while not imposing large costs, may 'add up' or cause unnecessary irritation and prevent a 'domestic like' experience in the other country.
- Any other information that reform would generate large gains.
- The likely costs of the preferred policy option.
- Recognise areas where national autonomy matters.

Source: Australian and New Zealand Productivity Commissions, drawing on Business Regulation and Competition Working Group (2011) and Regulation Taskforce 2006.

Most of these criteria need little explanation. However, the role that national autonomy plays in filtering options is less obvious. Many options for bringing about a closer relationship between Australia and New Zealand involve trading off some policy autonomy. This is not unusual, as there are many areas where national governments accept some loss of autonomy — for example, to local government or to international bodies, such as the World Trade Organisation — in order to achieve an overall benefit. But there will be limits on how large an erosion of autonomy is acceptable or indeed efficient.

For New Zealand, the impact of CER on the Māori population is an important issue to be taken into account when new policy initiatives are being considered (box 2.8). The New Zealand Government will need to recognise any valid

concerns that further policy initiatives could be inconsistent with Treaty of Waitangi obligations.

Box 2.8 **Trans-Tasman integration impacts for Māori**

The Treaty of Waitangi places upon the New Zealand Government a responsibility to consider the impact of policy decisions on Māori.

The Māori economy has historically included a strong focus on international trade, and there is an ongoing interest in developing and maintaining international markets. The Māori Economic Development Panel (2012) has noted that there is significant room for growth within the Māori economy, but that stronger connections with foreign markets are required. As such, trans-Tasman integration initiatives that aim to create a more 'domestic-like' business environment are likely to generate benefits for Māori businesses, many of which view Australia as a natural extension of their 'home base'.

However, views about the merits of closer economic relations between Australia and New Zealand vary among Māori. A submission received from Nga Hapu o Niu Tireni expressed concern that measures which enhance the economic relationship between Australia and New Zealand impinge on the rights of Māori under the Treaty of Waitangi:

> …we have seen major breaches [of the Treaty] with the formation of the Trans Tasman Food Standards Authority which undermines the mana and tino rangatiratanga of Hapu and whanau management of their own food in our home, farms, businesses, and marae, and also the Trans-Tasman Agency on Therapeutic Products which affect hapu and tohunga to practice our traditional medicines without consultation to hapu.[a] (sub. 20, p. 4)

While integration initiatives can raise questions about national autonomy, closer economic relations with Australia and the New Zealand Government's ability to respect the Treaty of Waitangi are not mutually exclusive.

[a] Māori words are explained in the glossary.

In the limit, economic integration could extend to political union. The Commissions have not detected support for this option in either Australia or New Zealand, which is in any event outside the study's terms of reference. Ruling out political union also rules out or limits the scope for some economic integration initiatives that would necessitate adherence to common political and policy positions, such as a monetary union, common fiscal policy and harmonised tax systems.

While the consequential loss of autonomy means that some policy options would be out of scope, many others do not raise such concerns, particularly where preferences are similar in both countries. The other criteria in box 2.7 can in these cases be used to inform selections from the remaining possibilities. Using these criteria to assist their judgment, the Commissions identified some 20 areas for further analysis (chapter 4).

How much analysis?

Equally important is how much analysis is needed to demonstrate that a policy proposal is the right one, while avoiding the risk of 'paralysis by analysis'. This is a common problem in public policy, but it is particularly significant when the number of potential policy initiatives is large. And there are many possible policy approaches to each potential initiative. For example, table 2.2 lists some of the different approaches to behind-the-boder regulation.

Table 2.2 **Types of regulatory coordination**

Type of coordination	*Trans-Tasman illustration*	*Strengths (S) and weaknesses (W)*
Unilateral		
Borrowing (New Zealand independently models a policy on Australian policy or vice versa)	New Zealand plans to introduce a single business number	S: Lower compliance costs for trans-Tasman businesses W: Countries may interpret laws differently; consistency lost if one country alters its laws and the other does not
Unilateral recognition of regulatory outcomes	New Zealand recognises Australian safety standards without requiring Australia to reciprocate	S: Lower business compliance costs; simple to implement W: Home country stakeholders have less say in overseas regulator's decision making and limited or no appeal rights
Cooperative		
Cooperation between regulators and enforcement agencies	Competition, tax and customs agency information sharing and enforcement assistance	S: More effective enforcement of business activity that crosses borders W: Higher administrative cost
Mutual recognition	Trans-Tasman Mutual Recognition Arrangement, 1998	S: Lower business compliance costs W: Countries may have differing preferences for level or type of regulation; home country stakeholders have less say in overseas regulator's decision making; administrative cost of recognising more than one regime
Adopting common rules, while retaining separate institutions	Planned joint regulatory regime for Patent Attorneys	S: Lower business compliance costs; reduced costs in law-making; efficiencies in interpreting and applying the law W: Inefficiencies if countries differ in preferences for level or type of regulation; administrative cost of ensuring common understanding of rules; higher cost of running separate institutions.
Adopting common rules, and establishing a single trans-Tasman institution	Australia New Zealand Therapeutic Products Agency (in progress)	S: Lower business compliance costs; reduced costs in law-making; efficiencies in interpreting and applying the law; economies of scale W: Inefficiencies if preferences for level or type of regulation differ; cost of establishing a single regulator; loss of country-level flexibility; each country has less say in regulator's decision making.

Source: adapted from Goddard, 2002.

Comparing options means assessing their costs and benefits, in order to discover the one that generates the largest joint net benefits. Some costs (for example, implementation costs) are direct and quantifiable; others may not be, yet still need to be considered. For example, if reducing a tax that is distorting Australia-New Zealand commerce leads to a loss of revenue that has to be replaced by increasing another tax, the distortionary effects of this replacement tax should be included in the analysis.

The Commissions have used an economy-wide model to illustrate orders of magnitude of some integration initiatives considered in chapter 4 (box 2.9).

Box 2.9 **Australia – New Zealand Economic Analysis model**

The Australia – New Zealand Economic Analysis (ANZEA) model has been used to illustrate mechanisms at work in integration, especially where the outcome is an empirical matter that depends on a large number of assumptions. The ANZEA model is a multi-country general equilibrium model derived from the GTAP model and database. The GTAP model has been widely used to analyse the effects of policy initiatives.

A general equilibrium model represents — at an aggregate level — all economic transactions that take place within and between economies. It includes data and behavioural equations that describe international trade in goods and services, the use of labour, capital, land and other inputs in production, incomes paid to households, private and government consumption and investment, and taxes and transfers.

The ANZEA model differs from the GTAP model in two respects. First, the ANZEA model is built on a comparatively simple structure and has fewer equations than the original GTAP model. This simple structure facilitates:

- modifications of the model to address issues relevant to the project
- sensitivity analysis; where appropriate, results are presented in the form of ranges.

Second, the ANZEA model accounts for bilateral capital flows at the industry level, which enables analysis of initiatives that relate to the commercial presence of services and FDI more broadly.

The ANZEA model divides the global economy into 25 separate economies including Australia and New Zealand, as well as the USA and the EU and the main economies in Asia.

Draft supplementary paper E provides details of the model and simulations.

Such analysis can, however, be resource-intensive and time consuming. And there will be limits to what is feasible. Hence judgments have to be made about the appropriate depth of analysis, and about the point at which conclusions can be reached, based on the underlying concepts and best quantitative assessments. The appropriate depth of analysis will be influenced by factors such as the size of

potential costs and benefits (as suggested by the criteria in box 2.6), the range of feasible options, the availability of pre-existing evidence and analysis, and the cost of developing new data. A detailed analysis would take into account both direct and indirect costs and benefits, but the breadth and depth of analysis needs to be proportionate to the importance of the issue at hand.

This means that a proportionate approach will in some cases require detailed analysis, whereas in other cases options can be more readily ruled in or out (box 2.10).

Box 2.10 **Rules of thumb**

A 'proportionate' approach would see some initiatives being ruled in or out without the need for extensive analysis. For example, the slow progress towards the national harmonisation of occupational health and safety regulation in Australia is a sign that the costs of achieving trans-Tasman agreement in this area are likely to be high. Unless the benefits of integration are expected to be very large, it seems reasonable to conclude without a great deal of analysis that the net benefits are unlikely to be positive.

Other indicators that the costs of trans-Tasman integration might be large and the benefits low are where the Australian and New Zealand Governments have different objectives, reflecting different community preferences. For example, as the ACTU and the NZCTU point out, 'many health and safety standards incorporate an element of judgement over acceptable risk that may differ between societies' (sub. 17, p. 6).

On the other hand, situations where the two governments have common objectives and similar policy instruments would be stronger candidates for integration, warranting less detailed analysis, because the costs of integration are likely to be lower.

2.5 Desirable features of trans-Tasman integration initiatives

The Commissions consider that initiatives that are compatible with broader integration and complement domestically-focused reforms are more likely to generate community-wide benefits, and so have sought to identify options with these characteristics.

Compatibility with broader integration

Changes to Australia-New Zealand agreements will occur within the context of both countries also having other bilateral, regional and multilateral agreements. This has two implications.

First, analysis of bilateral integration policy options should have regard for the implications arising from other trade agreements to which either Australia or New Zealand is a party. For example, does a change to an Australia-New Zealand agreement trigger changes in other agreements?

Second, a non-preferential approach to reducing barriers to trade avoids diversion effects and so typically would yield larger benefits (box 2.4). This was recognised at the inception of the CER by its intention to be outward-looking, including through strengthening trading relationships with third countries.

There are, however, exceptions to this non-preferential approach. For example, mutual recognition agreements in relation to occupational licensing are based on acceptance by both governments that the standards in each country are acceptable. While wider extension of mutual recognition to other countries would extend the scope of the market, *automatic* multilateral extension could require a country to accept service providers from a third country whose standards are considered to be unacceptable. It is also difficult to envisage either government extending the freedom of trans-Tasman labour mobility multilaterally.

The general presumption in favour of non-discriminatory approaches, alongside the existence of some significant exceptions, suggests that bilateral initiatives should not stall progress towards multilateral or plurilateral liberalisation unless there is a clear case for doing so. This can be achieved by aiming for non-discriminatory policies that permit similar arrangements with other trading partners, unless the benefits of a discriminatory approach clearly exceed its costs.

Initiatives should complement domestic policies

Both Australia and New Zealand have a strong interest in good public policy across the Tasman and bear some of the (opportunity) cost of poor policy in the other country. While many domestic policy initiatives do not feature on the trans-Tasman agenda, there are interdependencies that, if managed well, can promote both agendas.

First, it is in each country's interests to implement some initiatives unilaterally that are also on the trans-Tasman agenda. For example, reducing one's tariff barriers

is nationally beneficial, irrespective of what the other country does. Taking this insight into discussions about the next steps for CER, rather than holding out for offsetting concessions, will accelerate progress.

Second, some domestic policies may increase, or create the potential to increase, trans-Tasman integration. For example, reforms to either country's transport sectors that contribute to reducing trans-Tasman transport costs would facilitate integration. The costs involved in harmonising regulatory frameworks between Australia and New Zealand would also be lower where there are nationally agreed approaches within Australia.

Third, political and bureaucratic effort needs to be allocated efficiently between the domestic and trans-Tasman policy agendas, which is more likely to happen when there is:

- proportionate, publicly-available analysis of options, as discussed earlier
- an effective governance framework
- regular evaluation and benchmarking of policy initiatives, to inform government decisions about whether to extend, amend or end a policy initiative.

DR2.1 Analysis of integration policy initiatives should take into account both direct and indirect costs and benefits, be proportionate to the importance of the issue being considered, and be publicly available. Joint net benefits will be increased if policy initiatives are outward looking; do not impede profitable exchange with other trading partners; take account of linkages with other agreements; and are consistent with domestic policy improvement over time.

2.6 Cross-country distributional effects

The benefits from removing barriers to integration between Australia and New Zealand may be distributed unevenly between them. A further consideration is how to take account of the large number of Australian and New Zealand citizens who live across the Tasman.

Transfers between countries

Some policies that deliver efficiency gains for the two economies in aggregate might involve income transfers between them. One view is that only policies that generate benefits for both countries should proceed. An alternative view (box 2.11) is that an uneven distribution of benefits, or even losses to one country, from a particular integration initiative, should not matter provided a 'win-win' outcome can be achieved overall. If the two countries agreed not to seek immediate reciprocity, but rather to act in the confidence that their cooperative actions will benefit both in the long term, more policy initiatives are likely to be accepted, certain complementary packages of initiatives could become attractive, and trans-Tasman net benefits would be larger than otherwise.

The underlying reasons for the difference between these two views may be found in the limited use of formal compensation mechanisms between the two countries. Some commentators may also have limited confidence that some form of informal compensation will occur through the 'swings and roundabouts' of initiatives that benefit one country or the other over time.

Box 2.11 **A 'balanced benefits' approach'**

In a speech in 2011, Mr Simon Power (then New Zealand Minister of Commerce) considered whether net benefits should be measured on a case-by-case basis or as a package.

> [The net trans-Tasman benefit] principle is explicitly designed to encourage both sides to think about and address issues in the context of strengthening the trans-Tasman economy. It requires each of us to move beyond a narrower national benefit calculation on an issue-by-issue basis.
>
> The principle is designed to encourage both sides to address co-ordination issues in the longer-term context of the New Zealand and Australian economies becoming more deeply integrated and our respective national interests being more deeply linked to the health of the Australasian economy.
>
> The principle encourages an overall balanced benefits approach across the range of areas under the Outcomes framework and more broadly to achieve the goals of a more seamless market. It allows for trade-offs.
>
> This means that sometimes New Zealand may concede something in the interest of achieving other objectives and advancing the goal. At other times Australia will.

Source: Power (2011).

Consistent with the requirement in the terms of reference that the study should identify reforms where the joint net benefits are highest, in cases where a policy change would benefit both countries, the Commissions have put forward recommendations on the basis of whether they increase joint net benefits, even

where the distribution of the benefits may favour one country. There has been no attempt to rank recommendations on the basis of how these benefits would be distributed between or within each country.

A different approach is appropriate in the event that a policy initiative provides joint net benefits, but has a net cost for one country. Neither Commission considers that it could recommend an option in isolation that disadvantaged its country's citizens, even if there are net trans-Tasman gains overall. Hence, in the event that a policy initiative provides joint net benefits in aggregate, but has a net cost for one country, the Commissions propose to report the potential impacts, for possible consideration by governments as part of a wider package of actions.

Impacts on trans-Tasman residents

There are different options for taking account of the impacts of trans-Tasman residents (citizens of one country who live in the other) (box 2.12).

For most issues, it would be both difficult and unnecessary to identify separately the impacts of policy initiatives on these people. As Lloyd points out: 'there are few issues in which the choice of the current New Zealand population or the current population plus NZ-born people living in Australia will make a difference to the policy choice' (sub. 5, p. 13).

Some issues, however — such as entitlements to social security benefits (discussed in chapter 4) — do affect trans-Tasman residents disproportionately. In these cases, the Commissions have separately identified the impacts on these residents.

Box 2.12 **Treatment of trans-Tasman residents**

A national cost benefit analysis would assess the effects of policy changes at a national level, based on the welfare of residents. But potential spatial aspects of integration — such as the potential for 'brain-drain' — raise a question about the welfare of *citizens*, wherever they reside, versus the welfare of *residents*, because the two can diverge. With about 10 percent of New Zealanders living in Australia, and projection of a further 400 000 or so New Zealanders leaving New Zealand in the next 15 years (Yang and de Raad 2010), this is a significant issue. That said, population movements and their motivations are complex. Further, although many New Zealanders migrate, a significant proportion return, and many other migrants from around the world settle in New Zealand and Australia.

People who move between the two countries gain from the opportunity to exercise their choice. There are other effects, particularly associated with the taxation and social security systems. For example, elderly immigrants might secure access to pension and health entitlements in their new country without having contributed through taxation in that country. On the other hand, young immigrants may have benefited from subsidised education in one country, but then move to the other country where they pay taxes.

Options for considering the impacts on these residents in a cost-benefit framework include:

- never identifying separately the potential net benefits accruing to citizens of one country who live in the other
- always identifying separately the potential net benefits accruing to citizens of one country who live in the other and attributing them to their country of citizenship
- identifying the potential net benefits separately only in the case of policies that affect disproportionately the citizens of one country living in the other.

The ACTU and NZCTU support the second option, arguing that when considering the benefits and costs for each country, the outcomes for citizens of one country who are resident in the other should be separately identified (sub. 17, p. 3). However, for many issues it would be difficult to identify separately the impacts and the impacts will likely be negligible.

3 CER — achievements and implications for the future

Key points

- The ANZCERTA started slowly, but rapid progress on economic integration was made after a review in 1988. Tariffs and quantitative restrictions on virtually all goods traded across the Tasman were eliminated by 1990 and the CER agenda moved into new areas, such as services trade and behind-the-border regulatory barriers.
- Since 1990, there have been many CER initiatives that have incrementally increased the extent of trans-Tasman integration. Progress has also been made through informal engagements across government agencies.
- There have been marked similarities in economic policy approaches taken in the two countries, with Australia leading in some cases and New Zealand leading in others. Mutual policy learning has been a feature of the relationship.
- CER has been highly successful in removing explicit restrictions on trade and substantial progress has been made on reducing other barriers to integration.
- Australia and New Zealand have greatly reduced their import barriers against other countries, which has had large benefits for both countries. It is likely that CER helped pave the way for wider reductions in tariffs, particularly in New Zealand.
- There is sufficient evidence to conclude that CER has produced net benefits for Australia and New Zealand, notwithstanding uncertainty about the magnitudes.
- Following the 30 year experience with CER it is apparent that:
  - economic integration initiatives should generally be outward looking
  - with the services sector dominating both economies and with trans-Tasman barriers to goods trade having already been reduced to low levels, the shift in focus towards reducing barriers to services trade and investment should continue
  - further integration is becoming more difficult as the focus shifts to these more complex areas
  - domestic reform remains important for lifting productivity, and CER can play a useful complementary role
  - regulatory harmonisation can be costly and will only be the best option in some circumstances
  - a pragmatic approach to setting priorities, and light-handed governance and institutional arrangements for managing the integration agenda have worked well
  - political leadership is likely to remain important to progressing integration.

3.1 Evolution of the CER agenda

The first trade agreement between Australia and New Zealand, signed in 1922, extended British preferential tariff rates across the Tasman on some goods. However, until the 1960s trade relations between the two countries were not a high priority (BIE 1995). Both countries concentrated on agricultural and resource exports and sought to protect domestic manufacturers from import competition (including from one another). This meant that Australia and New Zealand were more competitors than trade partners.

By contrast, most Australians and New Zealanders have been free to move across the Tasman since colonial times. In 1973, formalisation of the free flow of people occurred through the Trans-Tasman Travel Arrangement (TTTA), which allows all citizens of Australia and New Zealand to travel, work and reside in both countries indefinitely (draft supplementary paper D). With the exception of the European Union, such free movement of people is permitted between few other countries.

In the mid 1960s, Australia and New Zealand began to pay greater attention to their bilateral trading relationship, in part because of concerns about the consequences of the United Kingdom joining the European Economic Community (BIE 1995). In 1965, the New Zealand Australia Free Trade Agreement was signed. This was a 'positive list' agreement, with tariff reductions and relaxation of quantitative trade restrictions applying only to an agreed list of products on each side.

New products were intended to be added to the list over time, but the process for doing this floundered. Some sense of the tortuous nature of the negotiations can be gained by considering the three additions made in 1976:

- meat extract preparations in solid forms (for example, Oxo)
- heraldic badges and crests (polyester)
- photomechanical process plates (not aluminium grained and anodised, and not further worked) for use as lithographic printing plates (Holmes 2003).

In the following year no additions were made at all. This glacial rate of progress was attributable not only to the process, but also to the underlying philosophy behind the agreement. It had been decided at the start not to expand duty-free coverage to goods where this might harm domestic producers in either country (Alchin 1990).

By the late 1970s it was clear to both governments and to some in the business community that a new approach to improving economic relations was needed. In

New Zealand, support came from various politicians, senior government officials and business leaders who shared a view that the domestic economy should be redirected from import-substitution to export-led economic growth. (There were also sections of business in New Zealand that remained strongly opposed to trade liberalisation.) On the Australian side, the government was keen to respond to the rise of other trading blocs and manufacturers sought the improved access to New Zealand markets that the existing agreement had not delivered (Alchin 1990).

Inception of ANZCERTA and early years

Following earlier ground work by Deputy Prime Ministers Anthony and Talboys, a meeting between Prime Ministers Fraser and Muldoon in Wellington in 1980 set in train negotiations for what became the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) (box 3.1). Both governments sought an outward-looking agreement that promoted broader regional integration. The Australian Prime Minister stated:

> If the two countries can cooperate more closely in their own trading relationship, with each concentrating on what it can do best, it will help both countries to grow stronger and to compete in wider markets. We agreed in Wellington that any closer economic relationship must be outward-looking, helping to strengthen our trading relationships with third countries, particularly in the South East Asian and Pacific Regions. (Fraser 1980, quoted in Snape, Gropp and Luttrall 1998, p. 508)

Box 3.1 What exactly is CER?

The 1983 agreement dealing with tariffs — which is formally titled the Australia New Zealand Closer Economic Relations Trade Agreement — is one of the few agreements with 'Closer Economic Relations' in its title. However, some subsequent agreements are known as 'protocols' to the agreement, giving the impression of being linked to the original ANZCERTA document. Other agreements seem to stand alone, although they also cover integration-related issues. And since 2004, the concept of a single economic market (SEM) has also resulted in initiatives across a range of issues.

It is not clear that there are meaningful distinctions between labels such as 'CER', 'CER and related agreements' and 'SEM' (which some might consider to be a rebranding of the evolving CER agenda). Accordingly, this report uses the terms 'CER' and 'CER agenda' to refer collectively to all trans-Tasman integration initiatives. ANZCERTA is used to refer specifically to the 1983 agreement.

The ANZCERTA came into force in 1983. Under the agreement, both countries agreed to extend preferential market access to each other. The stated objectives were to:

- strengthen the broader relationship between Australia and New Zealand
- develop closer economic relations through a mutually beneficial expansion of free trade between the two countries
- eliminate barriers to bilateral trade in a gradual and progressive manner under an agreed timetable and with a minimum of disruption
- develop trade between the two countries under conditions of fair competition.

In addition, the ANZCERTA served as a means of exposing the tradeable goods sectors in both countries to greater international competition. It included:

- the gradual elimination of tariffs on all goods not specified in the annexes to the agreement by 1988 (that is, a 'negative list' approach)
- the progressive elimination of quantitative restrictions by 1995 (such restrictions, in the form of import licences, were a major element of New Zealand's protectionist policies)
- a commitment to work towards the elimination of export subsidies on goods traded between Australia and New Zealand.

The initial agreement has been characterised as 'cautious, even timid' (Scollay, Findlay and Kaufman 2011, p. 22). The 'negative list' consisted of a large number of manufactured products for which the phasing out of trade restrictions and support schemes was delayed or scheduled to occur over a longer period. There were also modified arrangements for some agricultural products, including dairy products, wheat, sugar and tobacco.

The Australian Bureau of Industry Economics found that manufacturing industries affected by immediate reductions in trade restrictions accounted for only 5.5 percent of total trans-Tasman manufactured trade in 1986-87 (BIE 1989). Industries scheduled for later liberalisation (through the negative list) accounted for 44 percent of manufacturing trade, while around 50 percent were in sectors that were free of trade restrictions before 1983. The share of bilateral trade in manufactured goods immediately affected was thus quite small. However, trade in this relatively small group grew rapidly after CER came into force (BIE 1989).

There were some tensions in the early years of ANZCERTA. New Zealand business was concerned about the growing use of production subsidies in Australia to compensate for reductions in tariff protection. Australian exporters complained that New Zealand competitors received an unfair advantage from a 20 percent devaluation of the New Zealand dollar. There was also an escalation in anti-dumping actions between the two countries (Scollay, Findlay and Kaufmann 2011).

Despite its limited effects in the early years, the strengths of ANZCERTA were that it was comprehensive, with procedures that although gradual, were automatic and progressive. These features gave industries time to adjust, while avoiding protracted political renegotiations.

Rapid progress after a review

When the first review of ANZCERTA took place in 1988 the political environment was conducive to making progress on trans-Tasman integration. Both the Australian and New Zealand Governments had embarked on domestic economic reform agendas to which increased trans-Tasman integration was complementary (box 3.2). It has also been suggested that Australia developed a renewed sense of the importance of the relationship after the United States suspended its security obligation to New Zealand under the ANZUS Treaty (Alchin 1990).

The review culminated in the signing of a group of documents in August 1988 that were known as the CER Second Phase Agreements. Agreement had been reached to accelerate the liberalisation of goods trade, so that remaining tariffs and quantitative restrictions on virtually all goods traded between the two countries were eliminated by 1990, rather than 1995 as originally scheduled. Agreement was also reached to eliminate anti-dumping actions on trade between the two countries.

Beyond this, much of the focus was on pushing the CER agenda into new areas, to free up trade in services and reduce behind-the-border barriers to trade and investment caused by differences and deficiencies in standards, regulations and policies. Second Phase Agreements on these issues included the:

- *CER Services Protocol,* which committed the countries to eliminating restrictions on the trade in services by 1989, except for prescribed industries
- *Protocol on the Harmonisation of Quarantine Administrative Procedures*, which sought to achieve consistent quarantine administration in both countries
- *Memorandum of Understanding on Technical Barriers to Trade*, which committed both countries to harmonising technical specifications and testing procedures

Box 3.2 **Three decades of shared economic reform**

Both Australia and New Zealand commenced wide ranging economic reforms in the mid 1980s. In essence, the reforms aimed to free up markets, promote competition and ensure prices provided appropriate market signals. During the 1980s and 1990s:

- Australia and New Zealand continued the reduction in tariffs that had begun in the 1970s, and quantitative import controls were abolished
- financial and capital markets were significantly liberalised, including the floating of the currencies and the removal of exchange rate, interest rate and capital controls
- there was a shift from centralised wage fixing to enterprise bargaining and individual employment contracts
- inflation targeting commenced and reserve bank independence was formalised (1989 in New Zealand; and 1993 and 1996 respectively in Australia)
- commercialisation, corporatisation and privatisation of government business enterprises was progressively implemented and some network sectors, such as electricity, were opened up to competition
- major reforms to the public sector were introduced, including frameworks for sound fiscal management and accountability, and output-based budgeting (Maher 1995; Goldfinch 2006).

These reforms were influenced by international economic thought, but also by direct linkages and learning between the two countries. For example, New Zealand officials visited Australia to examine the float of the Australian dollar carried out in December 1983, before floating the New Zealand dollar in March 1985 (Goldfinch 2006).

The composition of reforms in each country over this period were similar, but there were some differences in timing, sequencing and detail. For example, New Zealand introduced a broad-based consumption tax in 1986, while a similar tax was not introduced in Australia until 2000. Additionally, New Zealand is said to have adopted more of a 'big bang' approach, whereas Australia took an incrementalist approach to reform.

Subsequent reforms have strengthened links between the two countries and have built on earlier measures. For example, in Australia, the National Competition Policy reforms introduced in 1995, and the National Reform Agenda in 2005, have sought to establish a broad competition policy framework that does not impede economic activity, productivity, or constrain the scope of markets for infrastructure and other services (Banks 2010). These reforms have been progressed through the Council of Australian Governments (COAG). New Zealand is a member or observer on the majority of the COAG ministerial councils, and in some cases has voting rights where issues impact on the Trans-Tasman Mutual Recognition Arrangement (Goldfinch 2006).

Other recent economic reforms have included: the establishment of pension reserve funds in order to meet future superannuation liabilities (New Zealand in 2003 and Australia in 2006); and the introduction of market-based policy instruments to reduce greenhouse gas emissions (New Zealand in 2008 and Australia in 2012).

- *Memorandum of Understanding on Harmonisation of Business Law*, which committed both countries to work towards identifying and pursuing potential areas for harmonisation with the aim of reducing transaction costs for firms that operate in both markets
- *Agreement on Standards, Accreditation and Quality*, which aimed to achieve a single system for product standards and accreditation (this lead to the Joint Accreditation System of Australia–New Zealand (JAS–ANZ) in 1991).

The priority given to CER fluctuated during the 1990s, with pressure for deepening of integration coming mainly from the New Zealand side (Lloyd 1995). Scollay, Findlay and Kaufmann (2011, p. 35) report:

> … the maintenance of momentum owed much to the intensive programme of regular meetings established between various groups of officials and ministers to give effect to the understandings reached between the two governments, as well as the formal reviews of ANZCERTA which took place, for example, in 1992 and 1995.

The CER agreements made during the 1990s were largely about following through on commitments made in 1988. The main agreements were the:

- *Agreement Between the Government of New Zealand and the Government of Australia Concerning a Joint Food Standards System* (or 'Food Treaty') (1996), which established what is now called Food Standards Australia New Zealand (box 3.3)
- *Australia New Zealand Government Procurement Agreement* (1997), which created a single trans-Tasman government procurement market
- *Trans-Tasman Mutual Recognition Arrangement* (TTMRA), which aims to allow producers and people in registered occupations to meet only a single set of regulatory requirements in order to do business in Australia and New Zealand.

Box 3.3 **A case study: trans-Tasman food safety regulation**

Under the Food Treaty (1996), Food Standards Australia New Zealand (FSANZ) was set up to develop a joint food standards code. Subsequently, the Australia New Zealand Food Standards Code (ANZFS Code) was adopted by both governments in 2002.

The Food Treaty aims to harmonise food standards between the two countries, reduce industry compliance costs and help remove regulatory barriers to trade in food. The 'single-regulator/many jurisdictions' model that now operates sees FSANZ researching and developing changes to the ANZFS Code, which are incorporated, subject to amendment, into the Food Acts of each of the Australian states and territories and New Zealand. The ANZFS Code covers general and particular food standards that apply in both countries, as well as food hygiene standards and primary production standards that apply in Australia only. Enforcement and interpretation of the code is undertaken by different regulators in each jurisdiction (including local governments in Australia).

Despite the joint approach to setting food standards, the food safety system is not fully harmonised between Australia and New Zealand, or even across the Australian states. The Food Treaty contains provisions that allow New Zealand to opt out of jointly set standards relating to safety and health outcomes, environmental concerns and trade or cultural issues. New Zealand also has separate food hygiene standards for consumer food safety that are more prescriptive than Australia's (PC 2009).

Despite operating in a complex multi-jurisdictional environment where regulatory differences remain, FSANZ is generally regarded as a success. Submissions to the scoping study have generally been positive about the joint food safety regulator. In particular, the Australian Food and Grocery Council (sub. 22) supports retaining FSANZ as the lead agency and mechanism for developing food regulation in Australia and New Zealand, and the New Zealand Food and Grocery Council (sub. 34) also strongly supports the joint food standards setting system, while not supporting an expansion of its scope.

The process of implementing agreements to reduce behind-the-border barriers has been complicated and time consuming. In some cases, work programs on integration continued to evolve over many years. A particularly striking example is the Australia New Zealand Therapeutic Products Agency, which is due to commence by 2016, seventeen years after Ministers first agreed to explore the viability of establishing a joint agency (box 3.4).

Box 3.4 The long journey to a joint therapeutic products agency

The Trans-Tasman Mutual Recognition Arrangement (TTMRA) has a number of exemptions, one of which is for therapeutic goods. This means that therapeutic goods satisfying regulatory requirements in Australia must meet separate regulatory requirements before being marketed in New Zealand, and vice versa.

Following the signing of the TTMRA in 1996, various options for harmonising regulation of therapeutic goods were explored. The preferred option that emerged was to create a joint regulatory scheme to be administered by a single regulator — the Australia New Zealand Therapeutic Products Agency (ANZTPA). One reason for this preference was that the increasing complexity of therapeutic products was making it difficult for New Zealand in particular to maintain the necessary level of regulatory capacity.

The journey towards the introduction of the ANZTPA has been a long and difficult one, and it is yet to be completed:

1999 Australian and New Zealand Ministers agree to explore the viability of establishing a joint agency.

2000 A consultation paper on a possible framework for a joint agency is released. The New Zealand Institute of Economic Research undertakes a regulatory impact analysis for a joint therapeutics agency that finds modest net economic gains for both countries.

2003 The Agreement for the Establishment of a Joint Scheme for the Regulation of Therapeutic Products (the Treaty) is signed. The Therapeutic Products Interim Ministerial Council is established to facilitate the creation of the joint regulatory scheme and joint agency.

2006 Enabling legislation is introduced in New Zealand, but fails to pass. This is due to concerns that the proposed arrangements would make complementary medicines and natural health products (including those used in Māori medicine) more expensive and that some could become illegal.

2007 Negotiations suspended (but the Treaty remains in place).

2011 The two Prime Ministers sign a statement of intent to implement the ANZTPA progressively over a period of up to five years. The New Zealand Government announces it will develop a separate framework for domestic regulation of complementary medicines and natural health products.

Sources: Gillard (2011b); TGA (2012).

Towards a single economic market

There was a rapid spread of preferential trade agreements in the Asia-Pacific region at the start of the new millennium. First New Zealand and then Australia

became involved in these agreements (box 3.5). Scollay, Findlay and Kaufmann (2011, p. 58) report:

> These developments raised questions over the degree of priority that both countries would in future place on their bilateral relationship, especially as they chose to pursue their new preferential arrangements individually rather than jointly. Rather than allow the bilateral economic relationship to wither, however, the two countries decided instead to try to rejuvenate it.

Box 3.5 The broader trade policy context

Australia and New Zealand are members of a number of bilateral, regional and multilateral trade and investment agreements. Each has also undertaken significant unilateral trade reform.

Both countries are foundation members of the World Trade Organization (WTO) and its long-standing predecessor, the General Agreement on Tariffs and Trade (GATT) (1947), as well as the Asia-Pacific Economic Cooperation (APEC) forum.

New Zealand has signed a number of bilateral preferential trade agreements, including Free Trade Agreements with China and Malaysia, and Closer Economic Partnership agreements with Hong Kong, Singapore and Thailand. It is also a member of the Trans-Pacific Strategic Economic Partnership (known as the P4 Agreement) and the Pacific Agreement on Closer Economic Relations. It is negotiating agreements with India, Korea, the Gulf Cooperation Council (GCC), and with Russia, Belarus and Kazakhstan. New Zealand is also part of the negotiations on the Trans-Pacific Partnership Agreement, an extension of the Trans-Pacific Strategic Economic Partnership.

Australia has signed preferential trade agreements with Chile, Malaysia, Singapore, Thailand and the United States. It is currently negotiating agreements with China, the GCC, India, Indonesia, Japan and Korea. It is also negotiating with other countries to join the Trans-Pacific Partnership Agreement. Similarly it is negotiating, along with New Zealand, an extension of the Pacific Agreement on Closer Economic Relations (PACER Plus).

Australia and New Zealand are also both members of a trade agreement with the 10 ASEAN nations (the ASEAN–Australia–New Zealand Free Trade Agreement, or AANZFTA).

In addition, there are many single-issue international organisations that impact on global trade levels and patterns, covering intellectual property, telecommunications, banking, shipping, aviation and the environment issues (PC 2010a). Many of these groups count Australia and New Zealand among their membership.

This rejuvenation was effected through the two countries deciding to pursue a Single Economic Market (SEM) in 2004. In most respects, this involved a

continuation of the existing integration agenda, but new impetus was given to efforts to harmonise elements of business law.

- A 2004 review by the Australian Commission led to enhanced cooperation between the Australian Competition and Consumer Commission (ACCC) and the Commerce Commission New Zealand on cross-border competition and consumer issues (PC 2004a).
- The Trans-Tasman Council on Banking Supervision was established in 2005 to promote a joint approach to banking supervision and to deliver a more seamless regulatory environment in banking services.
- A Treaty on Mutual Recognition of Securities Offerings was signed in 2006.

In the first two cases, consideration had been given to alternative 'full integration' options, but these were rejected because they were assessed to entail costs that would exceed the benefits. On competition and consumer protection regimes, the Australian Commission concluded:

> Full integration, requiring identical laws and procedures and a single institutional framework, would have high implementation and ongoing costs, change the operation of the existing national regimes and achieve only moderate benefits. (PC 2004a, p. xiv)

On banking regulation, the Reserve Bank of New Zealand reported that various options were assessed in the mid 2000s, including:

> … the creation of a single new regulator as well as a model in which the Australian Prudential Regulation Authority would become the supervisor for banks operating on both sides of the Tasman. The [New Zealand] Government concluded at that time that the risks and costs associated with a single regulator model outweighed any benefits. (sub. 12, pp. 4–5)

The creation of the Australia New Zealand Leadership Forum (ANZLF) was also part of the move to add momentum to the CER agenda. The ANZLF is a business-led initiative designed to further develop Australia and New Zealand's bilateral relationship as well as joint relations in the region. It brings together leaders from business, government, academia and the public sector. The Forum plays an active role in supporting progress on various trans-Tasman integration initiatives (ANZLF, sub. 15).

In 2009, a set of SEM principles was agreed by the Australian and New Zealand Prime Ministers (chapter 2). At the same time, the Prime Ministers agreed to a set of trans-Tasman outcomes spanning a range of areas of business law that were designed to accelerate and deepen trans-Tasman regulatory integration as part of the broader SEM agenda.

The Trans-Tasman Outcomes Implementation Group, jointly chaired by representatives of the Australian Treasury and New Zealand Ministry of Business, Innovation and Employment, was set up to oversee implementation of the agreed outcomes. The Implementation Group's most recent progress report noted the considerable progress that had been made towards achieving many of the outcomes, but also drew attention to some areas where progress was slowing (box 3.6).

A recent development in the trans-Tasman economic relationship was the signing of an Investment Protocol in 2011. The Protocol, which is yet to be enacted, reduces restrictions on trans-Tasman investment flows (draft supplementary paper C).

Box 3.6 Single Economic Market: Progress made but more to do

The Trans-Tasman Outcomes Implementation Group assessed that, as at February 2012, seven of the agreed short term outcomes had been achieved and 14 of the medium term outcomes were 'on track' for completion by the end of 2014. The remaining seven outcomes were assessed as either 'slowing', 'delayed' or 'on hold'.

Insolvency law: The Australian and New Zealand Governments have agreed to create a single cross-border insolvency proceeding with equivalent outcomes for insolvents in both countries. A working group is currently developing proposals and a joint instrument/legislation is on track to be finalised by the end of 2014.

Financial reporting policy: Governments have agreed that entities can use a single set of accounting standards and prepare one set of financial statements. This outcome has been achieved for publicly accountable for-profit entities and is on track for non-publicly accountable entities. Progress with not-for-profit entities is slowing.

Financial services policy: Governments have agreed to: make comparable the required disclosures by issuers of financial products; align corporate trustee regimes for financial products; and align business regulatory obligations in relation to anti-money laundering and countering the financing of terrorism. All outcomes are on track.

Competition policy: Governments have agreed firms operating in both markets should face the same consequences for anti-competitive conduct (on track) and that Australian and New Zealand competition and consumer law regulators share information for enforcement purposes (delayed). High level cross membership between the ACCC and the NZ Commerce Commission has been achieved.

Business reporting: Governments have agreed to deliver a standard set of electronic financial and performance data for the purposes of business-to-government reporting (on hold) and a single business identifier for use in both countries (on track).

(continued next page)

Box 3.6 (continued)

Corporations law: Governments have agreed that trans-Tasman businesses should only need to file company information once in order to meet the requirements of both governments. Progress has been made but is currently slowing.

Personal property securities (PPS) law: Governments have agreed to a single trans-Tasman register for PPS. Progress has been made but is currently slowing.

Intellectual property law: Governments have agreed to a single regulatory framework for patent attorneys, a single trade mark regime, a single application and examination processes for patents filed in both countries, and a single plant variety right regime. Progress is on track for all outcomes except the plant variety rights regime (slowing).

Consumer law: Governments have agreed to: harmonise consumer law enforcement and consumer credit requirements; streamline arrangements for mutual recognition of product safety standards; harmonise or coordinate product labelling regimes; and introduce equivalent approaches to trade measurement regulation. All outcomes have been achieved except for consumer credit which is on track.

Source: TTOIG (2012).

3.2 Achievements of CER

CER initiatives typically seek to reduce transaction costs that act as barriers to trade, investment flows and the movement of people. Achieving reductions in these barriers would generally be expected to increase trans-Tasman trade and factor flows more than otherwise. However, the ultimate objective is not to increase trade per se, but to produce net benefits for both countries through increased specialisation, economies of scale, wider consumer choice, lower prices and the sharing of knowledge. The achievements of CER in these areas are considered below.

Trade in goods is fully liberalised

The CER agenda has reduced transaction costs for trade in goods between Australia and New Zealand in various ways.

- Tariffs and quantitative restrictions on goods have been fully liberalised between the two countries for goods deemed to have originated in the partner country under the CER rules of origin.
- Rules of origin have been amended over the life of the agreement, in part with an aim of reducing compliance costs.

- Administrative procedures for biosecurity and quarantine have generally been harmonised, and customs authorities in both countries cooperate on trans-Tasman issues.
- A mutual recognition agreement (TTMRA) allows goods that can be sold in one country to be legally sold in the other without meeting further regulatory requirements, with some exceptions (such as industrial chemicals).
- Neither country allows its businesses to initiate anti-dumping claims against businesses of the other.
- Standards for food safety have been aligned and a single trans-Tasman food authority develops standards.

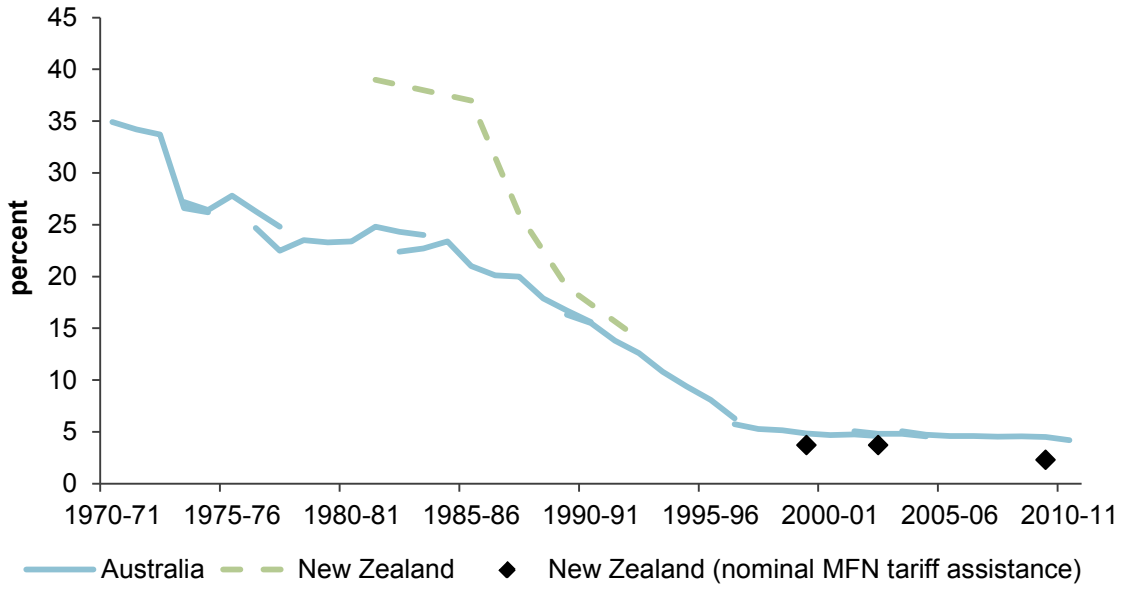
Influence on trade

As described above, CER initiatives have largely eliminated at-the-border barriers, while behind-the-border barriers have also been reduced. This would be expected to result in increased trade in goods between Australia and New Zealand, relative to what would have occurred otherwise.

However, there are many other influences on trans-Tasman trade, one of which is changes in trade barriers with other countries. From 1983 to 1990, as trans-Tasman at-the-border trade barriers were eliminated, a substantial gap opened up with protection rates for other countries. However, this gap soon closed as both countries reduced trade restrictions unilaterally on a 'most favoured nation' basis. Figure 3.1 shows the reduction in trade restrictions and other forms of assistance to domestic manufacturers in Australia and New Zealand over time.

Accordingly, CER would be expected to have lifted trans-Tasman goods trade up to 1990 relative to trade with other countries. However, after 1990 trade policy increasingly encouraged Australian and New Zealand exporters to look to other markets and this would be expected to have resulted in a decrease in the proportion of trans-Tasman trade (other things being equal). Reductions in behind-the-border barriers brought about through CER would be expected to partially offset this influence, although other factors are also prevalent (figures 3.2 and 3.3).

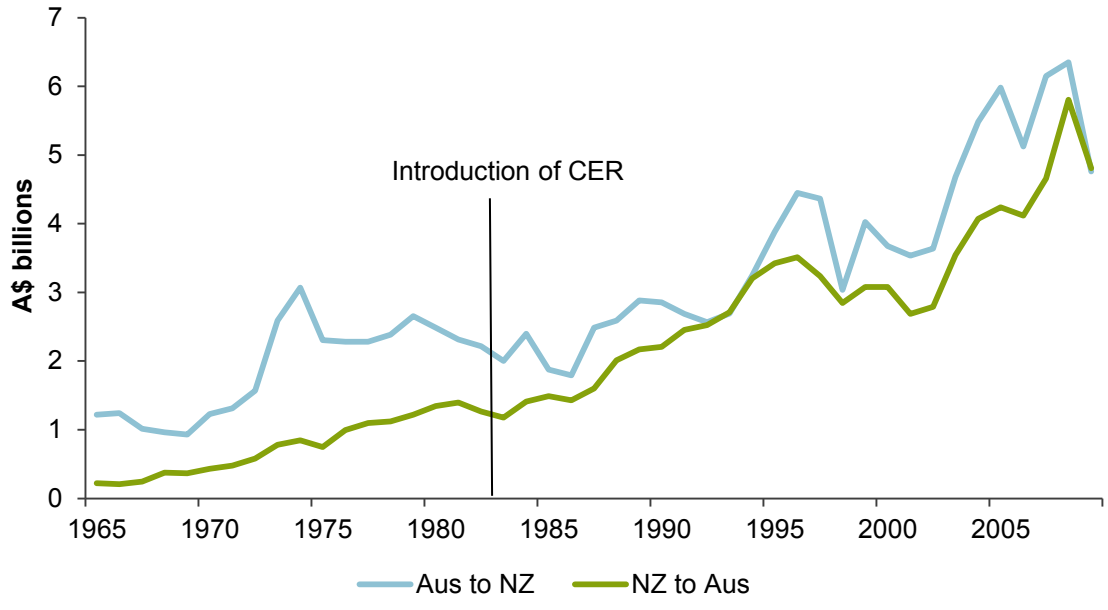
Figure 3.1 **Falling effective rates of assistance to manufacturing[a]**



a The effective rate of assistance is a combined measure of tariff, budgetary and regulatory assistance (including quantitative measures such as quotas), expressed as a proportion of an industry's value added. As quantitative and other forms of assistance have largely been eliminated in New Zealand, the nominal 'most favoured nation' (MFN) rate of tariff assistance can be used as a proxy for the effective rate of assistance – although this is not a perfect substitute.

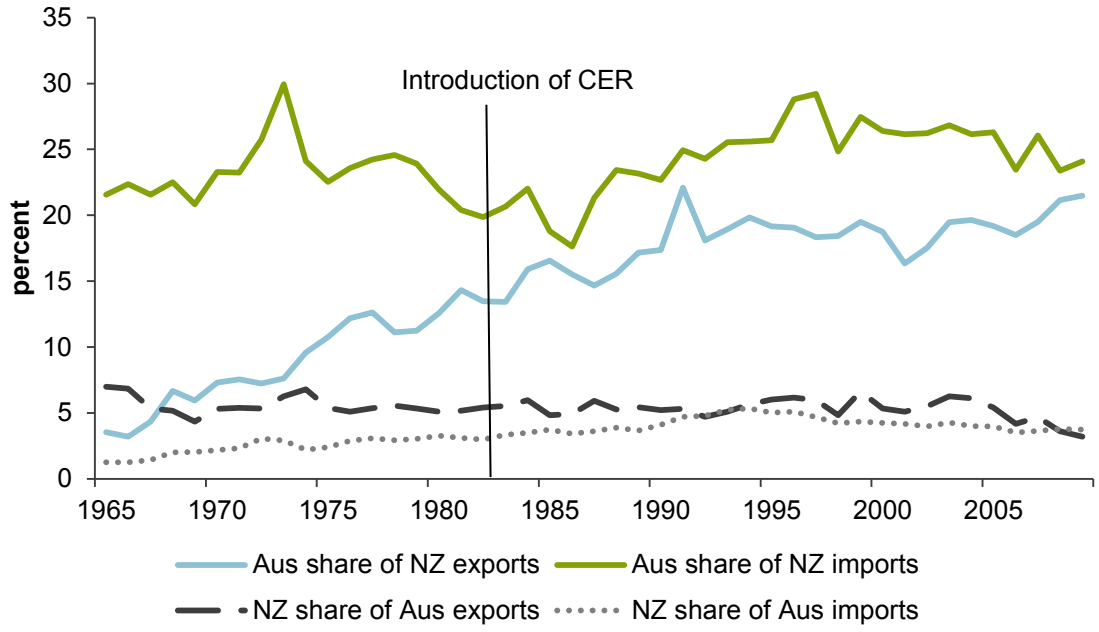
Sources: Duncan, Lattimore and Bollard (1991); MED (2003); NZIER (2010); OECD (1985, 1991); PC (2012a).

Figure 3.2 **Trans-Tasman merchandise trade, 2010 prices**



Source: UN Comtrade database (2012).

Figure 3.3 **Trans-Tasman merchandise trade as a share of total trade**



Source: UN Comtrade database (2012).

Trends in New Zealand's exports to Australia are reasonably consistent with the expectations described. The share of New Zealand's exports destined for Australia increased from 13 percent immediately before CER to 22 percent in 1991 (although the upward trend pre-dates CER). Thereafter this share has remained fairly flat (figure 3.3). Based on the value of imports and exports, Australia has become New Zealand's largest trading partner.

In contrast, the share of Australia's exports destined for New Zealand remained between 5 and 6 percent throughout most of the past 30 years (figure 3.3). However, the share has declined to around 3 percent over the past few years, despite the value of Australia's exports to New Zealand being at historically high levels. This is largely due to the rising share of mineral and energy exports to Asia. New Zealand is now Australia's seventh largest trading partner.

New Zealand exports mainly manufactured goods to Australia, including processed food. Other exports include light crude oil and gold. Australia is New Zealand's most diversified export market. Australia's exports to New Zealand are also dominated by manufactured goods, including computer parts, medicaments, passenger motor vehicles and a range of processed food (DFAT 2012; UN Comtrade database 2012). Evidence suggests that trade in processed food in particular has been boosted by CER initiatives (box 3.7).

Box 3.7 Trans-Tasman trade in processed food has increased

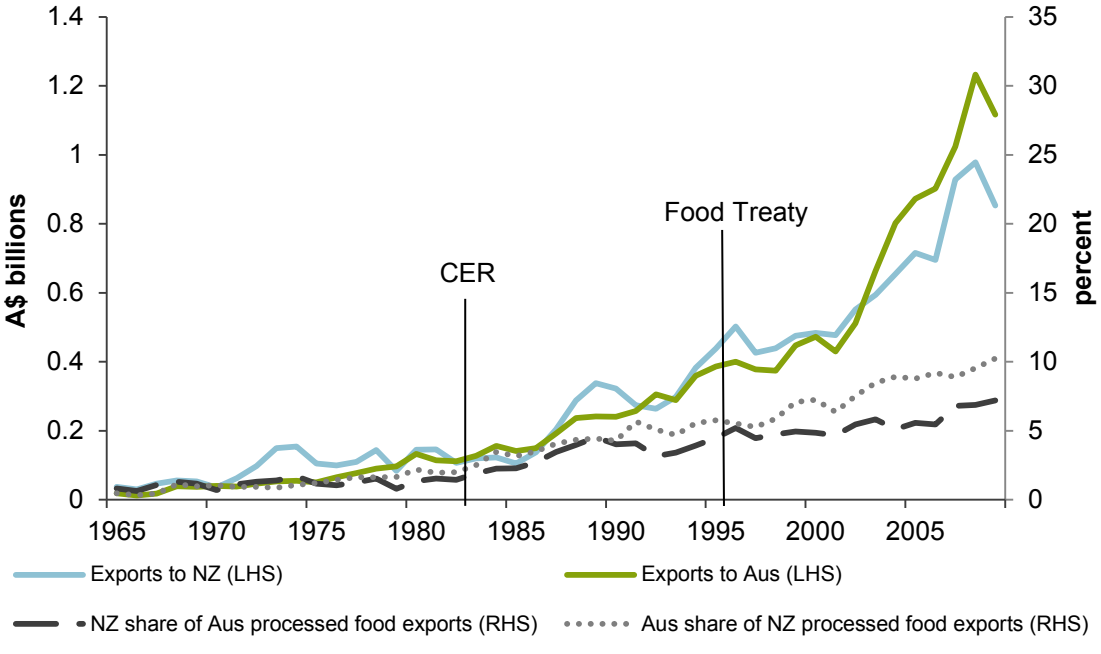
Trade in processed food products between Australia and New Zealand has grown substantially over the last three decades. Integration in this sector has progressed to the extent that 'the trans-Tasman market for food has become almost an extension of the domestic market of both countries' (MAF 2011, p. 21). Major subgroups of New Zealand exports to Australia include wine, dairy products, other processed food (including baked goods and confectionary) and seafood. Major subgroups of Australian exports to New Zealand include oils and fats and cereals. As shown in the figure below, the proportion of each country's food product exports that goes to the other has steadily increased since CER commenced.

CER initiatives have removed barriers to trans-Tasman trade in processed food in two main ways. First, bilateral trade restrictions on a range of food products were lowered, and eventually removed. For instance, the tariff on wine valued above $2 per litre was reduced from A$0.65 per litre in Australia and NZ$0.85 per litre in New Zealand in 1985 to zero in 1990. Similarly, tariffs on preserved milk and butter in Australia were reduced to zero from A$0.05 per kilogram and A$0.10 per kilogram respectively (Commonwealth of Australia 1983; *Customs Tariff Act 1982 (Cwlth)*; BIE 1995).

Fonterra stated:

> Since the establishment of the Australia-New Zealand Closer Economic Relations Trade Agreement in 1983, the trans-Tasman dairy market has been open to trade from both countries. Fonterra and its predecessors have built up a substantial business in Australia under this framework. (sub. 14, p. 2)

Figure **Trans-Tasman trade in processed food products, 2010 prices**



Source: UN Comtrade database (2012).

(continued next page)

Box 3.7 (continued)

Second, regulations concerning food standards have been progressively harmonised since 1995 under the Food Treaty (box 3.3). A major milestone was the introduction of a joint food standards code in 2002, which likely contributed to the sharp increase in trade that occurred from about this time. The Food Treaty was complemented by the Trans-Tasman Mutual Recognition Arrangement which came into effect in 1998, removing regulatory barriers to the sale of goods between Australia and New Zealand.

The Australian Food and Grocery Council reports that under this regime:

> … for the most part, food regulation in the two countries is uniform, and in those few areas of non-uniformity, there is no trade barrier that prevents the compliant good of one country from being sold in the other. (sub. 22, p. 8)

The Australian Commission found that the application of mutual recognition to export dairy systems had reduced certification requirements and that this might help explain increases in the value of cheese exports from New Zealand to Australia (PC 2009).

In addition to CER, there have also been a number of market and policy developments that have contributed to increased integration of food products markets. These include:

- the merger of the New Zealand Dairy Board (a statutory marketing board) with two cooperative dairy companies, to form a single cooperative entity (Fonterra) (this provided Fonterra with the scale and capability to make acquisitions, particularly in Australia)
- Progressive Enterprises acquiring Woolworths NZ in 2002, followed by Woolworths Australia acquiring Progressive Enterprises in 2005
- the entry of the German supermarket chain Aldi into the Australian market in 2001 (this coincided with the introduction of 'store brands', which created opportunities for New Zealand firms to break into the Australian market).

Econometric studies can be employed to isolate the trade effects of trade agreements from other influences. A number of such studies have found that CER has increased trade across the Tasman (box 3.8). For example PC (2010a) concluded that CER had had a positive, though small impact.

As discussed in chapter 2, at least some of the increased trade between partner countries resulting from preferential trade agreements can come at the expense of trade with other countries. This is known as 'trade diversion' — due to reduced barriers being offered to one (or more) countries, goods imported from lower-cost suppliers are displaced by goods from higher-cost suppliers due to them facing lower barriers.

Where trade diversion occurs, it erodes the potential gains from measures seeking to increase trade openness. The significance of trade diversion depends on the differences between preferential and non-preferential trade restrictions.

Only a few econometric studies have sought to assess the impacts of CER on trans-Tasman trade. Some early studies found that the CER may have been, on balance, trade creating, but the results of more recent studies suggest that CER has been net trade diverting (box 3.8).

Box 3.8 Past analyses of CER's impact on merchandise trade

The estimation of the impacts of preferential trade agreements, such as CER, has a long history. Assessing whether a particular agreement is trade creating or trade diverting is not straightforward, because there are often difficulties in isolating the impacts of trade agreements on trade flows from those caused by growth, changes in market conditions and other policy settings. Further, most studies do not account for potential scale effects associated with access to larger markets or productivity improvements that might arise from greater import competition (although such effects will normally be correlated with the net trade creating effects of the agreement, positive or negative).

Against that background, past studies of CER (and other preferential trade agreements) have yielded a range of results:

- In 1989, the Australian Bureau of Industry Economics (BIE) examined the impact of CER on Australian manufacturing industry, concluding that CER likely had had a small trade creating effect in affected sectors. It noted that any trade diversion effects of CER were likely outweighed by the separate trade creation effects of simultaneous general reductions in tariffs. The benefits of CER were attributed principally to rationalisation within industries, and specialisation across industries.
- A 1995 study by the BIE undertook modelling that indicated that CER had had a small positive impact on GDP and welfare in both countries.
- Adams et al. (2003) found that a large number of trade agreements were net trade diverting, including CER. However, the authors noted that the results were less robust for agreements with a small number of members, such as CER, and that their treatment of transport costs was likely to have underestimated the increasing attractiveness of Australia and New Zealand trading with other countries.
- DeRosa (2007) found that most preferential trade agreements have had net trade creating effects, but results for CER were often negative, although they varied with model specification.
- In a more recent study of the impacts of trade agreements, including CER, the Australian Commission drew on data on trade flows between 140 countries for the period 1970-2008 (PC 2010a). It also introduced a number of methodological innovations to address deficiencies identified in earlier studies. While recognising the need for careful interpretation of the results, the Commission estimated that CER had had a small positive impact on trade between Australia and New Zealand, but a larger negative impact on both countries' trade with the rest of the world.

Net benefits

The question of whether CER's influence on trade in goods has produced net benefits for Australia and New Zealand is partly dependant on whether it has been net trade creating or trade diverting. Trade creation generates benefits from increased specialisation, economies of scale, competition and consumer choice as discussed in chapter 2. By contrast, trade diversion means shifting trade from lower-cost to higher-cost suppliers.

The more recent studies referred to in box 3.8, and in particular PC (2010a), have benefited from developments in theory, data and statistical methods. These studies typically find that CER has been net trade diverting. While recognising that the results of such studies could not be considered definitive, the Australian Commission observed:

> … the analysis suggests that the preferential nature of the [ANZCERTA] agreement appears to have altered the focus of many exporters (and importers) in these economies to the smaller markets within the agreement, foregoing some of the potential gains that would otherwise have been expected from exploring trading opportunities in markets elsewhere. (PC 2010a, p. 143)

While it seems probable that CER caused net trade diversion in the past, the potential for trade diversion has been greatly reduced. Both countries have reduced barriers to imports generally and entered into agreements that extend preferential tariff rates to other countries. Moreover, CER may have helped bring about these broader tariff reductions, by helping to change opinions about trade protection for manufacturing, particularly in New Zealand (Scollay, Findlay and Kaufmann 2011). The broader tariff reductions have greatly reduced tariff preferences for trans-Tasman trade.

Accordingly, whether CER reductions in tariffs and quantitative restrictions on goods trade yielded overall net benefits or net costs for Australia and New Zealand in the past is unclear. What is clear is that CER tariff preferences are now low and so would be expected to provide only a modest ongoing boost to trans-Tasman trade, with minimal incentive for trade diversion. Therefore, any ongoing economic effects of CER tariff preferences are likely to be small.

The net benefits calculus for CER measures that aim to reduce behind-the-border barriers to goods trade is somewhat different. Such measures can increase trans-Tasman trade, but have a lower propensity to give rise to trade costs.

Reducing behind-the-border barriers can also save on resources devoted to complying with and enforcing regulations. For example, mutual recognition of product standards results in firms only having to comply with one set of regulations

rather than two. This can increase the gains from trade even if it does not increase the quantity of trade.

One source of evidence on the influence of behind-the-border CER initiatives on trans-Tasman trade is provided by the Australian Commission's Review of Mutual Recognition Schemes. This review examined the Mutual Recognition Agreement that operates within Australia as well as the Trans-Tasman Mutual Recognition Arrangement. The Review found:

> The views expressed by participants to this review, along with analysis undertaken by the Commission, suggest that the schemes have been effective in increasing the mobility of goods and labour within Australia and across the Tasman …. In so doing, they have almost certainly promoted efficiency, by allowing people and products to move to those uses that contribute more to community wellbeing. (PC 2009, p. xxiii)

However, initiatives to reduce behind-the-border barriers are sometimes costly to achieve, as demonstrated by efforts to introduce the Australia New Zealand Therapeutic Products Agency (box 3.4). While this initiative may in time prove to be worthwhile, so far considerable time and resources have gone into this process in expectation of future gains.

Trade in services is partly liberalised

Many services (such as banking, education and health services) that have in the past been considered purely domestic activities have become more tradeable due to new transmission technologies. The increasing importance of services trade has led to multilateral efforts to liberalise trade, most notably through the General Agreement on Trade in Services (GATS), which commenced in 1995. The *CER Services Protocol* pre-dates GATS.

Under the *CER Services Protocol* both countries agreed to treat service providers in the other country the same as they treat their own (the 'national treatment' principle). Each country maintains some protections for particular services on a 'negative list'. This list has been progressively reduced, with the remaining exclusions being in the areas of air services, broadcasting, third-party insurance, postal services and coastal shipping for Australia, and air services and coastal shipping in the case of New Zealand. Even though air services is an exclusion, substantial progress to open this sector to competition has been made through the Single Aviation Market Arrangements and Open Skies Agreements.

The BIE (1995) reported that the main significance of the *CER Services Protocol* was that it created an outward looking framework for services trade. Features of this framework include the use of a negative list (which prevents the exclusion of

new services as they become tradeable) and the elimination of export subsidies for trans-Tasman trade. Ochiai, Dee and Findlay (2009) found the *CER Services Protocol* to be relatively liberal compared to other agreements in the Asia-Pacific region. This was mainly due to CER having a low share of excluded sectors and no reservations that apply across all sectors.

As with goods, there have also been efforts to reduce barriers to services trade caused by regulatory differences between Australia and New Zealand. For example, the Trans-Tasman Council on Banking Supervision was established in 2005 to promote a joint approach to banking supervision and to deliver a more seamless regulatory environment in banking services.

Influence on trade and net benefits

Data on trade in services is far from comprehensive (for example, there is often limited data on trade via commercial presence) and this makes analysing trade influences difficult. According to the available data, two way trade in services between Australia and New Zealand amounted to about A$6 billion in 2010 (figure 3.4).

Figure 3.4 **Services trade between Australia and New Zealand, 2010 prices**

Source: ABS (2011).

The value of New Zealand's services exports to Australia has grown over the last 10 years, while there is no clear trend in the value of Australia's services exports

to New Zealand. However, little can be inferred from these data about the effects of CER on services trade, due to there being only 10 years of data as well as various measurement issues. Because of this, there is value in examining the experience of particular services sectors. Some sectors have experienced marked increases in trans-Tasman trade since CER commenced and CER initiatives may have played a role (table 3.1).

Table 3.1 **Possible effects of CER in selected services sectors**

Sector	*Likely role of CER and other factors*
Air services	
Since 1992, Australia and New Zealand have negotiated a range of agreements that have progressively strengthened competition in the trans-Tasman air services market. While Qantas and Air New Zealand continue to dominate the market, more airlines now fly across the Tasman. Low-cost carriers have emerged and there has been an increase in the diversity of routes served. As a result of greater competition, downwards pressure has been placed on airfares, resulting in broad community benefits.	The CER-related agreements have made the trans-Tasman market one of the most liberal in the world. They allow fifth freedom rights (under which carriers from third countries are able to operate), as well as seventh freedom rights for cargo services. Eligible Australian and New Zealand airlines are also able to operate domestically in each country. Ownership restrictions have also been relaxed.
Financial services	
Australian and New Zealand financial systems have become highly integrated through ownership, with Australian banks now owning almost 90% of the New Zealand banking sector. There is also a high level of Australian ownership of the New Zealand insurance industry. The integrated financial systems have played a role in each country's economic growth. Sound allocation of capital has enabled funding of economic opportunities, while at the same time encouraging efficiency in financial services.	Unilateral financial market deregulation in both countries appears to have been the major driver of increased trans-Tasman integration. However, it seems likely that the CER has produced benefits by harmonising certain regulatory procedures in ways that reduce transaction costs.
Telecommunications	
Prior to 1989, telecommunications markets in both countries were dominated by vertically integrated, government-owned monopolies. Both markets now have significant trans-Tasman and international commercial presence trade. For example: TelstraClear (wholly owned by Telstra), operates in New Zealand; and AAPT (wholly owned by Telecom NZ), operates in Australia. Greater integration has generated benefits from increased competition and the availability of foreign skills and technology. Consumers and producers face lower prices and improved availability of services.	Technological change, domestic policy reform, and CER and WTO agreements have driven integration. From 1989, microeconomic reforms in both countries opened markets to new entrants. The CER Services Protocol and the WTO's Basic Agreement on Telecommunications supported these reforms, furthering integration. CER initiatives, such as the harmonisation of consumer and competition law played a role by reducing business costs in the sector.

Establishing a commercial presence is the primary way that many services are traded internationally (Hardin and Holmes 1997). This could involve, for example,

a New Zealand architecture firm establishing an office in Australia. Establishing a commercial presence usually involves foreign direct investment (FDI). This means that there is a close link between services trade and investment.

Investment flows have increased substantially

Until recently, CER had not made progress in formally liberalising investment flows between the two countries. An Investment Protocol has now been signed, but is yet to be enacted. Despite this, there are some CER initiatives that have reduced barriers to firms expanding across the Tasman.

There is cooperation on securities regulation in both markets, including mutual recognition of securities offer documentation. ASIC (2009) found that this measure had reduced the cost of firms extending offers across the Tasman by between 55 and 95 percent. There is also an agreement between competition regulators in each country. For example, relevant competition legislation concerning misuses of market power has been amended to consider its impacts in the trans-Tasman market. In addition, there are agreements resolving issues of double taxation of personal income (although little progress has been made on removing double taxation of company profits), and an agenda to continue harmonisation of business law.

Box 3.9 provides some insights into the experiences of firms that do business across the Tasman (through both trade and investment) that are useful for understanding the barriers they continue to face.

The lack of a CER investment protocol has not prevented a strong bilateral investment relationship developing between Australia and New Zealand. Australia is now the largest foreign investor in New Zealand. According to the ABS, Australians held investments worth around A$74 billion in New Zealand in 2010, over half of which was classified as FDI — that is, investment where the foreigner creates, or gains a significant interest in, a local firm (ABS 2012a). In the other direction, New Zealand is Australia's ninth largest source of foreign investment. In 2010, New Zealanders held investments worth around NZ$34 billion in Australia, just under a third of which was FDI (SNZ 2011).

Box 3.9 **Firm level experience with trans-Tasman integration**

A survey of firms undertaken by ACIL Tasman and LECG Economics–Finance found that:

- over half of the surveyed New Zealand firms saw growth across the Tasman as crucial, while nearly all of the Australian firms saw it as incidental to wider ambitions
- reasons for involvement across the Tasman include incremental revenue and economies of scale, proximity and similarity, market diversification, outgrowing home markets, and a test market or learning experience for subsequent expansion elsewhere
- there were different types of integration experiences, covering different stages of the production and distribution chain
- many New Zealand firms found Australia difficult, especially at first, due to 'bureaucratic hurdles, a strong need for local networks and a more ruthless business culture' (p. ix)
- spin-offs from integration included: better positioning for eventual expansion elsewhere; greater interest from Australian venture capitalists; cross-fertilisation of ideas and products that can then be used elsewhere; improved ability to manage stocks through intra-firm trade; and improved career prospects for staff
- intermediaries, such as law firms, banks and telecommunication firms, have facilitated integration and been stimulated by it.

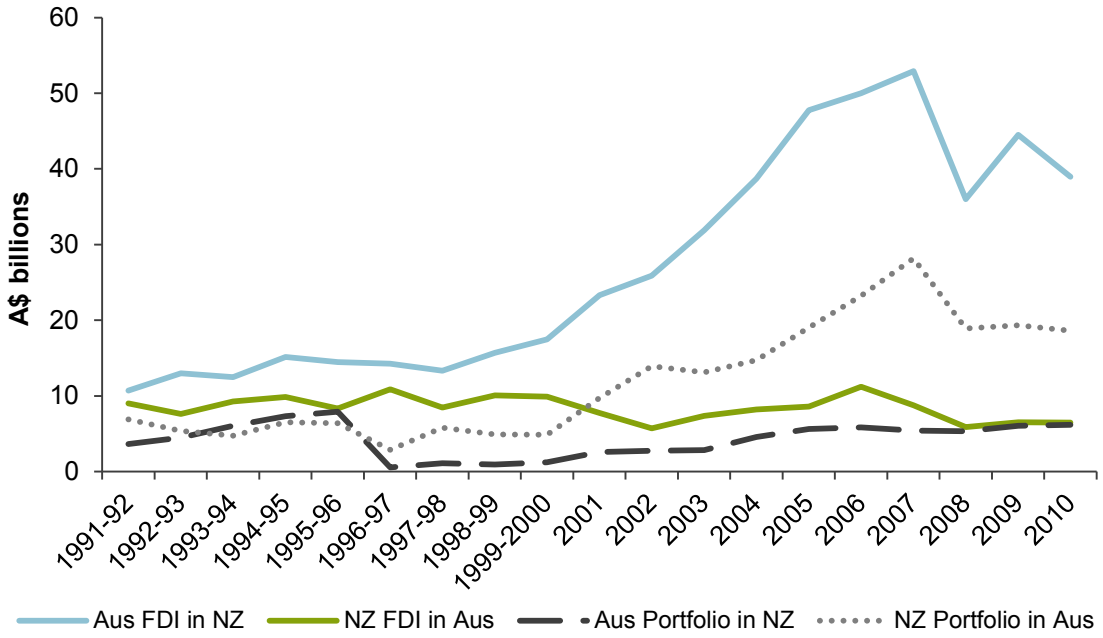
Barriers to integration identified by respondents include: travel, transport and communication costs; legal, bureaucratic, insurance and other start-up costs in Australia; tax differences; differences in legal systems; regulatory differences; and rules of origin.

Source: ACIL Tasman and LECG Economics–Finance (2004).

Figure 3.5 shows that the stock of Australian FDI in New Zealand has more than tripled in real terms over the past 18 years. The stock of New Zealand portfolio investment in Australia has more than doubled over this period.

There is a range of market and policy-related factors that could help explain the rise in the stock of Australian FDI in New Zealand. Capital has become more mobile across national borders generally. In addition, movements in exchange rates and labour costs are likely to have made some Australian investments in New Zealand more attractive. On the policy front, New Zealand made extensive changes to regulation of its finance sector between 1984 and 1987, including removing restrictions on foreign firms, including Australian firms, from acquiring New Zealand banks. CER initiatives are likely to have also played a role, but it is difficult to isolate their effects.

Figure 3.5 **Stocks of trans-Tasman investment, 2010 prices[a,b]**



[a] In 2010, FDI plus portfolio investment made up 61 percent of total Australian investment in New Zealand and 74 percent of total New Zealand investment in Australia. [b] Data for New Zealand portfolio investment in Australia in 2001 was unavailable and has been intercalated from data from 2000 and 2002.

Sources: ABS 2012a; 2012b.

Inward FDI produces significant benefits for Australia and New Zealand. The OECD (2005) argues that liberalisation of FDI is associated with increased investment, trade and economic growth in the host country. The recent growth in Australia's mining sector has been financed in part by a more than four-fold increase in FDI in the sector between 2001 and 2010 (PC 2012b). In terms of trans-Tasman flows, Australia accounts for over half of all FDI in New Zealand. New Zealand Treasury (2009) has stated that FDI inflows have improved economy-wide productivity by allowing domestic firms to access international supply chains, new technologies and foreign expertise and skills. Makin, Zhang and Scobie (2008) estimated that foreign investment in New Zealand between 1988 and 2006 (including direct and portfolio flows) increased incomes by NZ$3300 per worker and national wealth by NZ$14 000 per person (in 2007 dollars).

The free movement of people remains a key feature

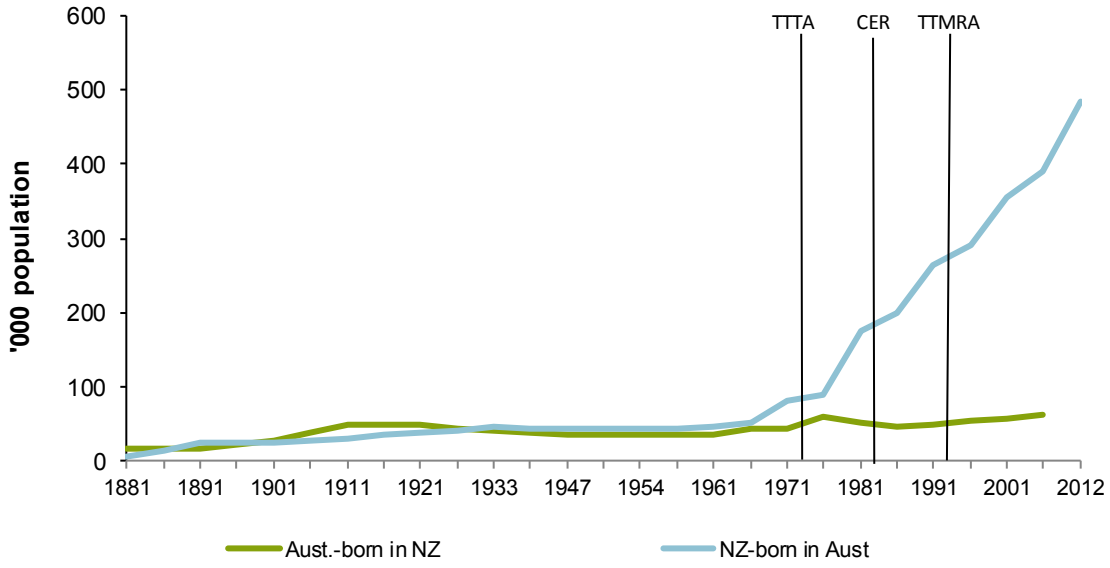
The free movement of people between Australia and New Zealand far pre-dates CER, but remains an important aspect of trans-Tasman integration. From this base, there have been some CER initiatives that have had some influence in

addressing barriers to people movement, such as TTTA, TTMRA and SmartGate (an automated passenger clearance system). However, changes have also been made to limit access to social security for some New Zealand citizens living in Australia (draft supplementary paper D).

People have moved between Australia and New Zealand since colonial times, with a long history of labour exchange at all skill levels (NZDoL 2010). Since the 1970s, there has been a substantial increase in the number of New Zealand-born people living in Australia, outpacing growth in the number of Australian-born living in New Zealand (figure 3.6).

The proportion of people living in Australia who were born in New Zealand has increased from around 1 percent in the early 1970s to just over 2 percent in 2006. In contrast, the proportion of New Zealand's population born in Australia has steadily fallen from around 5 percent in the early 1900s to just under 2 percent by 2011 (draft supplementary paper D).

Figure 3.6 **Australia's New Zealand-born population has increased sharply**



Sources: ABS (2012b); Poot (2009).

The TTTA and TTMRA are likely to have had an influence on trans-Tasman people movement. The TTTA formalised existing freedom of people movement, but also extended this to some citizens that previously faced restrictions. The TTTA has benefited both countries by easing the cost of visitor travel and allowing people to move to higher value employment, although there are some concerns in New Zealand about the number of people emigrating (draft supplementary

paper D). Other CER initiatives, such as SmartGate, have also benefited many travellers crossing the Tasman.

However, analysis suggests that economic factors — mainly higher wages in Australia — have been the main ongoing drivers of net migration flows of New Zealanders to Australia (DIAC 2011; Green, Power and Jang 2008; Hamer 2008; Stillman and Velamuri 2010). Poot (2009) also highlights the correlation between divergence of real incomes on either side of the Tasman from the late 1960s and migration flows from New Zealand to Australia.

Intergovernment cooperation is extensive

Collaboration between the Australian and New Zealand Governments is extensive and takes many forms, including:

- annual meetings of Prime Ministers
- regular ministerial and officials meetings (table 3.2)
- New Zealand ministers and officials being members, along with Australian federal and state counterparts, of many Council of Australian Governments Councils
- shared representation on other councils, boards and other bodies (such as the appointment of Commissioners from the other country to the ACCC and the NZCC)
- joint ventures or other unincorporated activity
- joint body, company or other incorporated institution (such as FSANZ and JAS-ANZ).

The CER agenda is developed and progressed through this collaboration, both formally and informally. This includes initiatives to coordinate regulations in various areas. In addition, the relationships and shared understanding developed through government-to-government contact have allowed each country to learn from the policy approaches taken in the other. This has allowed policy and regulatory frameworks to move closer together, which promotes increased integration.

Although Australia and New Zealand have mostly negotiated regional and bilateral trade agreements individually, they have taken a joint approach in some cases. The most notable example of Australia–New Zealand joint cooperation with other regional fora is the ASEAN Free Trade Area–CER dialogue. This initiative dates back to 1995. Since then, Australia and New Zealand have jointly negotiated a number of agreements with ASEAN, including the AFTA–CER Closer Economic

Table 3.2 **New Zealand ministerial and government agency interactions with counterparts in Australia, 2012[a]**

New Zealand agency	*Ministerial meetings*		*Officials meetings*		*Other interaction*	
	Number of groups	*Total number of meetings per year*	*Number of groups*	*Total number of meetings per year*	*Number of bilateral instruments*	*Staff exchanges*
Ministry of Foreign Affairs and Trade	8+	10+	14	17+	6	1
Ministry of Business, Innovation and Employment	9	10+	14+	21+	9	–
The Treasury	2	2	1+	1+	–	–
Inland Revenue Department	–	–	2+	2+	4	–
Ministry for Primary Industries	4	7+	6+	10+	6	1
New Zealand Defence Force/Ministry of Defence	3+	3+	2+	5+	2	1
New Zealand Customs Service	1	1	2	2+	3	1
Ministry of Education	2	2+	2	2+	–	–
Ministry for the Environment	1	2+	3	3+	–	–
New Zealand Police	1	2	2	6+	–	1
Ministry of Civil Defence and Emergency Management	1	1	1	4	2	–
Ministry of Health	1	3	1	3	1	–
Department of Internal Affairs	2	3	8+	10+	3	–
Others surveyed	3	2	5+	8+	7	1

a These data are drawn from a non-comprehensive survey of New Zealand government agencies that interact with Australian counterparts. – Nil or rounded to zero.

Source: provided by New Zealand Ministry of Foreign Affairs and Trade.

Partnership, signed in 2002. Negotiations for a Free Trade Area involving the 10 countries of ASEAN as well as Australia and New Zealand commenced in

2005. The agreement creating the ASEAN-Australia-New Zealand Free Trade Area (AANZFTA) eventually entered into force in 2010. AANZFTA provides for the progressive reduction or elimination of tariffs, market access commitments for services and commitments relating to investment liberalisation.

In social policy areas, both countries have agreed to reciprocal emergency health access for short term visits by residents of the other, and recognise child support determinations made by each jurisdiction. In addition, agreements have been made about access to social security in each country.

Summing up — CER has produced net benefits for both countries

The data presented above on trade, investment and people movements suggest that the Australian and New Zealand economies have become closely integrated and that CER has played a role in this. The conclusion is consistent with other measures of integration (box 3.10).

CER has been successful in removing explicit restrictions on trade and substantial progress has also been made in reducing behind-the-border barriers. Until recently, little progress had been made in reducing formal barriers to trans-Tasman investment, but this has not prevented a strong bilateral investment relationship from developing. Free movement of people between Australia and New Zealand was in place long before ANZCERTA commenced and this key feature of the relationship has been maintained.

As documented above, the CER agenda is made up of a large number of agreements dealing with a diverse range of issues. But CER has also been progressed through close government-to-government contacts and cooperation. This has promoted a subtle process of mutual learning that has improved domestic policy in both countries, and brought regulatory and policy approaches closer together.

The quantitative evidence on the benefits and costs of CER is not definitive. To some degree this simply reflects the difficulty of isolating CER's effects from various other policy and market influences. There is evidence of trade diversion in the merchandise area, but the potential for this to occur has diminished greatly as both countries have dismantled trade barriers more broadly.

Some CER initiatives have worked better than others. For example, it is clear that TTMRA has enabled transaction costs to be reduced on a broad front. It is reasonable to infer that this has brought considerable benefits and, as the cost

associated with this measure is modest, that net benefits have resulted. In contrast, efforts to harmonise the regulation of therapeutic goods through the creation of a trans-Tasman regulator have been protracted and costly, with the gains remaining prospective.

Box 3.10 **How integrated are we?**

Measures of economic integration are often based on the extent to which a single market operates across national borders. Increasing cross-border flows of trade, capital, people and ideas should lead two economies to display characteristics increasingly consistent with a single economy.

Assessments of integration from this perspective are based on 'de facto' measures of economic interdependence, as opposed to 'de jure' measures of policy barriers to integration. As such, one weakness is that they capture both policy and non-policy factors. So they cannot, for example, distinguish between the impacts of CER and improvements in transportation or communications technology on trans-Tasman integration. However, they provide a useful complement to assessments of policy barriers and have been widely used to measure integration in other economically close countries (see, for example, European Commission 2008).

So what do these techniques reveal about economic integration across the Tasman? First, the Australian and New Zealand business cycles have become more synchronised over recent years. This could be indicative of increased integration, driven by demand-side spillovers and financial linkages, or may simply reflect greater synchronisation of the world business cycle. Perhaps more conclusively, price changes for the same products have become more strongly correlated across Australia and New Zealand over the medium to long term and financial markets appear highly integrated. On balance, these results indicate that significant progress has been made towards achieving a single trans-Tasman market.

Notwithstanding this progress, the international border between Australia and New Zealand is estimated to be considerably 'thicker' than state boundaries within Australia. For example, the linkages between economic cycles and relative prices are tighter across states than they are across the Tasman. Greater economic interdependence across Australian states reflects internal trade and people flows that are much larger than between New Zealand and Australia. In addition, trans-Tasman price movements in a number of services markets are less correlated than in goods markets, indicating a greater extent of market fragmentation. Consequently, this suggests that the opportunities for future economic integration across Australia and New Zealand predominantly lie in the services sector.

Source: Conway, Meehan and Zheng (2012).

However, in the main CER has avoided integration options that would be costly to secure. This is evident, for example, in the approach taken to more closely aligning competition and consumer protection regimes.

It is also likely that CER has helped engender reform to broader policy settings in Australia and New Zealand. CER appears to have helped to change opinions about trade protection for manufacturing and paved the way for unilateral reductions in tariffs generally, particularly in New Zealand (Scollay, Findlay and Kaufmann 2011). In this way, and unlike some other bilateral or regional agreements, CER appears to have acted more as a 'building block' than 'stumbling block' in the pursuit of wider integration. Wider integration has in turn brought large benefits, including higher standards of living in both countries.

Overall, the Commissions' assessment is that CER has produced net benefits for Australia and New Zealand, notwithstanding uncertainty about the magnitudes.

3.3 Implications for the future agenda

Experience with CER over the past 30 years yields some insights that are relevant to the future trans-Tasman integration agenda.

Future progress will require careful assessment

The early years of CER saw major advances, with restrictions on virtually all goods traded between the two countries eliminated by 1990 and the agenda moved into new areas, such as services trade and behind-the-border regulatory barriers. Implementing agreements on reducing behind-the-border barriers has proven more complicated than the early agenda focused on merchandise trade.

That said, there is an ambitious agenda of business law reform, and progress towards integration in many other areas. However, as advances are made, new integration opportunities are becoming less obvious. Extending or deepening the trans-Tasman integration agenda will generally require tackling more complex and difficult areas of policy and regulation. This makes it particularly important to identify those initiatives that offer a satisfactory payoff. Good public policy processes will be instrumental in ensuring that the best policy initiatives are selected in the future.

Policy initiatives to encourage economic integration should be outward looking

CER was established to be outward-oriented, rather than focusing inwards on the bilateral relationship. Originally motivated by the need to find replacements for

European markets, the trans-Tasman integration agenda now needs to 'fit' with the broader challenges and opportunities in the 'Asian century' (Henry 2012). Australia and New Zealand's trade and investment links with Asia mean that what happens in Asia has repercussions for the trans-Tasman partners (box 3.11).

Box 3.11 **Transmission of Asian growth to Australia and New Zealand**

The ANZEA model was used to illustrate the effects on Australia and New Zealand of 10 percent growth in Asia. The first-round expansion was modelled as a uniform expansion in labour and capital (and corresponding incomes) in all Asian economies.

Asian growth contributes to GNP (Gross National Product) growth in Australia and New Zealand to a small extent — far less than 1 percent (see table). Growth in Asia:

- increases demand for Australian and New Zealand exports
- improves Asian competitiveness, crowding out Australian and New Zealand exports.

At the industry levels, growth in the Asian construction sectors (especially in China) translates into increased demand for Australian mining. Growth in Asian consumer demand (especially in ASEAN) translates into increased demand for agricultural products, especially dairy and meat products in New Zealand.

Lower bound results in the table are associated with high substitutability between domestic and imported products. Growth in inputs in Asia decreases production costs and prices. To the extent that cheaper domestic products can be substituted for imports, this domestic production crowds out Australian and New Zealand exports. This is especially the case for agriculture. Upper bound results occur when low substitution is assumed — the expansion effect dominates as Asian economies expand their use of unique Australian and New Zealand products and little crowding out occurs.

Table **Economy-wide effects of Asian growth[a]**

	Australia	*New Zealand*
GNP	0.01 – 0.15	(0.01) – 0.16
Exports	(0.16) – 1.37	(0.23) – 0.77
Value-added		
Agriculture	0.00 – 0.21	0.03 – 0.26
Mining	1.32 – 1.66	0.41 – 0.71
Exports to Asia		
Agriculture	1.37 – 2.44	1.97 – 3.03
Mining[b]	4.62 – 5.07	5.26 – 5.96

[a] Negative values in parentheses. [b] Mining accounts for only 0.64 percent of New Zealand exports. Thus even a relatively large percentage change in mining production contributes only small changes to New Zealand output. In contrast, mining accounts for more than 21 percent of Australian exports, and contributes significantly to Australian output.

Source: Australian Commission estimates.

The rise of Asia has seen the share of global GDP within 10 000 kilometres of Australia and New Zealand double in the past 50 years. This is bringing opportunities for industries such as mining in Australia and dairy in New Zealand, but elements of the manufacturing sector have experienced a more challenging environment, as they have faced more intense competition from a rapidly industrialising Asia.

At the same time, multilateral efforts to promote trade liberalisation have lost momentum. The Doha Round began 11 years ago, but is yet to be concluded and its future is uncertain. This has reinforced the need to consider trans-Tasman integration in a broader regional and global context. It means avoiding doing things that impede integration with other countries and extending trans-Tasman initiatives to reap further gains from broader integration in multilateral fora and at a wider regional level. Finding ways to ensure that trade and investment creation predominates more generally should continue to be an objective for CER.

The rise of Asia presents great opportunities for both countries — with benefits that potentially far outweigh those on offer through further integration between Australia and New Zealand, significant though these may be. The best way to position both economies to capture the benefits of the 'Asian Century' will be to enhance their productivity and competitiveness. This means that each country needs to remain outwardly focused, while continuing to pursue domestic policies that enhance efficiency and improve productivity.

The opportunities for Australia and New Zealand from growth in Asian economies will depend on there being sufficient flexibility and business capability in both economies to respond to changing patterns of demand. Hence, it is important that the integration initiatives and domestic reforms develop in ways that increase the capability of both economies to adjust to, and make the most of, changing economic circumstances.

CER also has the potential to be a model for reducing integration barriers in the Asia-Pacific region. That said, there are aspects of CER that are unlikely to be able to be extended to countries that do not share the two countries' institutional similarities. For example, mutual recognition of occupational licencing would not be likely to work well between countries with very different licencing requirements.

Finally, an integrated Australasian economic area with similar (high-quality) regulatory approaches, greater critical mass in high-value competencies and relatively seamless internal interactions can position itself as a more attractive economic region in the eyes of Asian businesses and consumers.

The focus has shifted towards the services sector

CER began as a trade agreement, and gradually evolved to have a broader coverage. This is consistent with the evolving composition of the Australian and New Zealand economies themselves. In common with other developed countries, both economies are oriented towards services, which now in aggregate account for around 80 percent of each countries' GDP (chapter 1). Moreover, there has been a dramatic increase in the share of services in global trade, particularly with developed countries.

While manufacturing was more important at the inception of CER — which is one reason why trade in manufactures was the focus of the initial agreement — it remains significant in both economies. That said, with the services sector dominating and with barriers to trade of manufactures having been substantially reduced under CER, initiatives that affect services trade and investment could be expected to absorb an increasing share of future policy effort.

Scale remains an issue

One of the drivers for CER was the expectation that improved access to trans-Tasman markets, in an environment where access was being denied to Europe, would enable firms in both countries to specialise and achieve economies of scale.

Thirty years on, the small scale of domestic markets remains an issue, particularly for New Zealand. Australia and New Zealand rank 13th and 55th respectively amongst world economies when size is measured by gross domestic product (GDP) (IMF 2012). Australia's population and labour force are each approximately five times the size of New Zealand's and its GDP is around seven and a half times as large (on a purchasing power parity basis). In terms of population, New Zealand is about the same size as Queensland, Australia's third largest state. These size differences have increased over time because of Australia's higher trend rate of growth in both population and GDP per person.

The difference in size of the two economies carries over to individual industries and sectors. For example, the Australian telecommunications market has between four and five times as many customers as New Zealand across fixed line, mobile and internet services. Industries with large fixed costs such as telecommunications and transport infrastructure suffer higher unit costs in small markets and are forced to pass these on to customers. Small markets also limit the scope for competition to drive efficiency and innovation (Berry 2011).

Both countries also face the challenge of their distant location from major markets and from places that are prime sources of creativity and innovation. According to empirical estimates in one study (Boulhol and de Serres 2010), the GDP per person of both countries is around 10 percent less than it would be if their distance from world economic activity was around the average for OECD countries.

The challenges of size and distance highlight how important it is that CER remains outward-oriented. They also explain why New Zealand firms place such importance on having access to the Australian market. Services delivered by commercial presence, as well as government services and regulatory functions, have better opportunities to reap economies of scale and scope in an integrated trans-Tasman market.

The combined GDP of Australia and New Zealand would rank as the 12th largest world economy. This is only one place higher than Australia on its own, but obviously represents a significant increase in ranking for New Zealand. It follows that closer integration between their markets is likely to be particularly attractive to New Zealand. It is thus through the twin track of a larger 'domestic' market and greater international integration in general that CER can contribute most effectively to overcoming the problems of scale.

People mobility is beneficial, but brings with it some complex issues

Over the past 30 years, large numbers of people on both sides of the Tasman have taken advantage of opportunities to move between the two countries, for both short and long-term visits (or permanent migration in many cases). This has brought gains, particularly for those involved, but some complex issues have arisen that may require further government attention. In particular, there are concerns about:

- adjustment costs, including possible 'hollowing out' of the New Zealand economy
- whether New Zealanders who have lived and worked in Australia for an extended period have appropriate access to social security entitlements and pathways to citizenship
- potential future costs to the New Zealand Government from New Zealand citizens returning after an extended absence and then accessing the pension.

CER should continue to complement domestic reform

Domestic imperatives in each country, rather than CER, were the primary drivers of the market-based reforms that commenced in the 1980s. Yet, as box 3.2 shows, there have been marked similarities in the policy approaches taken in the two countries, with Australia leading in some cases (such as in the removal of capital controls and floating the exchange rate) and New Zealand leading in others (such as central bank independence and the goods and services tax). While the countries have taken their own approaches to economic policy, cooperation with and learning from the other have also been a factor.

A further important implication is the need to strike the right policy balance between domestic reform, trans-Tasman reform and other regional and multilateral reforms. Developing and implementing policy in any area absorbs resources and the scarce time of ministers, parliamentarians, officials, and private-sector players. The wrong balance can have large opportunity costs. Consideration of trans-Tasman integration initiatives must take this into account, particularly given the ongoing importance of domestic reform for productivity growth.

Pragmatism can be a virtue

CER has benefited from the pragmatic approach taken by governments and bureaucracies over the years. In general, effort has been focused on areas identified as being important to business and consumers, and for which practical and politically feasible solutions could be anticipated (Scollay, Findlay and Kaufmann 2011). The institutional arrangements for managing the integration agenda have likewise been kept as simple and light-handed as possible. Some joint institutions have been established, but supranational institutions have been avoided.

A pragmatic approach has also been useful in relation to the unequal nature of the trans-Tasman relationship. As noted, Australia has a much larger economy and this means that trans-Tasman integration is a ‘higher stakes game’ for New Zealand. In the main, both governments have understood this imbalance and worked constructively with the consequences it brings. On the Australian side this has meant appreciating that integration brings larger adjustment pressures for New Zealand which need to be managed. On the New Zealand side, it has meant understanding that integration is a lesser priority for Australia, and that progress needs to be made when opportunities arise. In some cases, the best option open to New Zealand may be to simply adopt Australia’s regulatory approach.

In future, the CER agenda should retain this pragmatic approach, within the conceptual framework developed in chapter 2.

Harmonisation is challenging

Once a decision has been made to reduce at-the-border barriers such as tariffs, implementation is generally straightforward. By contrast, decisions to pursue regulatory harmonisation or other mechanisms by which to reduce behind-the-border barriers are usually more challenging. Agreement must be reached on the extent to which regulatory differences should be removed and whether institutional changes should be made (such as moving to a joint regulator). Enacting the desired changes may require extensive changes to legislation, administrative procedures and regulatory institutions.

The experience with regulation of food safety and therapeutic goods demonstrates the challenges of harmonisation (boxes 3.3 and 3.4). The success of FSANZ suggests that the inclusion of provisions that allow some level of flexibility for countries to respond to domestic issues and preferences within a harmonised regime can help to reduce the costs associated with the loss of national autonomy. The perceived lack of such flexibility in the original arrangements proposed for therapeutic products appears to have been a major contributor to delaying the introduction of the ANZTPA. Further, the case of FSANZ illustrates the point that harmonisation across the Tasman has a higher probability of success if it builds on reform and alignment that has already occurred across Australian jurisdictions.

The scope of ANZTPA's activities is to include the enforcement of regulations, while FSANZ does not perform this function. Accordingly, ANZTPA represents a more far-reaching model for harmonisation, and this has also contributed to the delays and costs of its introduction. The lesson here is that more complex forms of harmonisation generally bring added costs and so should only be embarked on where the net benefits can be substantiated as larger than for alternative options.

More broadly, it is important that any harmonisation efforts draw on the best regulatory approaches in both countries. Regulation imposes costs — compliance costs for businesses and broader efficiency costs when it distorts the allocation of resources — and any moves to align regulatory arrangements should weigh these costs against the desired regulatory outcomes. This point was noted by some industry participants (box 3.12).

Box 3.12 **Benefits and risks of harmonisation — industry perspectives**

A number of submissions called for greater alignment of regulatory arrangements between Australia and New Zealand. For example, the Pharmaceuticals Industry Council made the case for harmonising the rules and regulations for conducting clinical trials for new pharmaceutical products:

> Harmonising … would allow faster, easier and ultimately cheaper access to research sites across the two jurisdictions. This would not only give researchers the ability to recruit more patients into clinical trials, but also give patients in both jurisdictions faster access to new healthcare technologies. (sub. 43, p. 3)

However, it noted the risks of harmonisation:

> … Australia and New Zealand must ensure that a more harmonised system builds on existing strengths of each jurisdiction and does not impose one's weaknesses on the other. (sub. 43, p. 3)

In a similar vein, Accord Australasia noted that closer alignment of Australia's chemical regulations with those of New Zealand could significantly reduce industry costs while maintaining good health and safety outcomes. However it also cautioned:

> … we also do not believe that the regulatory requirements in either country should be increased to achieve this end — outcomes should optimise net trans-Tasman benefit. (sub. 54, p. 10)

Fonterra also referred to an instance where it believed harmonisation was desirable. It also emphasised the importance of selecting the right model for harmonisation:

> Laws relating to criminalisation of cartels should be harmonised, but not by adopting the Australian model. There is no sound policy basis for criminalising cartels, in particular no evidence that criminalisation increases compliance where there are already significant sanctions for breaches of the relevant laws. (sub. 14, p. 3)

Standards Australia also noted the challenges associated with harmonisation, specifically in the context of standards, but observed that there were opportunities:

> Where economic imperatives differ between countries, the harmonisation of standards can often prove challenging and avoiding a 'race to the bottom' is critical. However, the aforementioned high rate of adoption of international standards both regionally and internationally is an excellent opportunity to achieve harmonisation. (sub. 44, p. 2)

The immediate benefits of harmonisation generally accrue to firms and individuals who operate across or move between different jurisdictions. Harmonisation may also induce some firms and individuals to extend their activities from one to both countries. However, for those who continue to operate entirely within one jurisdiction harmonisation can be a negative. There may be one-off costs from the need to change systems to suit new rules and ongoing costs if the new regulations are more onerous. Accordingly, it is important to consider the costs and benefits of harmonisation on a case-by-case basis.

It should be noted that there are many areas of regulation where harmonisation even across Australia's own jurisdictions has not been achieved. Where this is the case, the prospect of and potential benefits from harmonising across the Tasman can be much reduced. In these and other cases, mutual recognition provides a worthwhile alternative (and can be a precursor to harmonisation) as demonstrated by the Trans-Tasman Mutual Recognition Arrangement.

Political leadership is important

Trans-Tasman integration initially had little active support from the business community in Australia or New Zealand, and strong vested interests opposed it. The steps forward during the New Zealand Australia Free Trade Agreement era and the early years of CER depended on advocacy by individual politicians. Some key business leaders, academics and government officials also played an important role. Although many of these were small steps, they were important in building a constituency for change. Political leadership was also instrumental in achieving the breakthrough reforms arising from the 1988 review. At various times political support has been important in regaining momentum for further integration.

Public opinion surveys suggest that there is support in both Australia and New Zealand for at least the current extent of integration, although the recent problems in Europe may add to public scepticism about further trans-Tasman integration initiatives. The history of CER suggests that political leadership is likely to continue to have an important part to play in carrying forward the CER agenda.

4 Opportunities for further integration

Key points

- This 'scoping study' identifies some 20 policy initiatives to strengthen trans-Tasman economic relations in ways that could yield joint net benefits.
  - Most of these address regulatory barriers (typically behind the border) to services trade and commercial presence, and some remaining impediments to integration in goods, capital and labour markets.
  - There is also greater scope for each government to cooperate with and learn from the other in policy development and service delivery.
- Some areas involve unfinished business (initiatives to which both Governments have committed but have not yet completed). Others are potential new initiatives, some of which will require more detailed consideration after the study is completed.
- For trade in goods, waiving rules of origin for all items for which tariffs are at 5 percent or less would reduce compliance and administrative costs for a significant proportion of trans-Tasman trade. Building on this reform, each country could reduce tariffs that exceed 5 percent down to that level by, say, 2015.
- For trade in air and sea transport services, while the trans-Tasman air route is already quite competitive, two regulatory barriers to competition on this route could usefully be removed. In relation to shipping, the exemption of ocean carriers from key parts of competition regulation is no longer necessary and there would be gains from removing it.
- For capital, the two Governments should implement the Investment Protocol they signed last year and consider removing the remaining restrictions. The issue of greatest concern for business participants is that companies are not allowed tax imputation credits on trans-Tasman investment. Mutual recognition of imputation credits could expand investment and bring efficiency gains, but would involve sizeable fiscal losses and income transfers, which could leave at least one country worse off.
- While the two countries have permitted virtually free movement of people between them, their different social security and tax systems may have placed some New Zealanders resident in Australia for long periods in anomalous situations. Information gaps, together with the broader ramifications for migration and social security tax systems, mean that further investigation of possible options would be needed after the study is completed.

The CER agenda over the past 30 years has involved a series of initiatives spanning a broad range of areas. This chapter sets out the Commissions' preliminary assessment of additional policy initiatives for moving the Australian and New Zealand economies further towards a single economic market. The chapter divides integration policy initiatives into three groups:

- 'unfinished business': namely, initiatives to which both governments have committed, but have not completed
- additional potential initiatives. The study has selected the initiatives that appear most promising from a wide range of possibilities, using criteria outlined in chapter 2. These initiatives are categorised according to which of the 'four freedoms' they address: goods; services; capital or labour. Opportunities for transferring knowledge and for closer integration of the public sectors are also explored
- initiatives that should not proceed.

More detailed analysis of the issues can be found in the draft supplementary papers.

4.1 Unfinished business: key areas to deliver

In five areas — business law, mutual recognition of occupational licensing, portability of superannuation, therapeutic products regulation and the CER Investment Protocol — the Australian and New Zealand Governments have committed to policy initiatives that are likely to be beneficial but have not been completed at the time of writing.

Business law reforms are mostly on track

The program as a whole

A report prepared by the Trans-Tasman Outcomes Implementation Group (TTOIG 2012) showed that, in February 2012, 14 of the 21 medium term outcomes in the business law single economic market program were on track for completion by the end of 2014, while the remaining seven outcomes were delayed or on hold (box 3.6). One of the delayed items (enabling auditors registered in one country to operate in the other country) took effect on 1 July 2012. The TTOIG report indicates that there are various reasons why the other six outcomes have been delayed.

- Work on a single set of financial statements for private not-for-profit entities has slowed to allow a cost-benefit evaluation to be undertaken, given that few, if any, such entities have reporting obligations in both countries.
- Progress on a single trans-Tasman register for personal property securities has slowed because consultations with finance stakeholders indicated that they had little interest in the outcome.
- Progress towards a single plant variety regime has slowed (although there has been in principle agreement to investigate a common application form).
- Sharing confidential information between competition and consumer law regulators in both countries requires the legislative changes in the *Commerce Commission (International Cooperation and Fees) Bill*. This Bill was introduced into the New Zealand Parliament in 2008 and received its second reading in May 2012.
- Standardised business reporting and single filing of company information are not being pursued for financial reasons, in the first case within New Zealand, and the second in both countries (TTOIG 2012).

With the possible exception of the application process for patents (see below), the Commissions consider that the TTOIG should complete those parts of the business law integration program for which it remains responsible according to the specified timetable, unless it considers that the net benefits are no longer evident or need further investigation. (This appears to be the case for a single set of financial statements for private not-for-profit entities and a single register for personal property securities.)

Three of the seven outcomes under the business law reform program to which both governments are committed are being delayed only because governments are unwilling to fund them or because of delays in passing legislation. The Commissions consider that these initiatives should be completed, again unless it can be demonstrated that they would no longer generate net benefits.

DR4.1

To promote further cooperation between the Australian Competition and Consumer Commission and the New Zealand Commerce Commission, the New Zealand Government should prioritise the passage of the Commerce Commission (International Cooperation and Fees) Amendment Bill.

In order to advance remaining initiatives from the business law reform program of the single economic market agenda:

- the New Zealand Government should implement the Standard Business Reporting program
- both Governments should implement the single filing of company information.

A single application and examination process for patents

This initiative, which is part of the business law reform agenda, is intended to simplify the process for those seeking a patent in both Australia and New Zealand and to facilitate closer coordination between the Australian and the New Zealand Intellectual Property Offices. However, the New Zealand Institute of Patent Attorneys (sub. 30) and Baldwins (sub. 46) suggested that simplifying the application process would increase applications by overseas owners of intellectual property for joint patents (when previously they would have only applied for a patent in Australia), to the disadvantage of New Zealand innovators.

The available evidence does not permit a judgment about these effects. The Commissions are seeking information about the impact of a single patent filing system on the rate of patent filing in both Australia and New Zealand.

Q4.1 Would a single application process affect the rate of patent filing in Australia and New Zealand?

Mutual recognition of occupational licensing

Under the Trans-Tasman Mutual Recognition Arrangement (TTMRA), 'people are able to register an occupation and practise in the other country if they are registered in this occupation in the home country' (Strutt, Poot and Dubbeldam. 2008, p. 11). The TTMRA followed the *Mutual Recognition Act 1992* in Australia, adopted by the states and territories to create a more efficient labour market. (The TTMRA makes similar provision for product markets.) The objective is to facilitate the movement of people (and goods) between jurisdictions on the basis that lowering regulatory and technical barriers would lower costs, increase competition and lead to efficiency gains.

Under the TTMRA, Australia and New Zealand each have an interest in the other's occupational regulation. For mutual recognition to work effectively, each country needs to have confidence in the other's regime. This does not mean that they need to be the same — indeed there can be value in diversity to allow some

regulatory competition and to help identify what approaches work best. The TTMRA allows differences, although they cannot be too large without undermining the confidence and trust on which mutual recognition depends.

According to the New Zealand Ministry of Foreign Affairs and Trade (cited in Strutt, Poot and Dubbeldam 2008), the TTMRA has lowered the barriers to people moving for employment purposes between the two countries. The Australian Commission reviewed both the MRA and the TTMRA in 2009 and found that both agreements have increased the mobility of goods and labour around Australia and across the Tasman (PC 2009).

The Australian Commission found that differences in occupational licensing regimes can impede labour mobility. Mutual recognition entitles a person registered in one jurisdiction to practise an equivalent occupation in another jurisdiction. Where the scope of authorised activities differs across jurisdictions, regulators can impose conditions on licensees, in order to define the boundaries of mutual recognition. This, however, complicates the task that regulators face and can result in mobility being lower than otherwise.

The Council of Australian Governments (COAG) is currently engaged in developing national licensing regimes for a number of occupations. While agreement on a national licensing regime within Australia would address the issue of inter-jurisdictional differences within Australia, it will take some time before such regimes are developed across all occupations. Moreover, they may not be worth the cost to develop for occupations of lesser significance or where licensing is only required in a few jurisdictions, or when there is little cross-jurisdiction movement (PC 2009).

Even when there is an Australia-wide licensing scheme in place, New Zealand generally will not be part of it, which means that the TTMRA remains important and that its interface with Australian licensing needs to be considered. For this reason, the Australian Commission's view in 2009 was that:

> … Given the importance of regulator cooperation in the operation of the TTMRA, engagement of New Zealand regulators in the development of new systems in Australia appears highly desirable. (PC 2009, p. 110)

COAG, as noted above, continues to work on occupational licensing, and the New Zealand Government is undertaking a scoping study of occupational regulation. Ongoing consultation and knowledge sharing across the Tasman would allow these separate national developments to continue without undermining the key element of mutual recognition.

DR4.2 Australian and New Zealand occupational regulators should share knowledge and lessons in developing efficient and effective occupational licensing systems. Relevant Australian and New Zealand regulators should be included in consultations around the development of national licensing systems in the other country.

Portability of retirement savings

In 2009 the Australian and New Zealand Governments agreed to develop legislation to facilitate the trans-Tasman transfer of retirement savings if a person resident in one country emigrated permanently to the other (ATO 2011). However, only New Zealand has passed the necessary legislation. One estimate (reported in Shadwell 2011) is that up to NZ$16 billion worth of superannuation funds have been accumulated by New Zealand citizens who had contributed monies under Australia's compulsory superannuation system while living in Australia and had since returned to New Zealand. These funds were not, however, available for transfer to New Zealand superannuation fund(s). Portability of superannuation funds from Australia to New Zealand may strengthen the New Zealand Kiwisaver program (estimated to be around NZ$8 billion in total), through increasing its capital and decreasing the average cost of funds management.

Given that trans-Tasman agreement has been reached and legislation has been enacted in New Zealand but not in Australia, drafting the Australian legislation should be concluded, for consideration by the Parliament of Australia.

DR4.3 The implementation of the trans-Tasman agreement on the portability of retirement savings has been impeded by slow progress in Australia. The Australian Government should proceed to complete these reforms.

The Australia-New Zealand Therapeutic Products Agency (ANZTPA)

As described in chapter 3, the journey towards ANZTPA has been a long and difficult one — and is not yet completed. A three staged process is now under way, with the new authority now expected to be operational by 2016 (box 4.1).

Box 4.1 Towards the Australia-New Zealand Therapeutic Products Agency

A three stage approach over a period of up to five years will be adopted to progressively achieve the goal of a single regulator.

1. The two countries' regulators, the Therapeutic Goods Administrator (TGA) and Medsafe, will immediately begin a program of work-sharing and increased joint operations. This will enable the separate regulatory systems of each country to be enhanced by sharing of data and information, training, and establishing centres of expertise in each country.
2. Building on this, a single entry point for industry will be established and a common trans-Tasman regulatory framework will be agreed.

   During these two preliminary phases, each country will retain its own regulator and continue to make its own regulatory decisions, but business will benefit from a significant reduction in red tape with only one set of requirements to operate in two countries.
3. As business operations become increasingly integrated and following a review of progress, the single regulator will be established.

Source: Department of Health and Ageing (2011).

The Australian Government has identified the benefits that ANZTPA will bring and the Prime Ministers recently signed a statement of intent to implement it (box 3.4). Implementation should therefore be completed by the agreed deadline. Given the difficulties in progressing this project, regular publication of progress reports (similar to the six-monthly report published by the TTOIG) would assist stakeholders of the proposed agency with their planning and would signal the need for remedial action should the latest deadlines be missed.

In the longer term, given that the ANZTPA will be the first trans-Tasman authority that enforces regulation as well as setting standards, it provides an important opportunity to learn from the experience. Once the ANZPTA is established, it would be useful to review why the project took so long to complete; how the barriers to establishing it were overcome; and whether other approaches could have achieved similar outcomes more quickly. The purpose of the review would be to draw out insights that could inform the identification and development of similar policy initiatives in the future. This would help to target future efforts on initiatives that generate the largest net benefits.

DR4.4 Given the long time it is taking to set up the Australia-New Zealand Therapeutic Products Agency, the Australian and New Zealand Governments should:

- publish regular progress reports
- once the Agency has been established, review the lessons from establishing it for other potential regulatory harmonisation initiatives.

CER Investment Protocol

Australia and New Zealand signed a CER Investment Protocol in 2011, but it has not yet been enacted. The Protocol lifts some investment screening thresholds and establishes a legal framework of investor rights. Due to various exclusions, it will have only a modest liberalising effect. Despite this, the Protocol is likely to generate net trans-Tasman benefits and should be implemented as soon as practicable (draft supplementary paper C). The case for further liberalisation of trans-Tasman investment restrictions is considered in section 4.6.

DR4.5 The CER Investment Protocol should be enacted as soon as practicable.

4.2 Identifying new areas for integration

Drawing on the criteria outlined in box 2.7, the Commissions have focused on the following areas and impediments.

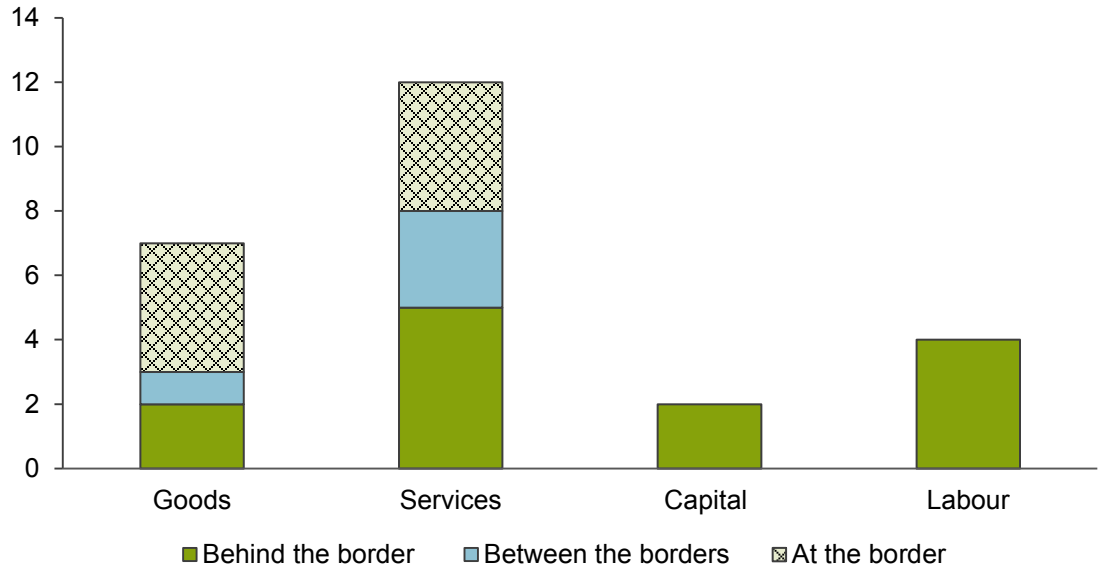
- In the *goods* markets, rules of origin (RoO) prevent transhipment from third countries through one member country to the other, to avoid the latter's general tariffs. These arrangements are costly to administer, can distort production and increase prices paid by consumers. Unnecessarily restrictive quarantine and biosecurity arrangements can also have a significant impact on particular industries, with the consequent cost increases passed on in part to consumers. The Commissions have also reviewed impediments to linking Australia's and New Zealand's emission trading schemes, given that carbon is a broadly used input to consumption and production.
- In *services*, policies that could reduce trans-Tasman shipping and air transport costs would have wide-ranging effects. The Commissions have also reviewed

regulatory impediments to an integrated telecommunications market, given the integral role of telecommunications in commerce.

- In relation to *capital*, three areas appear particularly important:
  - restrictions on direct investment across the Tasman, which are likely to have deep effects on some businesses
  - the taxation of dividend income, which emerged during consultations as the most important issue for many businesses operating in both countries
  - the banking system, which affects most trans-Tasman transactions.
- In relation to *labour,* the significant movement of people across the Tasman illustrates that barriers are low. Nevertheless, there are some remaining impediments, relating to trans-Tasman travel and, for New Zealanders staying on in Australia, to social security, residency and citizenship.

Sections 4.3 to 4.8 explore the opportunities for removing impediments to integration. Of the 20 areas and issues, most involve impediments to trade in services. Regulations behind the border are particularly important (figure 4.1).

Figure 4.1 **Where are the areas for reform?[a]**



[a] Areas that are likely to be substantially affected by the draft recommendations identified in chapter 4. Some recommendations are likely to affect more than one area.

4.3 ‘First freedom’: trade in goods

Considerable progress has already been made in removing barriers to trans-Tasman trade in goods (chapter 3).

Tariffs and rules of origin: remaining issues

Following reform programs in both Australia and New Zealand dating back to the 1980s, quotas on imports have all but been eliminated and general tariffs in both countries are low — generally 5 percent or less. Two key exceptions are:

- second hand cars in Australia — which attract a flat rate of A$12 000 in duty
- various textiles, clothing and footwear (TCF) items in both Australia and New Zealand, which attract tariffs of 10 percent — although in Australia these will be reduced to 5 percent by 2015.

Barriers to goods trade across the Tasman are even lower. Under the ANZCERTA, imports from the partner country enter duty free, provided they are deemed to have originated in the partner country under the CER RoO.

Both countries also have a range of preferential trading agreements (PTAs) with other countries (with some overlaps, but also some differences). As a result, a sizeable proportion of imports into both countries enter duty-free.

While tariffs in both Australia and New Zealand have generally fallen to low levels and their protective value will continue to be eroded as further free trade deals take effect, they continue to generate costs. These include administrative costs borne by the customs services and businesses, and distortions to production and consumption incentives. The pockets of remaining high tariffs are also likely to have a regressive impact, harming lower income consumers most. The Commissions consider that if governments seek to assist any activities or industries in the future, assistance should generally take the form of direct and transparent taxpayer-funded subsidies. Against this background, the goal of free trade in goods with all trading partners should be the longer term objective for both countries.

Policy options

The main issue for bilateral trade between Australia and New Zealand is the costs businesses incur in complying with the CER RoO. As the Australian Commission found in recent reports, the cost of transhipment generally exceeds 5 percent of

the value of imports (PC 2004a; 2010a). Thus, when tariffs are at 5 percent or less, there is no incentive for third parties to engage in transhipment, and thus no need for the associated RoO. Accordingly, the Commissions recommend that CER RoO should be waived for all items for which tariffs in Australia and New Zealand are at 5 percent of less. This would reduce compliance and administrative costs for a significant proportion of trans-Tasman trade.

Building on this initiative, each country could also reduce any tariffs that exceed 5 percent down to that level (by, say, 2015), allowing the trans-Tasman RoO to be abolished. The additional elements of this proposal would mainly affect the New Zealand TCF and Australian automotive sectors, to the benefit of consumers of those products. Reviews targeted at the implications for these activities could be undertaken first. The Commissions see merit in this option, which is discussed further in draft supplementary paper A, and seek comment on it.

The Commissions have closely considered the merits of a customs union and do not support this option. Under such an arrangement, the partners would need to adopt a common external tariff and align other border regulations covering substantially all trade in goods. This option could bring about reductions in tariffs and abolition of the RoO. However, depending on its implementation, there would also be a risk that tariffs on some items could rise and that disparities in assistance could widen. It would restrict the freedom of the partners to pursue trade arrangements with third countries. Among other concerns, the costs of designing the rules for a customs union to operate could be large. Some supporters of a customs union consider that it would increase the countries' combined bargaining power in trade negotiations, but they could still negotiate together without having to form a customs union.

DR4.6

Closer Economic Relations Rules of Origin should be waived for all items for which tariffs in Australia and New Zealand are at 5 percent or less.

Australia and New Zealand could also reduce any tariffs that exceed 5 percent down to that level (by say 2015), allowing the trans-Tasman Rules of Origin to be abolished.

Quarantine and biosecurity

While the biosecurity functions of Australia and New Zealand are administered by separate agencies, there is a long history of trans-Tasman cooperation (box 4.2). Reflecting this, the New Zealand Ministry of Foreign Affairs and Trade considers

that '[t]oday, the overwhelming majority of trans-Tasman biosecurity/quarantine issues have been resolved, with few remaining outstanding' (MFAT 2010).

Box 4.2 A cooperative approach to biosecurity

Biosecurity measures were excluded from the original CER agreement and the Trans-Tasman Mutual Recognition Arrangement. However, in 1988 Australia and New Zealand agreed to a Protocol on the Harmonisation of Quarantine Administrative Procedures, which established a basis for closer collaboration. The Protocol recognised that further progress towards harmonising processes would benefit both countries. The Protocol also commits to the principle that biosecurity should not be deliberately used as a means of creating a barrier to trade, where this is not scientifically justified (Australian and New Zealand Governments 1988).

In 1999, a Consultative Group on Biosecurity Cooperation (CGBC) was established to provide impetus and direction for trans-Tasman biosecurity harmonisation (CGBC 1999). It comprises Australian and New Zealand officials and reports annually to the relevant Australian and New Zealand Ministers, focusing on:

- streamlining risk analysis approaches in Australia and New Zealand
- ensuring that biosecurity requirements are based on sound science
- reviewing the mechanisms for information exchange and other interaction between the two countries on biosecurity issues (MFAT 2010).

There are also extensive trans-Tasman Ministerial and government agency interactions.

Despite sharing some similarities, Australia and New Zealand have different environmental contexts and biosecurity risks. This limits integration and rules out options such as adopting the same risk standards for imports from third countries and reducing quarantine restrictions on a trans-Tasman basis.

The issue therefore is how much additional cooperation is beneficial, given that biosecurity restrictions will inevitably remain. Currently, the trans-Tasman approach to biosecurity is characterised by formal and informal cooperation, information sharing, shared resources, and some collaboration in risk analysis. This approach benefits both countries and should be maintained. The relationship should also be flexible, given that new approaches may be required as new biosecurity risks emerge.

A more collaborative approach to risk identification and analysis is likely to benefit both countries and they have recently begun to undertake some aspects of risk analyses jointly. Findings from joint analysis will usually — but not always — need to be applied separately in each country. There is also scope for the two countries

to conduct peer review and evaluations of risk assessments carried out by their counterparts.

As the smaller partner, New Zealand stands to gain significantly from working with Australia's biosecurity agencies. While benefits for Australia would be less, access to staff with complementary experience and knowledge of different environments could be beneficial. Both countries may also benefit from pooling biosecurity resources, particularly when considering costly new technology such as testing and laboratory equipment.

DR4.7 Where it is cost effective, quarantine and biosecurity agencies in Australia and New Zealand should continue to develop common systems and processes and enhance their current joint approach to risk analysis.

Emissions trading

Australia is pursuing its greenhouse gas emissions reduction target through a Carbon Price Mechanism (CPM), with supplementary policy initiatives targeting areas such as energy efficiency standards. New Zealand will pursue its target through the New Zealand Emissions Trading Scheme (NZETS).

Likely differences between the two countries in the cost of reducing emissions create opportunities for trade, enabling emissions to be reduced at a lower cost for both countries than would otherwise be possible. Facilitating trade would, however, require some harmonisation between the CPM and the NZETS.

There would be even larger trade benefits from linking the CPM and NZETS into multilateral frameworks set up to reduce global emissions, given that other countries may have less costly abatement opportunities. For example, the NZETS is linked to the European Union's emissions scheme, and the Australian Government recently announced that the CPM will also be linked, with mutual recognition of carbon units to be in effect by 1 July 2018 (Combet 2012).

The Australia-New Zealand Carbon Pricing Officials Group, which has been given an explicit mandate by both governments to take forward the work on arrangements to link the CPM and the NZETS, is well positioned to assess the compatibility of each scheme and the potential for linking them. It can also deal with the complicated legal and practical issues that would result from either country pursuing multilateral harmonisation, or more binding treaty arrangements.

4.4 'Second freedom': trade in services

The CER provides for free trade in services, except for those services specifically listed as exclusions (namely, air services, broadcasting, third party insurance, postal services and coastal shipping for Australia, and air services and coastal shipping in the case of New Zealand). Participants in the study have not questioned whether it is appropriate to exclude some services from the CER. The Commissions are seeking further evidence about the advantages and disadvantages of these exclusions.

Q4.2 Should existing exclusions from CER (air services, broadcasting, third party insurance, postal services and coastal shipping in Australia, and air services and coastal shipping in New Zealand) be loosened or abolished?

Air services

With more than 40 000 flights across the Tasman each year, the importance of efficient air services for the two economies is evident (BITRE 2012).

Air service regulation

Despite the role of air services in facilitating growth in trade of goods and services worldwide, the air services sector itself remains highly regulated. International air services arrangements around the world are governed by a complex, interactive system of negotiated bilateral rights between countries through air services agreements (ASAs). In this setting, the air services arrangements between Australia and New Zealand are relatively liberal, but there remains potential for further reforms that would provide joint net benefits.

Single Australia-New Zealand Aviation Market

While air services are excluded from the ANZCERTA, a Single Australia-New Zealand Aviation Market (SAM) has been in place since 1996. In August 2002, the Australian and New Zealand Governments signed an Open Skies Agreement. This agreement removes restrictions on capacity, frequency and routes that airlines of either country can operate to, within or beyond the two countries. However, for airlines to be able to take advantage of this agreement, they must meet certain

designation criteria, including requirements regarding the ownership and control of the airline (NZ PC 2012).

The agreement has made the trans-Tasman air transport market one of the more liberal in the world (Vowles and Tierney 2007). The route between New Zealand and the eastern seaboard of Australia is one of the most competitive in the region, with passenger services provided by Qantas, Air New Zealand, Jetstar, and Virgin Australia. Some third-country carriers, such as Emirates, provide trans-Tasman services because of separate bilateral agreements with their home countries, and extensive code sharing arrangements also exist on flights across the Tasman. Australian airlines (such as Jetstar and previously Qantas and Virgin Blue) have also entered the New Zealand domestic market. Overall, however, Qantas and Air New Zealand continue to dominate in terms of the number of passengers carried across the Tasman.

Two remaining measures restrict full liberalisation of the market.

- 'Seventh freedom rights' for the movement of passengers are denied. These allow carriers to operate services between two foreign countries without requiring the carrier to originate or terminate the service in its home country. (For example, without seventh freedom passenger rights, Air New Zealand is only able to fly between Australia and Singapore if it incorporates a leg back to New Zealand.)
- The current requirements for airline designation, which include specifications on airline ownership and control, limit carrier entry to the trans-Tasman market. As well as preventing greater competition, the requirements are inconsistent with the recent policy positions of both the Australian and New Zealand Governments in the negotiation of open skies agreements.

Granting seventh freedom rights could benefit the Australian and New Zealand communities by creating opportunities to expand further the range and quality of services from Australia and New Zealand to third countries and exert downward pressure on airfares.

Liberalising designation requirements, including current requirements for ownership and control under the Australia-New Zealand open skies agreement, would enable airlines to pursue broader commercial opportunities and ownership structures. It would also provide broader benefits for the community through increased competition.

Given that competition on the trans-Tasman route is already strong, the impact of removing these restrictions is unlikely to be great. However, the restrictions do not appear to be serving any useful purpose from a community-wide perspective, and

moving to full liberalisation of the market should produce benefits, particularly on international routes from Australia and New Zealand.

DR4.8 The Australian and New Zealand Governments should work towards removing the remaining restrictions on the single trans-Tasman aviation market, to maintain competitive pressure on airfares and potentially improve the range and quality of services.

Beyond the Single Australia-New Zealand Aviation Market

Given the complex, restrictive and inefficient regulation of the broader international aviation market, reform of international air services is likely to yield larger benefits for both countries, including having spillover benefits for trans-Tasman travel. The international nature of these reforms indicates that it would be appropriate for the Australian and New Zealand Governments to work together to encourage reform globally.

At present, there is some ambiguity in each country's policy objectives for air services. For instance, in Australia the current policy goal for international aviation is cast in terms of balancing the interests of the Australian aviation industry and the interests of the community more broadly (DITRDLG 2009). New Zealand's aviation objective is to help grow the economy and deliver greater prosperity, security and opportunities for New Zealanders (MoT 2012). Both Governments should ensure that the objective of air services policy is to enhance the wellbeing of the community as a whole.

Given the nature of global air services regulation, benefits will come from continued negotiation of open skies agreements. Both countries should re-commit to pursuing reciprocal open skies agreements, which includes granting all freedoms (including cabotage, where appropriate). Where bilateral partners do not seek open skies agreements, efforts should be made to secure the most open package of air services agreements, including negotiating additional freedoms and capacity ahead of demand. Further liberalisation will reduce constraints on market entry and the controls on the rights of airlines to service particular routes. It would enhance economic efficiency by placing competitive pressure on the cost of air travel; may provide consumers with greater choice, particularly in terms of the range of services offered; and encourage innovation and cost minimisation by airlines, including through more efficient operation of their networks.

Both countries have committed to a designation criterion of 'incorporation and principal place of business' in their bilateral agreements wherever possible. In

practice, however, this has not always been executed in agreements with other bilateral partners.

Alongside a revision of designation requirements, the appropriateness of current foreign ownership restrictions for national airlines, including for Qantas and Air New Zealand, could also be reviewed. Both countries currently limit foreign ownership in national airlines to 49 percent, with various sub-limits on certain investors, such as foreign airlines. Both Governments have indicated an intention to make changes to these sub-limits, or in the case of Air New Zealand to review them in the context of implementing a mixed government/private ownership model. Restrictions on foreign direct investment are discussed below.

Constraints in air services arrangements often affect foreign airline services to smaller cities and regional airports. The Australian Government has decreased regulatory impediments to the use of regional airports. Nevertheless, there may be further opportunities to enable foreign airlines to serve more destinations (although other barriers may also exist to regional airports operating international flights).

DR4.9

Further liberalisation of air services would be expected to benefit Australians and New Zealanders through enhanced competition, lower airfares, and an expanded range of services. Accordingly, the Australian and New Zealand Governments should:

- ensure that the objective of air services policy and legislation is explicitly directed at promoting net benefits for the community
- pursue reciprocal open skies agreements, including the granting of all air freedoms and cabotage where appropriate
- where open skies agreements are not possible, ensure that agreements provide for capacity well in advance of demand
- revise designation and ownership requirements
- remove any remaining restrictions on airlines' access to secondary/regional airports.

Passenger movement charge

During the course of this study, participants have called for the removal, restructure or reduction of the Australian Passenger Movement Charge (PMC) on the Australia-New Zealand route, to treat trans-Tasman travel more like a domestic flight. They highlight the potentially disproportionate impact of the charge on trans-Tasman travel, as a short and otherwise low-price route.

Introduced in July 1995 to replace the Departure Tax, the PMC forms part of the cost of the ticket of a person departing Australia for another country. It was intended as a cost recovery measure to recoup the cost of customs, immigration and quarantine processing of inward and outward passengers and the cost of issuing short-term visitor visas. The PMC is expected to generate A$794 million in revenue in 2012-13 (with around 8 percent from trans-Tasman travel), rising to over A$1 billion in 2015-16. Carriers remit the PMC to the Australian Customs and Border Protection Service.

Legally, the PMC is a tax, levied under the *Passenger Movement Charge Act 1978* and collected under the *Passenger Movement Charge Collection Act 1978,* with proceeds going to consolidated revenue. At different times, the PMC has been found to have both over-collected and under-collected the costs of providing border services. Most recently, the *Review of Australia's Future Tax System* concluded that the PMC does not recover all the costs of border services, nor does it reflect specific costs (Commonwealth of Australia 2010).

Reconfiguring the PMC as a genuine cost recovery mechanism for border services as originally intended, would increase users' awareness of the costs of the service they are paying for, potentially increasing pressure for efficiency in service delivery. Requiring those who use a service to pay for its costs may also be seen to be more equitable than current arrangements. Whether the level of the charge is higher or lower than the current PMC would depend on whether the efficient cost of service provision exceeds or is less than the PMC.

In New Zealand, the Government currently funds the costs of providing biosecurity and customs passenger clearance processes through general revenue, with the costs of aviation security services met by the airline industry (Carter 2010). Border services for cargo, on the other hand, are fully cost recovered. The New Zealand Government could review whether the current arrangements for funding passenger clearance services are appropriate, given the potential advantages from moving to a cost recovery mechanism in which the charge reflects the cost of the services provided.

DR4.10 In order to enhance transparency and efficiency in service delivery, and potentially equity, the Australian Government should reconfigure the Passenger Movement Charge as a genuine user charge for border services. The New Zealand Government should review its border passenger charges to achieve full and transparent cost recovery, in line with existing arrangements for cargo.

Sea freight

Nearly all of Australia's and New Zealand's international trade by volume, including that across the Tasman, is carried by ships.

International container shipping

Currently, exemptions from key parts of the *Competition and Consumer Act 2010 (CCA Act) (Aus)* and the *Commerce Act 1986 (CA Act) (NZ)* allow ocean carriers to form agreements on prices, capacities and schedules. These exemptions reflect a view that allowing collusive agreements between ocean carriers is necessary because the sector's characteristics (high fixed costs, and the existence of economies of scale and scope) could otherwise lead to market instability.

Both Commissions have reviewed the exemptions and recommended removing or narrowing them in order to increase competition and enhance productivity (NZ PC 2012, PC 2005). These reviews found little evidence that reliable shipping services depended on the ability to make collusive agreements or that the agreements should be presumed to be in the public interest. The New Zealand Commission (2012) also found there would be benefits in coordinating reform of the exemptions across Australia and New Zealand.

For these reasons, the Australian and New Zealand governments should remove the exemption for ratemaking agreements. There should also be a later review of subsequent costs and benefits of removing the remaining exemptions.

DR4.11 To enhance competition and lower the price of services, the Australian and New Zealand Governments should remove — preferably on a coordinated basis — the exemption for international shipping ratemaking agreements from legislation governing restrictive trade practices.

Coastal shipping

Australian coastal shipping restrictions currently require foreign-flagged vessels to obtain a licence and to employ Australian crew under Australian conditions and rates of pay while in Australian waters. Until recently, if licensed ships could not meet all coastal shipping demand, the Minister could issue single or continuous voyage permits (lasting up to 3 months), which allowed foreign vessels to operate without having to satisfy cabotage requirements. However, a package of changes

in 2011 and 2012 included new requirements for foreign-flagged vessels to pay award rates in Australian waters; abolished single and continuous voyage permits for foreign-flagged vessels; and established a new licensing system to protect the domestic shipping industry, with tax concessions for Australian registered ships.

By contrast, in New Zealand, restrictions on coastal shipping have largely been removed. The *Maritime Transport Act 1994* (s. 198) allows international operators to compete on coastal routes against domestic operators, provided they do so as part of an international voyage and do not operate in New Zealand longer than a continuous period of 28 days (NZ PC 2012).

Protecting domestic shipping from overseas competitors assists the local shipping industry at the expense of its customers and, ultimately, the wider community. The experience in New Zealand suggests that removing restrictions on coastal shipping has reduced freight rates, and improved the range and quality of shipping options (Cavana 2004).

The application of different policy approaches to coastal shipping across the Tasman provides an opportunity for a comparative review of the impacts of the two approaches on each economy and on trans-Tasman trade.

DR4.12 In order to ensure benefits for the wider economy, when reviewing the restrictions on competition for coastal shipping, the Australian Government should adopt a broad cost-benefit framework and draw on the experience of New Zealand with its different regulatory approach.

Ports

While the performance of Australian and New Zealand container ports has improved significantly over the past decade, large variations within and between each country point to scope for further productivity improvements. For example, the Australian Commission found the potential improvements in productivity of container ports from full implementation of the National Reform Agenda (NRA) ranged from 3 percent in South Australia to 10 percent in New South Wales and Western Australia (PC 2006b).

While both Governments have improved their regulatory frameworks for ports, problems remain. The New Zealand Commission found that difficulties in resolving multiple objectives in publicly owned enterprises and work practices and behaviours in some ports, have contributed to problems in areas such as

operational efficiency, labour relations and investment planning (NZ PC 2012). Work practices and behaviours in some ports are impeding productivity and innovation.

Given that many factors contribute to efficient port operation, collaborative work across the Tasman would help to identify opportunities to improve productivity.

DR4.13 Given the importance of port efficiency for each economy, there would be benefits from systematic monitoring, data collection and benchmarking of ports' performance between Australia and New Zealand.

Telecommunications

While Australia and New Zealand have significantly liberalised their respective telecommunications markets, four potential barriers to further integration are:

- differences in regulation and technical standards
- deficiencies in regulation
- high prices in Australian and New Zealand mobile roaming markets
- restrictions on foreign direct investment.

Differences in regulation and technical standards

Differences in regulations and technical standards between the telecommunication markets in Australia and New Zealand can discourage integration by increasing compliance and transaction costs for telecommunications businesses operating in both markets. Operating two regulatory systems may also be more expensive for governments to administer than a single system. There may, however, be sound reasons for some differences in approach. The question is whether the regulatory differences exceed those that are justified by the special circumstances of each country.

Regulation of telecommunications markets occurs within the context of national competition and consumer protection regimes. The Australian Commission's review of the Australian and New Zealand regimes found that significant harmonisation had occurred and that the regimes were not significantly impeding businesses operating in Australasian markets (PC 2005). The report noted that a transitional approach to further integration could yield some further benefits. Two

Australian parliamentary inquiries in 2006 found that there would be benefits from reducing divergence in telecommunications-specific regulation between Australia and New Zealand.[1]

Telstra and TelstraClear, in a joint submission, noted that recent reform has resulted in largely similar laws governing telecommunications in the two countries (sub. 48). Some informal harmonisation of technical standards for the broadband networks under construction in both countries has recently been undertaken. However, Telstra has identified remaining differences in telecommunications regulation and technical standards that may impose costs or impede trans-Tasman operations (sub. 56). Table 4.1 outlines some of these differences.

Telstra and TelstraClear proposed that the Australian and New Zealand Governments undertake a study into options for further harmonisation of telecommunications specific regulations that could lead towards the goal of a 'SEM in telecommunications services' (sub. 48). Telstra suggested that a telecommunications chapter in the ANZCERTA could be used to 'lock in' the current level of alignment in telecommunications and to minimise future deviation between the regulatory regimes (sub. 56).

Telecommunications services are an important, complex and fast-changing component of the Australian and New Zealand economies. It is beyond the scope of this discussion draft to assess the regulatory differences identified by Telstra. Further information and review is needed. The Commissions refer readers to Telstra's supplementary submission (sub. 56) and welcome comment on the extent to which the differences it identifies impose unnecessary costs on operators or impede further integration between the two countries. In particular, the Commissions welcome comment on which differences impose the greatest costs or impediments.

1 The Joint Standing Committee on Foreign Affairs, Defence and Trade reviewed the ANZCERTA agreement, and the Joint Standing Committee on Legal and Constitutional Affairs' investigated opportunities for further harmonisation of legal systems between the two countries.

Table 4.1 **Examples of differences between Australian and New Zealand telecommunications regulation and technical standards[a]**

Issue	*Australia*	*New Zealand*	*Degree of alignment*
Is there a telco-specific competition law?	Yes – part XIB of the Competition and Consumer Act 2010.	No – general competition law regulates competition in telecommunications markets.	Not aligned.
'Misuse of market power' offense by a carrier or carrier service provider	Offense is subject to a 'purpose' and 'effect' tests.	Offense is subject to a 'purpose' test only and is interpreted differently.	Aligned to the extent there is a 'misuse of market power' offense with a 'purpose' test in both countries.
Enforcement powers under competition laws	The ACCC may issue 'competition notices' to stop anticompetitive conduct if it 'believes' such conduct has occurred.	The NZCC cannot issue 'competition notices'.	Not aligned.
Procedure for deciding if a 'service' is subject to regulation	The ACCC has the power to 'declare' a service.	The NZCC recommends 'designation' of a service to the Minister for final decision.	Aligned but the Australian process is more independent of the political process.
Penalties for failure to provide access to networks	The Federal Court may make orders requiring compliance and imposing penalties. Fines up to A$10 million for a carrier or A$250 000 for a non-carrier.	The NZCC may serve a civil infringement notice imposing a penalty, or apply to the High Court for a pecuniary penalty of up to NZ$300 000.	Not aligned – significantly lower penalties apply in New Zealand.
Common technical standards for broadband networks to allow trans-Tasman retail service provision	NBN Co. has adopted Australia wide standards for the National Broadband Network.	Crown Fibre Holdings has stated it will achieve national consistency across the various Local Fibre Companies (LFCs).	Not aligned – NBN Co. and LFCs do not appear to be coordinating standards across the Tasman.
Number of mandatory codes and standards	There is a range of industry codes, industry standards and technical standards.	There are two industry codes.	Not aligned – much larger scope for mandatory codes and standards in Australia.

a The complete list of differences identified by Telstra can be found in the supplementary submission 56 on the study website.

Source: Telstra, sub. 56.

Deficiencies in regulation

Deficiencies in domestic telecommunications regulation may limit trans-Tasman integration by discouraging carriers in one country from entering and expanding in the market of the other country.

Participants in the two Australian parliamentary inquiries just mentioned pointed to some deficiencies in competition regulation in New Zealand's telecommunications market. Since then, technological change and New Zealand policy reforms have improved competition. Rapid technological change is expected to continue to improve contestability in telecommunication services over time.

Government policies and regulatory settings in both countries will continue to have significant impacts on competition. For example, the structural separation of the dominant fixed line carriers in each country should increase retail competition in fixed line services. (Telecom NZ 'demerged' in 2011, while Telstra has committed to structurally separate by 2018.)

Governments in both countries are also making large public investments in new fibre optic broadband networks (the National Broadband Network in Australia and the Ultra-fast Broadband Network in New Zealand) and have made commitments to limit the network operators to wholesale provision of basic connectivity services. Telstra has noted that an agreement between the two countries that entrenched this 'wholesale only' commitment would provide greater certainty to investors wishing to provide retail services on the networks and that this would underpin the development of a trans-Tasman market in broadband retail services.

As noted, telecommunications markets and technologies are complex and dynamic, and it is important to maintain up-to-date regulation that promotes rather than inhibits competition. The Commissions would welcome comments on the extent to which deficiencies in domestic telecommunications regulations may be imposing costs and impeding trans-Tasman integration.

Q4.3 What deficiencies in telecommunications regulation or differences between New Zealand and Australia impede further trans-Tasman integration? How significant are these costs or impediments and how might they be reduced?

Trans-Tasman mobile roaming

Mobile roaming (including voice calls, short message services (SMS) and data usage) occurs when customers of one mobile network use a network owned by another provider. Trans-Tasman roaming involves two distinct markets — New Zealand users roaming on Australian mobile networks and Australian users roaming on New Zealand networks. There is evidence to suggest that:

- Australian and New Zealand consumers pay higher prices for trans-Tasman roaming compared with international price benchmarks
- Australians roaming in New Zealand pay considerably more than New Zealanders roaming in Australia (DBCDE 2012).

A joint Australia-New Zealand departmental investigation into trans-Tasman roaming prices (being undertaken by the Australian Department of Broadband, Communications and the Digital Economy and New Zealand Ministry of Business, Innovation and Employment) released a draft discussion paper on 23 August 2012. It found that:

- there is limited competition in trans-Tasman retail and wholesale markets
- while wholesale and retail prices and margins have been trending down since 2009 (particularly for data roaming), margins are still high. (The decline in prices is attributed primarily to the ongoing investigation by the two governments.)

The two departments are now consulting on options to reduce roaming prices and are expected to release a final report at the end of 2012. The Australian and New Zealand Governments have announced that they will consider and respond to the final report's findings.

Foreign investment restrictions

Both Australia and New Zealand restrict foreign direct investment in telecommunications markets (including screening regimes and foreign ownership limits on carriers). Such restrictions can impede trans-Tasman and broader integration by increasing transaction costs and creating uncertainty for investors. Restrictions can also reduce the transfer of skills and technology and restrict competition by limiting the entry and operations of new carriers. Enacting the CER Investment Protocol, as recommended earlier, will reduce trans-Tasman impediments to a limited extent. The merits of further liberalisation in telecommunications and other sectors are considered in the next section.

4.5 'Third freedom': capital

Foreign direct investment

Australia and New Zealand both restrict foreign direct investment through screening regimes, foreign equity limits on specific businesses and other means. The CER Investment Protocol that has been signed but not yet enacted, will reduce some of these restrictions for trans-Tasman investment.

Under the Protocol, Australia is to apply higher screening thresholds for some types of investment by New Zealanders. However, screening thresholds for 'sensitive sectors' (such as telecommunications, media and transport) remain unchanged. This is similar to the preferential treatment provided to US investors under the Australia-United States Free Trade Agreement.

For Australian investment in New Zealand, the Protocol also lifts some screening thresholds. However, the effects of this are likely to be modest, because many proposals involve some element of 'sensitive land', for which the screening requirements are unchanged. Equity limits in both countries are not affected by the Protocol.

While scrutiny of proposals involving genuinely sensitive land is appropriate, New Zealand's approach appears to create unnecessary uncertainty for Australian and other foreign investors. This is because, as currently defined, 'sensitive land' encompasses a large proportion of New Zealand's territory, and the screening criteria applied permit a high degree of discretion as to how relevant costs and benefits are weighted. There is likely to be scope to improve this aspect of New Zealand's foreign investment policy.

Given that the effects of the Investment Protocol are likely to be limited, there is value in considering the costs and benefits of further liberalisation. There are several types of economic costs associated with restrictions on foreign direct investment.

- Screening regimes entail administrative costs for governments and compliance costs for firms.
- Restrictions may deter FDI and result in higher cost domestic capital being used in its place.
- Restrictions may deter FDI that would have brought with it firm-specific assets, such as human capital, technology and international reputation. This can be particularly important in service sectors, where foreign investment restrictions

can result in less competition, less diversity and innovation and higher prices (as foreign service suppliers must enter markets via alternative, less efficient, means than FDI — if they enter at all).

Restrictions on foreign investment can also bring benefits by preventing investments that would have adverse effects on competition, the environment, national security or even local culture in the host country. However, domestic policies (for example, competition policy, or environment regulation or targeted support) are often better placed to deal with these issues. That said, foreign investment restrictions do have a role to play, for example, in considering issues arising from investment proposals from entities that are owned or controlled by foreign governments.

The OECD's FDI Regulatory Restrictiveness Index suggests that Australia and New Zealand have more restrictive investment regimes than many other OECD countries (OECD 2012). While there is debate about the methodology and information content of this index, there is clearly scope to reduce the costs of restrictions, which would promote further integration of the Australian and New Zealand capital markets, bilaterally and globally. A possible option initially is for Australia and New Zealand to extend to selected other countries the preferential arrangements they have already agreed to provide to each other. This would be in line with the outward-looking approach outlined in chapter 2 and follows the historical precedent of Australia and New Zealand liberalising trade restrictions with one another first and then with other countries.

The focus of this study is on bilateral arrangements and in this regard there is considerable scope to move beyond the limited changes incorporated in the CER Investment Protocol. The 'direction of travel' should be towards national treatment of investors from the other country. There may be legitimate reasons for not preceding with this to the full extent (for example, relating to national security or the Treaty of Waitangi), but where this is the case the reasons should be made transparent.

DR4.14 In order to further reduce the cost and uncertainty of trans-Tasman investment and more fully realise the benefits from the free movement of capital, the Australian and New Zealand Governments should consider expanding the scope of the Investment Protocol by lessening the remaining restrictions on bilateral foreign direct investment. The policy rationale and the costs and benefits of any restrictions left in place should be made clear.

Draft supplementary paper C provides more detailed information and analysis on foreign direct investment restrictions.

Taxation

There are many ways in which differences between the separate tax systems of Australia and New Zealand may influence the allocation of resources across the Tasman. Participants pointed to the costs of having to be familiar with two different taxation systems (AiGroup, sub. 38); issues with dividend and interest withholding tax (Australian Bankers Association, sub. 37); and tax residency issues (Fielding, sub. 41).

Mutual recognition of imputation credits

For a number of participants, the biggest concern was the absence of recognition of imputation credits across the Tasman. While many supported the introduction of mutual recognition, most also acknowledged the complexities involved and that the issue has been on the agenda for more than 20 years (box 4.3).

In both Australia and New Zealand, shareholders are entitled to 'imputation' (or 'franking') credits on dividends, when companies have paid corporate income tax. This eliminates double taxation of corporate income: when tax is paid on corporate income at the company level, dividend recipients can credit this tax against their personal (or institutional) tax liability. While dividend imputation removes double taxation of distributed company income, imputation credits only apply domestically. Australian shareholders, for example, can use imputation credits from Australian-sourced income from local companies, but cannot use imputation credits from shares they hold in New Zealand companies. The consequence is that company income is taxed twice if it crosses the Tasman, but only once if it remains within its source country.

Box 4.3 Participants' comments on mutual recognition of imputation credits

This issue has been the subject of consideration by regulators and governments of both countries, including ministerial statements in New Zealand and bilateral discussions dating back to at least 1991.(New Zealand Bankers Association, sub. 24, p. 3)

Mutual recognition has advantages

Under mutual recognition the capital markets of Australia and NZ would become more integrated and competitive. The pool of investors from which capital could be sourced would be expanded and the cost of capital reduced as equity returns would no longer carry the tax inefficiency from double taxation.(ANZ, sub. 50, p. 6)

Australia and New Zealand cannot progress to a genuine single economic and investment market without mutual recognition of franking credits (Australian Bankers Association, sub. 37, p. 1)

The two countries would be affected differently

CPA Australia supports the introduction of a Mutual Recognition Regime [MRR] in respect of imputation credits between Australia and NZ. …. any MRR is likely to be more costly for Australia than for NZ, given the greater Australian investment in NZ than vice versa. Solutions for addressing this would need to be considered as part of any MRR. One option could be to require each country to pay some form of subsidy to the other for the tax credits provided by the other country to its residents. This approach would address the higher cost of an MRR for Australia, thereby making it more economically viable for an MRR to be negotiated between the two countries. (sub. 53, pp. 2–3)

Tax design issues

The [Corporate Taxpayers] Group has been an active supporter of mutual recognition of imputation credits …. the Group would be extremely concerned if any fiscal costs arising as a result of mutual recognition were countered by the addition of new or increased taxes, or more restrictive tax rules for businesses. The Group is also conscious that there will be a number of issues to resolve at both a macro and micro level…..For example, the Group would expect that for mutual recognition to work in practice there would need to be greater alignment of the continuity regimes in both countries (for example relaxed shareholder continuity tests). A further example of a macro issue that will need to be considered is the appropriate taxation of Australian and New Zealand superannuation funds investing on either side of the Tasman. This issue is particularly important to resolve given the divergence of current treatments, the disincentives that would exist if treatments continued to be different, and the possible reluctance of each government to refund imputation credits to superannuation funds in the other jurisdiction. (Corporate Taxpayers Group, sub. 35, p. 5)

Unilateral action?

Should the Australian Government not support a full mutual recognition policy, NZVCA considers the New Zealand Government should still consider a policy whereby a full tax credit is available in New Zealand for Australian franking credits. This policy may give rise to an initial revenue loss to the New Zealand Government. However, NZVCA considers longer term benefits to New Zealand will outweigh any initial cost. (New Zealand Venture Capital Association, sub. 32, p. 2)

This means that the tax rate faced by a top-tax-rate Australian investor in a New Zealand company is 60.4 percent compared to 45 percent for income from an Australian company. For a top-tax-rate New Zealand investor in an Australian company, the comparable figures are 53.1 and 33 percent. This amounts to a significant tax wedge between domestic and trans-Tasman investment.

In a submission to the *Review of Australia's Future Tax System* (Commonwealth of Australia 2010), the New Zealand Treasury and Inland Revenue argued that, as a result:

- domestic investors have an incentive to invest in domestic businesses even where investment would yield a higher return across the Tasman
- this reduction in investment meant that competition was reduced in both markets
- businesses may favour debt relative to equity simply in order to minimise the effect of double taxation
- there is an incentive to set up artificial schemes to shift profits from one country to the other.

From a trans-Tasman perspective, gross returns from investment (including taxes paid to either government and post-tax returns to resident shareholders in either country) are treated as additions to trans-Tasman income. Removing the double taxation distortion created by the lack of mutual recognition would enhance Australasian welfare to the extent investment shifted across the Tasman to achieve higher returns.

The larger the distortion to patterns of investment from lack of mutual recognition, the larger the potential joint welfare gain from more efficient investment. The impact of the distortions in practice will reflect the interplay of a range of factors, including the responsiveness of investment to a reduction in the cost of capital, the elasticity of capital supply and the effects of other aspects of the corporate tax system, including capital gains tax and investment incentives.

Mutual recognition of imputation credits would reduce the tax revenues of the Australian and New Zealand governments. Using 2011 data, preliminary estimates provided by the Australia New Zealand Leadership Forum (ANZLF sub. 58) suggest that full trans-Tasman recognition of imputation credits would reduce annual taxation revenue by NZ$ 250 million to NZ$ 1 billion (around A$ 195 million to A$ 780 million) in Australia and from NZ$ 80 to NZ$ 300 million in New Zealand. The outcome within the range depends on the proportion of profits that are distributed as dividends, with the upper figures assuming 100 percent distribution.

take account of the revenue impact of increases in trans-Tasman investment induced by mutual recognition.

The tax revenue lost would provide large windfall gains to the previously double-taxed investors. There would be an efficiency cost from replacing this revenue with other taxes, but this is likely to be modest if the revenue were raised from existing broadly-based income or consumption taxes. However, to contain redistributive effects within the corporate sector, an alternative could be a modest rise in company tax rates (which may impose a somewhat larger dead weight loss) or reductions in company tax concessions (which, by broadening the tax base, could be efficiency enhancing in their own right).

Another potential effect of granting mutual recognition would be the inducement for some Australian and New Zealand investors to withdraw investment from third countries and invest more in Australia or New Zealand. This redirection could be inefficient from a global perspective, but not from an Australasian perspective, because taxes paid to third countries are a cost with no offsetting benefit (unlike taxes paid within Australasia if a joint welfare test is to be applied). However, to the extent that lower-cost sources of capital from world markets were crowded out as a result of reduced taxation of trans-Tasman investors, this would represent an efficiency loss for both countries.

While mutual recognition could lead to improved trans-Tasman investment allocation (and the potential dynamic benefits associated with improved allocation) and thus higher aggregate income, both countries would not share the benefits equally. This is because mutual recognition involves income transfers between Australia and New Zealand and there can be no presumption that these would cancel out. The relative magnitudes of cross-Tasman transfers would depend on the relative magnitudes of investment flows, tax rates and the distribution of investment returns. The outcome for the two countries could be win-win (with one win almost certainly larger than the other) or win-lose (one country ending up worse off).

While an unequal distribution would not necessarily rule mutual recognition out, the Commissions consider that identifying the likely direction and order of magnitude of the distributional effects is a prerequisite for informing both Governments on this matter. For example, if it were found that the efficiency gains were substantial, but that one country gained at the expense of the other, one possible solution (as noted by CPA, sub. 53) would be for mutual recognition to be accompanied by some form of compensation mechanism.

Box 4.4 Modelling for the Australia New Zealand Leadership Forum

The Australia New Zealand Leadership Forum (sub. 58) commissioned the New Zealand Institute of Economic Research (NZIER) and Centre for International Economics (CIE) to model the possible impacts of the trans-Tasman mutual recognition of imputation credits (MRIC). The MRIC was modelled as an increase in the after tax rates of return on trans-Tasman capital, and a corresponding decrease in tax revenues for both Australian and New Zealand governments (offset by increased broad–based taxes). The modelling projects a small increase in each country's GDP from MRIC, albeit larger for New Zealand than Australia.

The modelling also estimates revenue losses for each country, based on current investment levels. The ANZLF submission suggests that revenue losses would be short term. But in fact tax transfers to dividend recipients would endure, requiring permanent increases in other taxes or reduced public spending. The below table presents the projected GDP gains and associated tax transfers.

Table **NZIER-CIE modelling: estimated impacts of MRIC**
NZ$m, 2012

	Australia	New Zealand	Trans-Tasman total
Net Present Value[a]			
Increase in GDP	2 200	3 100	5 300
Tax transfer	6 464	2 041	8 505
Average annual value			
Increase in GDP	168	237	405
Tax transfer	494	156	650

[a] Net present value over 20 years assuming 5 percent real discount rate.

Source: Australian Commission estimates based on ANZLF sub. 58.

While the model projects changes in GDP, the welfare implications of MRIC for each country are not immediately apparent. For example, consumption measures need to be adjusted for foreign liabilities incurred if they are to proxy welfare. And analysing the welfare of countries separately is not equivalent to a combined welfare analysis. Whereas a reallocation of tax revenue from government to factor owners can be considered a pure transfer *within* a tax system, this is not so internationally unless the two countries share a common tax and transfer system.

For example, if Australia recognised New Zealand's imputation credits, it would forgo some tax revenue. As the supply of capital to New Zealand expands in response (and returns to capital fall) some of the foregone tax revenue will accrue to capital owners in Australia (through increased *post-tax* returns). The remainder will effectively accrue to owners of complementary inputs in New Zealand (such as labour and domestic capital) in response to the decline in the user cost of capital, and represent an income loss to Australia. Whether one or both countries are net beneficiaries of an MRIC policy will thus be a function of the relative magnitudes of trans-Tasman capital ownership, tax revenue changes in each country, the extent of any fall in the cost of capital and the investment response to it.

While modelling submitted by the Australia New Zealand Leadership Forum just prior to release of this discussion draft suggests that there would be small income gains for each country (sub. 58), the Commissions need to explore further the basis for the results, and the assumptions underpinning them. For example, as noted in box 4.4, it is unclear how cross-country transfers, which are critical for measuring welfare effects in each country, have been accounted for in the model.

In the lead up to the final report, further analysis and modelling, as well as consultation with experts, will be undertaken to gauge both the scope for investment responses and the associated tax transfers.

The fact that this issue has now been on the agenda for more than 20 years without resolution, underscores the complexities involved and hence the need for careful assessment (box 4.5.). Major stumbling blocks appear to have been the magnitude of tax revenue losses and consequent tax redistribution implications, and the possibility of one country (Australia) losing overall. In addition, major tax reviews in both countries have taken a broader perspective, focussing on the distortionary impacts of all elements of their respective corporate tax systems on investment from (and to) all countries.

Box 4.5 Past Australian and New Zealand proposals to remedy distorting taxation of international investments

Many remedies for the international investment consequences of dividend imputation and other tax differences have been proposed. Most have favoured unilateral, non-preferential approaches:

- Building on analysis in the 1999 *Ralph Review*, in 2003 the Australian Board of Taxation recommended a 20 percent credit for all foreign-sourced company income distributed to local equity holders, regardless of the amount of foreign tax actually paid.
- The 2001 New Zealand tax review recommended reducing taxation of both inbound (all foreign sourced) investments and offshore investments (to all countries) by New Zealand residents.

The 2010 *Review of Australia's Future Tax System* (the 'Henry' review) observed that if increased integration between the two economies were desired, there would need to be a broader consideration of tax harmonisation than mutual recognition of dividend imputation, as well as consideration of longer-term reform directions in Australia.

Sources: Australian Board of Taxation (2003), Commonwealth of Australia (1999; 2010), The New Zealand Treasury (2001).

Banking

Prudential regulation

The Australian and New Zealand banking systems are closely linked, with predominant Australian ownership of New Zealand's banking institutions. Almost 90 percent of New Zealand bank assets are owned by Australian banks. This constitutes around 15 percent of the total assets of Australian banks (Bollard 2011; Doan et al. 2006).

The frameworks for prudential regulation in Australia and New Zealand have broadly the same high-level objectives of promoting the safety, stability and efficiency of their respective financial systems. Both country's banking supervision operates within the framework established for by the Basel Committee on Banking Supervision. However, there are some differences in approach:

- The Australian framework emphasises risk-based supervision by the Australian Prudential Regulation Authority (APRA) and has a depositor-preference regime covering deposits in Australia for all locally incorporated authorised deposit-taking institutions (ADIs). This is in addition to the disclosure and other requirements imposed on banks under the provision of the *Corporations Act 2001* in Australia.
- The New Zealand regime places comparatively more emphasis on disclosure, and on the legal responsibilities of banks' boards of directors for what is disclosed. This is in addition to the disclosure and other requirements imposed on all companies under the provisions of the *Companies Act 1993*. New Zealand does not have a depositor preference regime. The RBNZ's supervision is intended to complement and not duplicate the work of APRA in its oversight of Australian-owned banks' New Zealand operations.

Also, in the event of an Australian-owned bank failing — either the New Zealand subsidiary or the parent bank in Australia — there would be trans-Tasman failure management issues to resolve. These involve some matters where there could be differences in national interests. The Australian depositor preference regime means that without some form of 'ring-fencing', New Zealand depositors could be disadvantaged. Whether or not to use tax-payer funds to support a distressed bank is a matter for the respective governments to decide.

To enable each country to have some ability independently to manage a bank failure in the interests of their respective economies, the regulators in both countries require the (major retail) banks to operate at arms-length from their parent/subsidiary banks in the other country. This includes:

- local incorporation requirements
- requirements that the separate banks in each country maintain core operational capabilities that would be resilient to the failure of service providers, including of a parent or subsidiary to which core functions are out-sourced. This limits, for example, the scope for trans-Tasman banks to use a single IT platform to serve the operational needs of the banking group across both countries (ANZ, sub. 50)
- limits on provision of funding (and other intra-group credit exposures) between the parent bank in Australia and the subsidiary in New Zealand (and vice versa).

At the same time, given the extensive Australian ownership of New Zealand's banks, steps have been taken to harmonise, where appropriate, the prudential standards that apply in each country, and to establish arrangements that would assist in the trans-Tasman handling of the failure of a trans-Tasman bank.

Ministerial and officials' meetings in 2004 resulted in the pursuit of an 'enhanced home-host' model for supervision, which aims to avoid imposing unnecessary compliance and operating costs on banks, while preserving national autonomy in approaches to bank crisis and failure management. Also, the Trans-Tasman Council on Banking Supervision (TTCBS) was established, with the role of promoting ongoing coordination, cooperation and harmonisation of trans-Tasman banking regulation. This ongoing work has led to significant progress.

On the advice of the TTCBS, in 2006 legislation was passed in each country that requires the respective prudential regulators to consider what impact their actions would have 'across the Tasman' (APRA 2011; Doan et al. 2006). Specifically, the legislation requires that each regulator support the other in meeting their statutory responsibilities and, to the extent practicable, avoid any action that would be likely to have a detrimental effect on financial system stability in the other country; or, to the extent considered practicable given the urgency of the situation, to consult with the other before taking such action.

Further to those statutory provisions, in September 2010, the TTCBS agencies signed a Memorandum of Co-operation on the management of trans-Tasman bank distress (Financial Stability Board 2011), and in 2011-12 a trans-Tasman crisis management exercise was conducted to test arrangements for handling an episode of trans-Tasman financial distress.

Submissions received by the Commissions support further integration of bank supervision to achieve as much alignment as possible in supervisory standards and to reduce compliance costs (Australian Bankers' Association, sub. 37; ANZ,

sub. 50; New Zealand Bankers Association, sub. 24). The RBNZ (sub. 12) considers the harmonising of New Zealand's regulatory regime with that in Australia to be an ongoing task, but also that the marginal benefit is likely to decline and may eventually turn negative if taken too far.

With respect to bank failure management, the RBNZ considers it necessary to ensure that there is a clear capacity for New Zealand to manage crises affecting banks with large scale operations in New Zealand. This is so that the interests of the New Zealand economy and New Zealand customers of banks can be adequately protected in a crisis, when the interests and judgments of New Zealand and Australia, and the respective governments, may differ (sub. 12).

The ANZ considers that there needs to be alignment of bank resolution schemes between Australia and New Zealand, 'given that any bank failure in New Zealand is by logic a failure of a major Australian bank' (sub. 50, p.9).

Prudential regulation is a constantly evolving process, with significant developments occurring in multilateral for a — notably the Basel Committee on Banking Supervision and the G20/Financial Stability Board — in response to lessons learned during the global financial crisis. This work includes considerable efforts to find better ways to manage the failure of banks, in particular large and cross-border banks.

The TTCBS is the appropriate forum for progressing these matters in the trans-Tasman context.

Banking: international transfer fees

Some submissions raised the matter of the fees for and delays involved in transferring funds and making payments across the Tasman through the banking system. These issues arise because of the way in which these transfers have to be handled, through correspondent banking arrangements, across different national payments systems.

The standard fee for sending funds by bank telegraphic transfer appears to be between NZ$20 and NZ$25 (with possibly additional fees applied by the receiving bank). The Commissions are not in a position to assess whether the fees are excessive; nor whether fees charged to frequent customers (for example, exporters and importers, or firms with a trans-Tasman business presence) may be lower than the standard fee.

However, developments in technology are enabling banks, and a range of other providers, to provide payments services at lower cost, at least for 'retail' amounts. These include, for example, facilities that enable funds to be transferred cross-border from person to person using stored value cards, and by non-bank payment service providers using internet-based payment channels.

These developments suggest that technology and competition may result in the fees for trans-Tasman payments coming down over time.

Q4.4 The Commissions seek participants' views on their experience in using non-bank providers to transfer money between Australia and New Zealand.

Financial services

Australian investment is prominent in New Zealand's wider financial services sector — which includes wealth management (superannuation), insurance and the securities market.

Australian and New Zealand financial sector regulators have broadly similar principles and objectives, but with some differences. For example, Australia has more consolidated institutional arrangements (FMA, sub. 57).

Despite this difference, there has been significant integration between the two countries' regimes, with regulators sharing a strong commitment to remove or reduce regulatory barriers that unnecessarily inhibit the flows of capital between the two countries (ASIC 2010).

Financial services regulation is an area where the regulatory authorities have pursued integration through unilateral adoption or mutual recognition, where appropriate.

- Mutual recognition of securities offerings has allowed offer documents that comply within one country to be offered in the other (ASIC 2010).
- Mutual recognition of arrangements for financial advisers will enable financial advisers to work in both countries — subject to their qualifications and experience (ASIC 2012).
- The FMA recently implemented an Effective Disclosure Guidance regime modelled on an Australian scheme, after extensive consultation with ASIC (FMA, sub. 57).

Some submissions suggested that further trans-Tasman integration in financial services regulation may lower transaction costs, such as compliance costs for financial institutions operating in each market (Business NZ, sub. 40, FMA, sub. 57, ICA, sub. 36, IAG, sub. 23, Nottage, sub. 55). The New Zealand FMA (sub. 57) noted that differences in institutional arrangements impede further integration, and that more comprehensive trans-Tasman integration of financial services is desirable. For example, it supports cross-membership of the FMA and ASIC (sub. 57).

Q4.5 How might further integration of trans-Tasman financial services take place? What are the likely gains from such integration?

4.6 'Fourth freedom': cross border movement of people

Short term travel and visitors across the Tasman

Trans-Tasman travel

People moving across the Tasman are undertaking an international journey, with all that this entails, and visitors from some third countries require visas. The study has considered ways to reduce the costs involved in entry and exit procedures.

Trans-Tasman travel by Australian and New Zealand citizens

Fast-track entry processes at the border can reduce the costs and waiting times of trans-Tasman travel for eligible Australian and New Zealand citizen passengers. The Australian Government has introduced reciprocal fast-track entry for Australian and New Zealand ePassport holders under their SmartGate systems (ACBPS 2012a, b and c). A similar arrangement operates in New Zealand for Australian citizens travelling to New Zealand.

The Australian Customs and Border Protection Service and the New Zealand Customs Service have undertaken a trans-Tasman trial at one site (Gold Coast airport) aimed at further integrating Australia's and New Zealand's SmartGate systems (ACBPS 2012b). The trial commenced in July 2011, and operated for 12 months.

Further integration of the SmartGate system across the two countries would further simplify customs and immigration checks for eligible travellers. This could usefully include Australia adopting SmartGate for departures as well as arrivals. At present only New Zealand has adopted SmartGate for departures. Traditional checks by Customs officers could then be better targeted at higher-risk passengers (Evans 2010).

The benefits of SmartGate will be constrained if it is only available at major airports. However, the costs of the infrastructure used to operate SmartGate should be factored into decisions about how widely it is implemented.

DR4.15 The Australian and New Zealand Governments should progress the further roll out of SmartGate and associated systems where it is cost effective to do so, focusing on departures from Australia and on regional airports.

Trans-Tasman travel by other citizens

Many foreign visitors to this region travel to both Australia and New Zealand. According to the Tourism and Transport Forum (sub. 25), more than four in every ten arrivals into New Zealand originate from Australia. In addition tourists from a range of countries prefer dual destination travel — in the year ending March 2012, 51 percent of all tourists from the Republic of Korea and 71 percent of all tourists from China visited both Australia and New Zealand (MBIE 2012). A single trans-Tasman tourist/visitor visa, enabling visitors and tourists to Australia and New Zealand to use a single visa to visit both countries, would reduce the cost of foreign travel to both countries from travellers currently requiring a visa to visit both countries (for example, nationals from the People's Republic of China).

This proposal would have fiscal implications for both countries, but these could be offset through the use of a cost recovery model. (The Australian Government is already moving towards a cost-recovery model for visa-related charges.) In addition, the two Governments would need to agree on an appropriate sharing of the costs and revenues.

DR4.16 To improve the attractiveness of Australia and New Zealand as a joint tourist destination, the Governments should explore a 'trans-Tasman tourist visa' for citizens from other relevant countries who wish to travel here. The charges for this visa should be based on a cost-recovery model, with agreed sharing of revenue and costs.

Long term trans-Tasman residents

There is a long history of both short and longer term movement of people as well as permanent migration between Australia and New Zealand, facilitated by the Trans-Tasman Travel Arrangement (TTTA) and the TTMRA.

The flows of New Zealanders and Australians in each direction were relatively even until the early 1970s. However, following the TTTA and as Australia's economy and wage levels started to grow more quickly than New Zealand's, the flows of citizens responded accordingly. As a result there are now estimated to be around 480 000 New Zealand-born people living in Australia, compared to around 65 000 Australian-born people living in New Zealand.

Empirical studies consistently show that the net effects of migration on the receiving country are small and positive, with the so-called 'migration surplus' larger for skilled immigrants (PC 2011). While the focus for source countries tends to be on 'brain drain' and 'hollowing out' issues (chapter 2), the net effects of emigration depend on the skill level of replacement immigrants and return migration of emigrants, who bring back additional skills and know-how (Coppel, Dumont and Visco 2001). Box 4.6 illustrates the effect of a one percent increase in trans-Tasman migration to Australia from New Zealand on gross national product and gross national product per worker in both economies.

Box 4.6 **Modelling the effects of trans-Tasman migration**

Owing to complex reporting systems, measuring migration flows in and out of Australia and New Zealand is difficult. Although there is a net flow of migrants from New Zealand to Australia, there are also return flows to both countries and inflows from other parts of the world. Migrants respond largely to differences in remuneration and to the monetary and non-monetary costs of migration.

The ANZEA model (box 2.8) was used to simulate the effects a 1 percent increase in the number of New Zealanders working in Australia. This translates into a movement of approximately 3 000 workers, equivalent to a 0.13 percent decrease in the supply of labour in New Zealand and a 0.02 percent increase in the supply of labour in Australia.

The trans-Tasman wage differential is allowed to adjust in response to this movement. The migrating workers are assumed (i) to have similar qualifications as Australians (and New Zealanders who remain in New Zealand) and (ii) to be accompanied by a typical family (the structure of families in Australia and New Zealand are similar). The new demand for goods and services (for example, schools and health) generated by the migrants is similar to that generated by Australians. The analysis abstracts from foreign remittances (as these have been a small fraction of income earned by New Zealanders abroad) and no account is taken of the impacts on other sources of migration. The modelling does not allow for replacement migration nor return migration.

The increased supply of labour in Australia allows output and income to expand, while the reverse occurs in New Zealand (see below table). Output per worker in Australia declines as more workers are spread across the existing capital stock, while the converse occurs in New Zealand.

Table **Illustrative effects of trans-Tasman migration**[a,b]
Percentage changes relative to base

	Australia	*New Zealand*
GNP	0.01	-0.08
GNP per worker	-0.01	0.06

a 1 percent increase in New Zealand labour in Australia. **b** Sensitivity analysis did not produce ranges that are significantly different from the results reported.

Source: Australian Commission estimates.

Long term residents in Australia

While migration can promote the efficient allocation of resources and increase aggregate economic output, open access to taxpayer funded resources is generally not desirable from the receiving country's perspective. Hence, access limits to social security and/or residency arrangements are appropriate.

Over time and incrementally, in response to various developments and with the agreement of New Zealand, the Australian Government has limited the access of various cohorts of New Zealand migrants to social security and Australian permanent residency and citizenship. As a result, social security arrangements for many New Zealand citizens have become relatively complex. Some individuals and their families who have lived in Australia for a considerable time are denied, or have limited access to, some social safety nets.

Eligibility for social security

Australian and New Zealand citizens living in the other country potentially have access to a variety of social payments and supports and medical benefits.

Arrangements for Australian citizens living in New Zealand are relatively simple and rarely leave individuals and families without access to an appropriate safety net if required. They have the same social security entitlements as New Zealand citizens, provided waiting periods (generally around 2 years) have been met. They also have immediate access to publicly funded health and disability services if they are able to demonstrate that they are intending to live in New Zealand for two or more years. Budgetary costs of some benefits are shared between the two governments in proportion to the time an individual spends in each country.

New Zealand citizens living in Australia have immediate access to family payments (such as Family Tax Benefit, Baby Bonus, Child Care Benefit, and Parental Leave Pay), and health care under Medicare Australia. But various limitations on access to social security for New Zealand citizens living in Australia have been introduced (draft supplementary paper D), which limit the fiscal risk to Australian taxpayers.

The result has been that social security treatment of New Zealand citizens in Australia sits somewhere between the treatment of temporary residents and newly-arrived permanent residents. For example, non-Protected Special Category Visa (SCV) holders (applying to people who generally arrived in Australia after 26 February 2001; box 4.7 and box D.2 in draft supplementary paper D) have less generous social security entitlements than newly arrived permanent resident visa holders to Australia, but have more generous social security entitlements than temporary resident visa holders. (Temporary residents cannot generally access social welfare benefits or national public health cover.)

Box 4.7 **Visa arrangements for Australian and New Zealand citizens**

Australia

On entering Australia, under the TTTA New Zealand citizens are considered to have applied for a temporary entry visa and, subject to health and character considerations, are automatically provided with a temporary entry visa, which is recorded electronically. Unlike other temporary visas, this particular visa — known as Special Category Visa (SCV) subclass 444 — has no time limit while the holder is a New Zealand citizen.

Under current social security legislation, SCV holders are either Protected or non-Protected SCV holders. Protected SCV holders generally arrived prior to 26 February 2001, while non-Protected SCV holders generally arrived after that date.

New Zealand

On entering New Zealand, Australian citizens and people who hold a current Australian permanent residence visa or a current Australian resident return visa do not need a New Zealand visa.

Sources: DIAC 2010; Immigration New Zealand nd.

Potential options available to non-Protected SCV holders who may be at risk of having no or limited access to certain Australian welfare payments (namely Newstart, Youth and Sickness Allowances and Special Benefit) are for them to return to New Zealand or obtain permanent residency and/or citizenship. The latter course was made more difficult following changes introduced in 2001, which require New Zealand citizens to go through the same process as applicants for permanent residency and citizenship from other countries (DIAC 2011). In Australia, permanent residency is a prerequisite for citizenship, and permanent residence visas are subject to selection criteria and quotas.

There are challenges within both the 'demand-driven' and 'supply-driven' pathways to Australian permanent residence and citizenship for a growing cohort of New Zealand citizens who have arrived since 2001.

- Australia's 'demand-driven' pathway is largely met through employer sponsorship. While New Zealand holders of subclass 444 visas are exempt from the skills and English language capability criteria under the two visa categories in the Employer Sponsored Migration program, they are generally not exempt from the requirement that applicants be under 50 years of age and are not eligible for the Temporary Residence Transition stream (DIAC 2012). For some individuals and employers the A$3060 application fee may represent a significant 'post-border' transaction cost.

- The ‘supply-driven’ pathway is now based on a framework of developing ‘specialised skills’. In practice, the new process means that ‘supply-driven’ applicants are sorted on the basis of their points test scores. The mark will vary each year so that the volume of invited applications roughly balances the annual allocation of these skilled visas (Cully 2011).

Accordingly, a proportion of New Zealand citizen residents, who may have been working in Australia for many years, may not be employed in an occupation that is defined as ‘in need’ and on the Skilled Occupation List at the time they seek to become permanent residents. Indeed, the ease with which New Zealand citizens can be employed by Australian businesses to meet their specific needs also means that these occupations may never be defined as ‘in need’ or, if they were, may no longer be defined as ‘in need’ at the time of the New Zealand citizen’s application.

According to information from the Australian Department of Immigration and Citizenship (DIAC), as at 30 June 2011 there were around 240 000 New Zealand citizens in Australia who had arrived after 26 February 2001. Based on its analysis of passenger cards, DIAC estimated that around 40 percent of these New Zealand citizens may be eligible for a permanent visa through existing skilled and/or family stream visa classes. This suggests that the remaining 60 percent of non-Protected SCV holders may be ineligible for the safety net payments mentioned above.

The Commissions have not been able to establish how extensive or problematic the lack of access to these safety net payments is in practice — a precondition for developing an appropriate policy response. That said, with the strong growth in migration from New Zealand to Australia, the number of New Zealand citizens affected is likely to grow over time.

Q4.6 The Commissions seek information about the numbers of New Zealanders who have been affected by lack of access to certain welfare payments in Australia and the numbers who have returned to New Zealand as a consequence.

In the interim, however, there is a strong case for providing more information to New Zealand citizens before they arrive in Australia, to ensure that the conditions applying to social security payments and social policy supports are readily understood and transparent. This is because the ‘domestic like’ travel experience under the TTTA, combined with the unlimited duration of the temporary visa, may lead some individuals to misconstrue the potential ‘post-border’ costs when considering staying for long periods in Australia.

DR4.17 To ensure that in future non-Protected Special Category Visa holders are aware of the current limitations on eligibility for certain Australian social security payments, the Australian Government, in consultation with New Zealand, should take steps to make information more readily available to New Zealand citizens before they arrive in Australia.

There may be concerns that easing non-Protected SCV holders' access to Australian social security payments and social policy supports may impose a fiscal burden on Australia. Further work is needed to assess these complicated effects.

The fiscal risks from trans-Tasman movements need to account for offsetting tax revenues as well as other considerations. For example, in 2001 it was estimated that social security outlays directed to New Zealand citizens living in Australia amounted to A$1 billion, compared to an estimated tax revenue of A$2.5 billion collected from this group as a whole in that year (MFAT 2011). Based on a partial analysis, the NZIER (2000) also estimated net direct fiscal benefits to Australia from New Zealand citizens in the order of A$3 000 per person at that time. Whether the net benefits for Australia (taking into account a wide range of costs and benefits) generated by this group of migrants is higher than would be generated by other groups of migrants is difficult to gauge, and ultimately requires a judgment by government based on a wide range of considerations.

Permanent residency and citizenship

As noted, the more limited pathways to Australian permanent residence and citizenship for some members of this group compound the problem for non-protected SCV holders. The Commissions understand that both governments are aware of the situation and that the Australian Government is working towards a resolution (Gillard 2012).

DR4.18 Given its significance to New Zealand citizens living long term in Australia and the long term operation of the trans-Tasman labour market, the Australian Government should finalise its consideration of alternative potential pathways to Australian permanent residence and citizenship.

A framework of principles?

Differences in social security and migration policies in the context of an integrated labour market between two countries can create incentives for government transfer shopping and back door migration. But equity issues arise when workers who have moved internationally because labour markets are integrated, and who have the same work history and other similar circumstances, are treated differently within one country.

Looking forward, consideration could usefully be given to developing principles to guide the treatment of long term New Zealand citizen residents in Australia. Based on EU experience and certain characteristics of an integrated labour market (see draft supplementary paper D), some possible principles are:

- Policy independence — the country in which a citizen lives should determine the social security legislation under which they are covered.
- Prevention of Government Transfer Shopping — access to social security should not encourage migration of citizens from one country to another. Waiting periods to prevent this should apply in most circumstances.
- Equal Treatment — subject to the relevant waiting periods or other initial conditions, individuals should have the same rights and obligations as citizens or permanent residents in the host country.
- Portability — each country should have its own portability rules for the payments it covers.

But these principles contain inherent tensions. For example, in the trans-Tasman context, equal treatment could only be implemented if there were effectively full alignment of the two countries' migration and citizenship programs with respect to nationals from third countries. This is because migration is the key point of entry to the labour markets for both countries. Seeking to maintain an integrated labour market between two countries with a growing gap in incomes per person will inevitably push the focus of attention in this direction. Lloyd (sub. 5) observed:

> As with trade policy, both countries have retained independent screening of potential immigrants from outside the Tasman area. Differences in immigration criteria and assessment methods mean that there is a possibility of "people deflection" analogous to trade deflection. This occurs if potential immigrants wanting to emigrate to one Tasman country are prevented to do so by that country's assessments but are able to enter the other Tasman country and after acquiring residence and citizenship to then move to their country of first choice. Because of its higher per capita incomes and larger established immigrant population, this means in practice emigrants going first to New Zealand then to Australia. (p. 11)

The extent of future 'back door migration' is difficult to assess. While both countries' arrangements emphasise skilled migration, there remain distinct differences between their immigration policies. In particular, New Zealand has a Samoan quota and the Pacific Access Category (where Samoan citizens and people from Kiribati, Tuvalu and Tonga are invited to apply for residence under these schemes).

The impacts on national security would also need to be considered in parallel with any consideration of migration policies.

Q4.7

How significant a risk is 'back door' immigration?
Given its significance to the evolution of the trans-Tasman labour market, would there be net benefits from closer alignment of the two countries' migration policies?
What would be the difficulties/issues in seeking to achieve this?
Would there be value in developing a framework of principles to guide access to social security under the Trans-Tasman Travel Arrangement?
What changes to Australian Government social security limits could promote a better balance between prevention of government transfer shopping and equal treatment?

Return migration poses some risks for New Zealand

New Zealand Superannuation (NZS) is the New Zealand Government's flat-rate basic age pension. Eligibility is conditional on reaching a given age (65) and a minimum residence requirement (where at least 10 years must be lived in New Zealand over the age of 20, with at least five of these after the age of 50) and there are no specific contributions or work-related requirements.

Dale et al. (2011) noted the fiscal risks to New Zealand Superannuation (NZS) — the New Zealand Government's flat rate, non-means tested age pension payment — from the return migration of New Zealanders:

> In the future, with an increasing state pension age in Australia, a harsher income test, and because 'totalisation' can be applied under the Social Security Agreement, it may become relatively attractive for New Zealanders to return home to retire, especially if New Zealand does not increase the state pension age. This would increase the burden on the working age population of New Zealand, without the benefit of the earlier tax contribution from these retirees. (pp. 8–9)

These factors may also make it attractive for some Australian citizens to retire in New Zealand with their privately managed superannuation monies which would also not be subject to means testing (abatement) under NZS rules.

Q4.8 The Commissions seek further information on the costs and risks to New Zealand Superannuation from return migration from Australia.

4.7 Government services

Opportunities for coordination

Integrating markets for goods, services, labour and capital requires coordination in many parts of the public sector. While the Australian and New Zealand Governments are sovereign entities, coordination between them is extensive and takes many forms, as described in chapter 3.

Such coordination can reduce compliance costs for trans-Tasman businesses, enable more effective regulation of business activity that crosses borders and, in the case of joint bodies, increase economies of scale. However, coordination may also impose administrative costs and reduce local accountability and flexibility.

Greater use of private delivery of government services allows the profit motive to drive innovation, including the adoption of foreign innovations. Often, however, the profit motive is absent and there is a need to think differently about how to promote integration of government functions. Governments can, for example, motivate agencies to consider coordination by attaching greater weight to such coordination when setting Ministerial expectations and performance measures for agencies.

DR4.19 In order to improve regulatory outcomes and potentially reduce the cost of public services, the Australian and New Zealand Governments should encourage government agencies to consider opportunities for trans-Tasman coordination on a case-by-case basis.

Joint action in multilateral fora

In some circumstances, there may also be benefits from the Australian and New Zealand Governments taking coordinated action in multilateral fora. Where both countries have a shared interest or objective, coordination can have potential benefits, such as by reducing the cost of representations or increasing the chances of achieving an international outcome favourable to both countries. However, as noted above, coordination may also impose administrative costs and reduce local accountability and flexibility.

Telstra and Telstra Clear note a possible example of this type of cooperation. Recent coordination by Australian and New Zealand regulators and industry representatives, to develop and promote an Asia-Pacific approach to using the radio spectrum frequencies freed up by the switch from analogue to digital television, led to a trans-Tasman plan being adopted by Asian-Pacific regulators (sub. 48).

There may be other cases where such coordination can generate joint benefits. For example, the characteristics of the international aviation system mean that greatest benefits for Australia and New Zealand would come from multilateral reform. It would therefore be in Australia and New Zealand's interests to work together and jointly push for a multilateral air services reform agenda.

Performance benchmarking

There may be value in taking a more integrated approach to future performance benchmarking of government services. International comparisons can be a useful addition to the existing national measures. There may be scope for either country to adapt performance measures being used 'across the ditch' rather than developing new measures from scratch.

For example, New Zealand could make use of Australia's *Report on Government Services*, produced under the direction of the Steering Committee for the Review of Government Service Provision. Options include New Zealand independently

developing its own parallel report or having formal involvement in the one produced in Australia. This would be most beneficial where New Zealand and Australian government service providers are pursuing similar objectives, against which performance can be compared using the same performance indicators. The feasibility and cost of New Zealand involvement would also depend on whether it is already collecting data for these performance indicators and, if not, the cost of doing so.

The benefits of trans-Tasman benchmarking appear strong in principle, but more detailed work would be required to determine how best to proceed.

DR4.20 The New Zealand and Australian Governments should consider development of joint performance benchmarking initiatives. As an initial step, Australia and New Zealand should investigate opportunities for increased involvement by New Zealand in the Report on Government Services, produced under the auspices of COAG.

4.8 Options that should not proceed

This chapter has identified 'unfinished business' that should be completed as scheduled, and prospective areas where additional policy initiatives should be considered. There are also several areas where the Commissions do not have sufficient evidence to put forward a view, and where further evidence is sought.

There are, however, areas where either the evidence available to the Commissions or its own analysis indicates that further integration is not justified. As discussed in chapter 2, excluding political union as a realistic option also rules out or limits the scope for some economic integration initiatives that would necessitate adherence to common political and policy positions, such as common monetary and fiscal policies. In addition, the considerable differences between the two countries' tax systems indicate that harmonisation is not a viable option.

For reasons discussed earlier in the chapter, the Commissions also do not support a customs union. Regulatory areas where there are significant differences among Australian states are unlikely to be promising candidates for integration with New Zealand, although the Commissions would not go so far as to say that such areas should be ruled out.

The monetary union issue

The possibility of a monetary union between Australia and New Zealand has often been raised in the past and was discussed in a number of submissions.

Determining which economies might benefit from forming a monetary union is a complicated task (Mundell 1961), and the limited available research only provides an overview of the costs and benefits of a monetary union (RBNZ, sub. 12).

Monetary unions offer a number of potential benefits. First of all, they remove the exchange rate risk on trade between member countries and permit price comparisons. This potentially increases investment and trade, and facilitates specialisation and productivity growth (Mundell 1961; Rose 2008). However, the consequent increases in trade are generally small (Cote 1994). This is likely to be the case for Australia and New Zealand, since Australia accounts for only 23 percent of New Zealand's merchandise exports (table 1.1), while New Zealand accounts for a much smaller share of Australia's trade.

Monetary unions also entail a number of costs. They imply a loss of autonomy over monetary policy and exchange rate flexibility, which are important tools for macroeconomic stability. This means that in the event of an economic shock to New Zealand, but not to Australia (or vice versa), adjustment through the exchange rate or through monetary policy would no longer be possible, and would instead necessitate adjustment through prices, wages and employment. Adjustment through these channels is typically slower and can result in more volatile prices and output (Rose 2008; RBNZ, sub. 12). The size of such effects will depend in part on the frequency of asymmetric shocks and the degree of synchronisation of the business cycles of the economies within a monetary union. Business cycle synchronisation will itself depend on policy settings, the structure of the economies and resilience to economic shocks.

Determining the appropriateness of a monetary union involves assessing the significance of the benefits and costs. Available studies of a trans-Tasman monetary union suggest that the potential costs would outweigh the benefits. For example, Drew et al. (2001) and Hall (2005) found that if New Zealand had adopted Australia's monetary policy in the 1990s, aggregate output in New Zealand would have been slightly higher, but this would have come at the cost of higher inflation and more volatility in both output and inflation. McCaw and McDermott (2000) and others have also shown that a common trans-Tasman monetary policy would have produced greater volatility than occurred under current policy alignment. There are few instances where monetary union has worked effectively without some degree of political union.

Overall, the Commissions do not consider that the prerequisite conditions for a trans-Tasman monetary union exist — a view that is shared by most participants in the study (box 4.8).

Box 4.8 Participants' views about a trans-Tasman monetary union

> Tying New Zealand's fortunes to Australia's currency would result in monetary policy being driven by Australian conditions with decisions made by the Reserve Bank of Australia. Clearly this may not always be appropriate for New Zealand, particularly when economic conditions are different and when experiencing divergent business cycles. (FFNZ, sub. 33, p. 5)
>
> Available research for New Zealand does not provide conclusive answers about the economic desirability of a currency union with Australia. While currency union with Australia could provide many important benefits, the loss of autonomous monetary policy would expose New Zealand to the possibility of increased inflation and output volatility in general and larger adjustment costs in the event of significant New Zealand-specific shocks. As such, the sustainability of a currency union will depend on the effectiveness of alternative adjustment mechanisms like price and wage flexibility and particularly common fiscal arrangements in helping the economy cope with shocks. Because currency union membership involves the loss of monetary autonomy (and possibly fiscal sovereignty), the decision to enter into a currency union must ultimately be determined within a broader economic and political context. Maintaining effective union-wide fiscal arrangements may be difficult without significant steps toward political integration. (RBNZ, sub. 12, p. 3)
>
> I see no material net benefits for the short through to medium term if pursuing any of the other level 4 elements of Common Currency, Common Monetary Policy or Common Fiscal Policy. (Hall, sub. 31, p. 1)
>
> We [Lloyd and Seng 2006] concluded that a case for monetary union has not been established and that is still my view. (Lloyd, sub. 5, p. 5)

5 Making it happen

Key points

- The Commissions have identified a range of integration initiatives that could have significant joint net benefits. However, economic integration between Australia and New Zealand is well advanced and some new initiatives will be more complex and challenging.
- Successful implementation requires sound governance arrangements, including to enhance the capacity for ongoing evaluation and review.
- CER governance arrangements have to date been light-handed and pragmatic. They have worked reasonably well. But there is scope to build on them to match the more complex policy challenges that lie ahead and enhance the capacity for evidence-based policy.
- Some initiatives that could be considered are:
  - a clearer leadership and oversight role within CER
  - regulatory proposals at the national level should consider opportunities to lower the costs of doing business across the Tasman
  - arrangements that facilitate more joint action in regional and multilateral fora
  - five-yearly public reviews of CER's direction and achievements.

Regardless of how good a policy idea may be on the 'drawing board', successfully implementing it can be a formidable challenge. Effective implementation of policy requires governance arrangements that are suited to the task. This chapter looks at existing arrangements for the leadership, implementation and management of CER reforms. It considers whether improvements could be made in the light of experience, and in order to better meet the requirements of an evolving CER agenda.

5.1 The forward agenda

In chapter 4 the Commissions proposed (i) completing some unfinished CER business (ii) some worthwhile new initiatives on the basis of available evidence; and (iii) some areas that warrant further, more detailed investigation. The chapter grouped the initiatives according to whether they concern the markets for goods,

services, capital or labour. Two further categories — opportunities for transferring knowledge and for closer integration of government services — were also explored.

Taken as a whole, this amounts to a substantial forward agenda for CER, and one that contains ongoing challenges if the two countries are to 'maximise joint net benefits'.

That said, it is recognised that CER initiatives would need to take their place alongside domestic reform priorities and participation in broader regional or multilateral initiatives. It is outside the scope of this study to compare the relative priorities within this wider policy landscape. The focus here is on achieving CER initiatives that are worth pursuing in their own right.

Many of the initiatives relate to the reduction of impediments to trade in services, particularly those that operate behind the border. Compared to conventional border restrictions on merchandise trade, these can pose special challenges for reform. For one thing, the impediments often arise as an unintended by-product of pursuing a domestic policy objective. This may be a social or environmental objective that is not seen primarily in economic terms, or that is not publicly accepted as a legitimate subject for international negotiation. The 'impediments' themselves are typically regulatory in nature and can involve multiple dimensions that may interact.

This places a premium on having governance arrangements for CER that can play an effective ongoing role in marshalling evidence, establishing priorities and monitoring outcomes — so as to provide coherence in an overall agenda that is well communicated and publicly accepted.

Evidence from OECD case studies (Tompson and Dang 2010) indicates that cohesive political leadership and effective communication are key to getting reforms successfully implemented. Where two governments are involved, that is likely to be more difficult. Yet the past achievements of CER are indicative of the scope to implement the forward agenda successfully.

Governance will be important to this. Good processes are generally a necessary, if not sufficient, condition for good outcomes. Acharya and Johnston (2007, p. 264) have examined a number of regional international institutions and found that their design is a deliberate and complex process that reflects multiple factors. They conclude that 'institutional design does affect the nature of cooperation, especially when it comes to the realization of their [the parties'] initial goals'.

Thirty years on from the signing of ANZCERTA, it is timely to ask whether its governance arrangements remain 'fit for purpose', given the evolution of CER, changes in external circumstances and the types of reforms that are likely to be needed to achieve further mutually beneficial integration.

5.2 Past and current governance of CER

CER governance can be characterised as light-handed and pragmatic. It is a model that has been held up as a workable alternative to EU-style integration with its grander visions and powerful supra-national institutions (Leslie and Elijah 2012).

The key CER decision-making processes remain within the respective governments of Australia and New Zealand. While no Ministers have formal responsibility for the trans-Tasman relationship, the two Prime Ministers hold de facto ministerial responsibility for CER and meet periodically. There are also regular trans-Tasman meetings at ministerial and departmental levels which drive efforts to coordinate and integrate.

The Trans-Tasman Outcomes Implementation Group (TTOIG) has served since 2004 as an oversight, coordination and review body in relation to a program to integrate business laws within the Single Economic Market phase of CER. It comprises a small group of senior officials jointly chaired by the Australian Treasury and the New Zealand Ministry of Business, Innovation and Employment. It oversees and reports six-monthly on progress towards achieving 28 outcomes across nine areas of business law (section 4.1 has more detail) and has been largely successful in keeping the program on track.

The Council of Australian Governments (COAG) has become an important component of the current CER governance arrangements (box 5.1). In some areas, CER reform has taken its cue from the efforts of COAG to remove barriers to create a 'seamless national economy' within Australia. One example is the trans-Tasman joint agency for food standards, FSANZ, which grew out of the Australian national food standards developed through COAG.

Box 5.1 **New Zealand's participation in the Council of Australian Governments (COAG)**

New Zealand Ministers have had observer status at relevant COAG Ministerial Councils for nearly two decades. In 2008 a report by the Australian House of Representatives Standing Committee on Legal and Constitutional Affairs recommended full membership. The Australian Government accepted this recommendation in relation to those Ministerial Councils that consider matters in which New Zealand has an interest. When the new COAG structure was put in place in 2011 New Zealand was invited to and opted to join the Ministerial Councils and Fora detailed below.

Standing Councils	*Select Councils*	*Legislative and Governance Fora*
Community and Disability Services	Climate Change	Consumer Affairs
Energy and Resources	Housing and Homelessness	Food Regulation
Environment and Water	Immigration and Settlement	
Health	Women's Issues	
Law and Justice	Workplace Relations	
Police and Emergency Management		
Primary Industries		
Regional Australia		
School Education and Early Childhood		
Tertiary Education, Skills and Employment		
Transport and Infrastructure		

New Zealand does not participate in the Select Councils on Disability Reform and Gambling Reform or in the fora on Corporations, Gene Technology and the Murray-Darling Basin.

Source: Provided by the New Zealand Ministry of Foreign Affairs and Trade.

Benefits of light-handed CER governance

As described in chapter 3, the approach to CER reform has been incremental and pragmatic. This style has generally worked well, in that it has:

- delivered significant integration with broad public support in both countries
- taken into account political, cultural and social preferences
- had relatively low transition and administrative costs.

An early examination of trans-Tasman integration (Holmes 1995, p. 47) noted its low administrative costs and a relative absence of bureaucracy: 'There has been

no need for the creation of a regional bureaucracy like the European Union's, or to devote large amounts of official time to managing the operation'. In its review of Mutual Recognition Schemes, the Australian Commission commended TTMRA as a 'low maintenance' system that does not establish a new bureaucracy or require repeated updating (PC 2009).

Box 5.2 **Differing styles of governance**

The European Union (EU) stands out for the breadth and depth of its economic integration. Trans-Tasman integration efforts bear both similarities to and important differences from European integration. Both regions aim to achieve a single market for goods, services, labour and capital. In both, the principle of mutual recognition by member states of each other's national regulations, standards and qualifications has been important in furthering integration. In the EU this has proven relatively easy for goods, but more difficult for services.

The designers of the EU created supranational institutions — the European Commission, the European Parliament and the European Court of Justice. These function alongside the inter-governmental European Council. Member states have ceded some decision-making powers to these supranational institutions, which have authority over a wide range of issues and can create policies and laws that have 'direct effect' in the member states.

Australia and New Zealand have created some joint institutions — the Joint Accreditation System Australia-New Zealand (JAS-ANZ); Food Standards Australia New Zealand (FSANZ); and the planned Australia New Zealand Therapeutic Products Agency (ANZTPA) — but the authority of these is limited to specific issue-areas. The two governments also maintain some (ministerial) control over these institutions.

The Nordic countries — Denmark, Finland, Iceland, Norway and Sweden — share a long history of cooperation as well as geographic proximity and cultural and linguistic similarities. In contrast to the size and diversity of the EU (27 member states), this smaller group of similar countries has more in common with CER.

The Nordic Council of Ministers is the inter-governmental body of Nordic cooperation. It brings together Ministers from national governments. Areas of policy cooperation include culture, leisure and media; economy, business and working life; education and research; environment and nature; legislation and justice; the Nordic region and the surrounding world; and welfare and gender equality.

The Nordic Passport Union enables passport-free movement of Nordic citizens and establishes their right to live, work and study with full equality with nationals in other Nordic countries. A related initiative is the public information service 'Hello Norden' which provides information to potential migrants within the region about rules relating to living, studying and working in other Nordic countries.

As has been remarked, trans-Tasman governance differs markedly from arrangements in the EU, where member states have delegated not only monitoring

but also some rule-making functions to supranational institutions notably the European Commission and the European Court of Justice. CER also differs from the North American Free Trade Agreement, which has several administrative bodies, and other regional trading arrangements (Lloyd 1996). A closer comparator is the arrangements of the Nordic countries (box 5.2).

Too light-handed?

While 'Kiwi-Aussie pragmatism' (as a roundtable participant described it) in CER governance arrangements appears to have served the two countries well thus far, it has not been without some downsides.

A number of commentators and reviews have expressed concerns about the fragmented and ad hoc character that CER has displayed from time to time. They have pointed to the absence of an oversight role, lack of cohesion, and cyclical variations in activity, and some have suggested ways to overcome these (box 5.3).

Box 5.3 **Recent perspectives on CER governance**

> … the absence of a single goal statement is a problem for making progress… At the moment there is a list of outstanding issues that are being addressed in various ways, but no real sense of impetus. (Nicklin, sub. 11, p. 2–3)
>
> …there have been variations over time in the pace at which the overall integration agenda, and individual issues within that agenda, have been pursued. (Scollay, Findlay and Kaufmann 2011, p. 4)
>
> Certainly ministerial level engagement provides leadership and a semblance of co-ordination. However, it is an open question whether these provide the necessary degree of capacity for change. (Mahony and Sadleir, sub. 28, p. 3)
>
> …there does not seem to be one driving force behind the implementation of CER. (JSCFADT 2006, p. 20)

In carrying out this study, the Commissions have been struck by the number and variety of the different parts of what could loosely be called the 'CER enterprise'. Because there is no overall design or management, it has been a major task even to document the many agencies and players involved and their interactions.

5.3 Strengthening the governance of CER

Given the past largely positive experience, yet the likely more complex and challenging nature of CER's future agenda, the Commissions' view is that some potential improvements could be made to CER's governance arrangements.

These are in tune with the past light-handed and flexible approach and build on existing institutional structures. They are likely to strengthen oversight and enhance support for a more evidence-based approach to policy.

In the Commissions' view, key opportunities for improvements include:

- a clearer leadership and oversight role within CER
- regulatory proposals at the national level giving more systematic consideration to impacts on the costs of doing business across the Tasman
- arrangements that would facilitate more joint action in the quest for further and better regional and multilateral integration, and greater leverage in global rule making and standard setting
- five-yearly public reviews of CER's direction and achievements.

A clearer leadership and oversight role within CER

A risk with the current decentralised model of CER governance is that fragmentation can mean that the integration agenda loses continuity. The policy areas and associated governance arrangements are diverse. There is no single minister or agency responsible for setting the overall agenda, overseeing the relationship and monitoring progress and performance.

Currently, TTOIG comes closest to having this oversight role. However, TTOIG focuses on a program of business law reform which is due to be completed in 2014. In addition, while TTOIG has been able to facilitate good progress on outcomes, in part this is because the TTOIG co-chairs are senior officials in the departments with direct responsibility for delivery of most of the outcomes (the New Zealand Ministry of Business, Innovation and Employment and the Australian Treasury).

A leadership and oversight role for the CER agenda as a whole could usefully encompass responsibility for setting direction and priorities, communication of key messages, monitoring progress, and holding officials to account. It would also arguably enhance the profile and momentum of the CER agenda. But its benefits would need to be weighed against the risks of additional bureaucracy.

The role could be realised in different ways. Suggestions include having a senior Minister in each country with overall responsibility for CER, or a joint Australia-New Zealand Council of Ministers meeting once a year along the lines of the Nordic Council of Ministers. However, arguably a surer way forward would be to build stronger administrative support for the annual meetings that already take

place at the highest political levels — between the two Prime Ministers and between the Treasurer (Australia) and the Minister of Finance (New Zealand).

For this purpose, a group of officials could be designated that would:

- operate along the lines of the current TTOIG, but have coverage of all CER issues
- continue and broaden TTOIG's existing monitoring function
- improve continuity of institutional knowledge about CER, with potentially greater foresight about upcoming opportunities and challenges.

DR5.1 The Australian and New Zealand Governments should create a clearer leadership and oversight role for CER, building on existing governance arrangements and the annual meeting of Prime Ministers.

Regulatory proposals should consider trans-Tasman implications

Another risk of current fragmented governance arrangements is that, when either country is introducing new or modified regulations, the opportunity to design the changes in a way that lowers transaction costs for businesses and people operating across the Tasman could be overlooked. Two examples where regulations differ, but could have been aligned, are internet copyright violations and film censorship classifications.

New areas of regulation at the national level constantly arise (for example 'cyber bullying', privacy laws) and there could be gains from a collaborative approach between the relevant agencies across the Tasman.

Regulatory impact assessment (RIA) processes are well developed in each country and are required for all significant new regulations or modifications of existing ones. The RIA could be an appropriate point for the responsible government agencies to consider whether collaborating with their trans-Tasman counterparts would bring tangible gains. Of course the choice among options would still need to be based on an overall cost-benefit test.

DR5.2 When significant new regulatory proposals or modifications arise at the national level, the responsible government agencies should examine opportunities for trans-Tasman and/or broader collaboration that would lower costs and deliver net benefits.

Facilitating joint action

Chapter 3 noted the outward-looking nature of CER and its ability to act as a building block for Asia-Pacific integration. As Sir Frank Holmes noted some years ago, 'Cooperation between the two countries in developing external relationships must inevitably assume increasing importance in their bilateral dealings with one another in the future' (Holmes, 1995, p. 32). CER governance arrangements are likely to influence the way in which Australia and New Zealand interact with the wider region and how often they work collaboratively to pursue their aspirations in the region and more widely.

As also described in section 3.2, Australia and New Zealand acted together in negotiations with the Association of Southeast Asian Nations (ASEAN) to eventually form the ASEAN-Australia-New Zealand Free Trade Area. Close cooperation and joint approaches have occurred in other cases (eg, overseas development assistance in the Pacific, the 'Cairns group' in WTO trade rounds), but these tend not to be pursued systematically.

As noted in section 4.3, the Commissions consider that Australia and New Zealand should retain discretion about whether they negotiate jointly or individually with other countries (thus removing one argument for a Customs Union). However, there would be benefits from working jointly when opportunities arise. These opportunities could also include cases where the two countries can exert greater leverage by speaking with a single voice in multilateral fora such as the WTO, and in rule-making and standard-setting bodies in areas such as customs, biosecurity, telecommunications, intellectual property and aviation.

A more deliberate or systematic approach to making the best of such opportunities seems desirable. However, further work would be needed to determine what changes to institutional structures would best achieve this.

DR5.3 The Australian and New Zealand Governments should undertake further work on how to facilitate joint action to achieve successful regional and multilateral integration, and greater leverage in international rule making and standard setting.

More regular reviews

Arrangements to review the effectiveness of major programs are an important part of good governance. There is room to improve the monitoring, evaluation and review of CER. This can be achieved through adopting guidelines for appropriate ex-post evaluation of initiatives, evidence-based policy making, and by periodic reviews of outcomes from, and the direction of, CER. It is important to learn whether initiatives achieved their intended benefits and whether there were any unintended effects. Such feedback can also help build the evidence base for improving policy settings and developing new policies.

To date, apart from the merchandise trade area, there is little research on CER reforms and their effects.

Currently, the mechanisms for evaluation of CER initiatives are quite fragmented. Each of the multitude of agreements between the two countries tends to contain a clause requiring some form of review. For example, the 2011 CER Investment Protocol states that 'The Parties agree to meet in or shortly after the first year of entry into force of this Protocol, and regularly thereafter, to review the operation of this Protocol.' However, there is no consistent approach to such reviews, which have varied in quality and frequency. As a general rule, any significant trans-Tasman initiatives should include a commitment to cost-effective evaluation.

There is also merit in formal reviews that examines the overall health of CER. Currently these are conducted 'in house' as part of the annual Trade Ministers' meetings (Australian High Commission, New Zealand 2012). The character of these meetings can pre-dispose them to focus on immediate or short-term issues. Further, their scope to encompass more substantial analysis is limited.

The Commissions believe there would be merit in re-introducing more comprehensive CER reviews conducted publicly at around five-yearly intervals. These reviews should focus on the broad direction of the CER agenda and also draw together what has been learnt from the individual project evaluations and other relevant research that has been conducted in the interim years.

DR5.4 The Australian and New Zealand Governments should undertake five-yearly public reviews of CER to take stock of what has been achieved and learnt, and ensure that the agenda remains relevant and forward looking.

A Stakeholder engagement

Roundtables

Melbourne, 20 April 2012

ANZ Bank
Australian Confederation of Commerce and Industry
Australian Industry Group
Business Council of Australia
Food & Beverage Importers Association
Medicines Australia
Pharmaceutical Industry Council
Shipping Australia

Auckland, 16 May 2012

Air New Zealand
ASB Bank
Fletcher Building
Australia New Zealand Leadership Forum
Fonterra
NZ Institute of Finance Professionals
QBE Insurance NZ
Westpac Institutional Bank

Wellington, 16 May 2012

Business NZ
Manufacturing and Export NZ
Ministry for the Environment
New Zealand Bankers Association
New Zealand Council of Trade Unions
New Zealand Trade & Enterprise
Pacific Fibre
Tourism Industry Association

Visits

Auckland Chamber of Commerce
Australian Council of Trade Unions (ACTU)
Australian Department of Finance and Deregulation
Australian Department of Foreign Affairs and Trade
Australian Department of the Prime Minister and Cabinet
Australian Department of the Treasury
Australian High Commission, New Zealand
Australia and New Zealand Customs High Level Steering Group
David Walker, Ministry of Foreign Affairs and Trade
Dr Tom Richardson, CEO AgResearch, NZ
Federation of Māori Authorities
Fonterra
Financial Markets Authority
Kea New Zealand
Māori Economic Development Panel
New Zealand Inland Revenue Department
New Zealand Bankers Association
New Zealand Council of Trade Unions
New Zealand Customs Service
New Zealand Institute of Economic Research
New Zealand Ministry of Business, Innovation and Employment (formerly Ministry of Science and Innovation, Ministry of Economic Development, Department of Labour and Department of Building and Housing)
New Zealand Ministry of Foreign Affairs and Trade
New Zealand Ministry of Health
New Zealand Shippers' Council
New Zealand Trade and Enterprise
New Zealand Treasury
OliverShaw
Paul Hamer, Victoria University of Wellington
Peter Mumford, Ministry of Business, Innovation and Employment
PricewaterhouseCoopers New Zealand
Professor Jacques Poot, University of Waikato
Professor Klaus Zimmerman, Institute for the Study of Labor, Bonn University
Reserve Bank of Australia
Simon Murdoch, former NZ High Commissioner to Australia and former Secretary of Foreign Affairs and Trade
Simon Power, former Minister of Commerce, New Zealand
Sir Michael Cullen, former Deputy Prime Minister and former Minister of Finance
Telstra
TelstraClear
Vodafone NZ

Presentations

Murray Sherwin and Jonathan Coppel 2012, *Building on CER's 30 Years: The Next Phase* – Joint Productivity Commission Report Australia-New Zealand Leadership Forum (ANZLF), presented the A-NZ Economic Integration Issues Paper, Sydney, 13 April.

Gary Banks 2012, *Whither trans-Tasman economic relations?*, presented to CEDA's State of the Nation Conference in Canberra, 18 June.

Submissions

Company/Individual/Organisation	*Sub No.*
Accord Australasia Limited	54
Action Key Trust Foundation	39
ANZ	50
Auckland Chamber of Commerce	42
Australia New Zealand Leadership Forum	15, 58
Australian Bankers' Association	37
Australian Council of Trade Unions & New Zealand Council of Trade Unions	17
Australian Financial Markets Association	9
Australian Food and Grocery Council	22
Australian Industry Group	38
Baldwins Intellectual Property	45
Bob Catley	1
Bottom-line Ownership and Management Services	19
BusinessNZ	40, 59
BusinessSA	8
Christchurch International Airport Limited	21
Corporate Taxpayers Group (New Zealand)	35
CPA Australia	53
Doug Calhoun	29
Family Business Australia	3
Federated Farmers of New Zealand	33
Financial Markets Authority	57
Fonterra Co-operative Group	14
Geoff Cole	4
Germana Merle Nicklin	11
Greg Cutbush and Malcolm Bosworth	51
Greg Mahony and Dr Chris Sadleir	28
Insurance Australia Group	23
Insurance Council of Australia	36
Insurance Council of New Zealand	49
Joel Krose	2
John Fielding	41

Company/Individual/Organisation	*Sub No.*
Joseph Qiangfu Jin	7, 27
Lindsay Clarke	60
New Zealand Bankers' Association	24
New Zealand Food and Grocery Council	34
New Zealand Institute of Patent Attorneys Incorporated	30
New Zealand Privacy Commissioner	16
New Zealand Venture Capital Association	32
Nga Hapu o Niu Tireni/Treaty of Waitangi Partners (On behalf The Hapu of New Zealand/Tiriti o Waitangi)	20
Nuplex Industries Limited	47
NZ Law Society	6
NZ Shippers Council Inc	46
Office of the Australian Information Commissioner	10
Pharmaceuticals Industry Council	43
Professor Luke Nottage	55
Professor Peter Lloyd	5
Professor Viv Hall	31
Reserve Bank of New Zealand	12
Standards Australia	44
Standards New Zealand	52
Stokes Partners International	18
Telstra Corporation	56
Telstra Corporation and TelstraClear Limited	48
Temperzone Holdings Limited	13
Tourism and Transport Forum	25
Universities Australia	26

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