# 4 Opportunities for further integration

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| Key points |
| * This chapter identifies 28 policy initiatives to strengthen trans-Tasman economic relations in ways that could yield joint net benefits. * Most 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. * Some involve initiatives underway (initiatives to which both Governments have committed but have not yet completed). Others are new initiatives, some of which will require more detailed consideration. * There is also greater scope for each Government to cooperate with and learn from the other in policy development and service delivery. * Waiving rules of origin for traded goods 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. * While the trans-Tasman air route is already quite competitive, two regulatory barriers to competition on this route could usefully be removed. * The exemption of ocean carriers from key parts of competition regulation is no longer necessary and should be repealed. * The two Governments should implement the Investment Protocol they signed last year and consider removing the remaining restrictions. * Mutual recognition of tax imputation credits (MRIC) on trans-Tasman investment could expand investment and bring efficiency gains, but would involve sizeable fiscal losses and income transfers, which are more likely to leave Australia worse off. The two Governments should either initiate a process for determining whether there is an efficient, equitable and robust mechanism to ensure a satisfactory distribution of the gains from MRIC; or announce that MRIC will not go ahead if such a mechanism is considered infeasible. * Different social security and tax systems have placed some New Zealanders resident in Australia for long periods in anomalous situations. The Australian Government should enhance information for arriving and long term resident New Zealanders; address the issues faced by non-Protected Special Category Visa holders living long term in Australia including by developing pathways to citizenship; and seek to improve their access to tertiary education. * Within the context of the CER, the SEM and the TTTA, the Australian and New Zealand Governments should review the principles governing access to social security and further develop bilateral engagement on migration policies. |
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This chapter assesses initiatives to further integrate the Australian and New Zealand economies. Some are ‘initiatives underway’, that is, initiatives to which both Governments have committed, but have not completed (section 4.1). Others are new initiatives (sections 4.2–4.6). The areas and impediments covered in these sections have been selected drawing on the filtering criteria outlined in box 2.7. Most involve impediments to trade in services. Regulations behind the border are particularly important (figure 4.1).

Figure 4.1 Areas potentially affected by recommendations**a**

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| Figure 4.1: Areas potentially affected by recommendations. This figure includes all potential effects of recommendations in chapter 4 of the report. It classifies these effects as to where they occur: between, at or beyond the borders and which type of transaction they affect: goods, services, labour or capital. |

a Number of areas substantially affected by the recommendations identified in chapter 4. Some recommendations are likely to affect more than one area.

The chapter also considers initiatives that the Commissions consider should not proceed (section 4.7).

The Commissions’ analysis is summarised in this chapter. Supplementary papers examine many of the initiatives in more depth.

## 4.1 Initiatives underway: key areas to deliver

The Commissions have identified four areas — business law, mutual recognition of occupational licensing, therapeutic products regulation and the CER Investment Protocol — in which the Australian and New Zealand Governments have committed to policy initiatives that have not been completed at the time of writing.

### Business law reforms are mostly on track

#### The program as a whole

In September 2012, the Trans-Tasman Outcomes Implementation Group (TTOIG) reported that one of the 19 medium term outcomes in the business law SEM program had been completed, 12 were on track for completion by the end of 2014, four were slowing or on hold, and two have been removed, with ministerial agreement (box 3.6). Eight short term outcomes have been completed; one has been delayed. The delays to outcomes were explained as follows.

* *Aligning corporate trustee regimes for financial products*: Other priorities in Australia continue to delay the review of the corporate trustees regime for debentures.
* *A standard set of financial and business performance data for reporting to governments*: Progress in New Zealand has been affected by the creation of the Ministry of Business, Innovation and Employment. It is expected that the outcome will be further progressed in 2013.
* *A single plant variety rights regime*: It may be difficult to achieve a single application process for trans-Tasman plant breeder’s rights until New Zealand ratifies the International Union for the Protection of New Varieties of Plants Convention 91. The intellectual property regulators are considering revising this outcome so that it does not depend on this ratification.
* *Sharing confidential information between competition and consumer law regulators in both countries*: The necessary legislation has been passed in both countries. The memorandum of understanding between the two competition agencies will need to be revised to comply with new statutory requirements.
* *Single filing of company information*: Financial reasons have delayed progress in both countries, although the relevant regulators are exploring how to make progress within current funding (TTOIG 2012).

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.

#### A single application and examination process for patents

A single application and examination process for patents, 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. A facility that allows for a single patent application will be introduced in 2013, while joint examinations will be phased in from 2014 (TTOIG 2012). Separate patents will still be granted in each jurisdiction, avoiding the need for full alignment of the two countries’ patent laws.

This initiative should have benefits for both countries. The patent examination process is complex, and it may be increasingly difficult for small countries to maintain the necessary capacity to conduct effective examinations (Barton 2004). Closer cooperation between the Australian and New Zealand Intellectual Property Offices will offer knowledge transfer and greater specialisation which can improve the ability of both offices to respond to current and future demands (TTOIG 2012).

On the cost side, the New Zealand Institute of Patent Attorneys (NZIPA, sub. 30) and the intellectual property firm Baldwins (sub. 45) suggest that a single process would increase applications by overseas owners of intellectual property for patents in both countries (when previously they would have only applied in Australia), to the disadvantage of New Zealand innovators. The NZIPA (sub. DR89) suggests that the experience of countries that have recently joined the European Patent Convention — a regional patent system that shares some similarities with the proposed trans-Tasman reforms — supports this contention.

IP Australia (sub. DR89, p. 5) accepts that the single examination process could increase patent filings in either country, but for two reasons expects any increase to be ‘modest’. First, although the proposed reform is anticipated to reduce costs, the commercial viability of seeking patent protection in an additional jurisdiction depends on a range of other costs associated with prosecuting, maintaining and enforcing patent rights. Second, Australia and New Zealand are both members of the Patent Cooperation Treaty, an international patent law treaty, which already provides a streamlined approach for filing applications in multiple jurisdictions. As such, the proposed changes merely present another option for applicants who wish to file in Australia and New Zealand. IP Australia also suggests that increased patent filing will not necessarily diminish local innovation. It notes that the threshold for granting a patent (for example, the required levels of inventiveness and disclosure) has a more important impact, and that both countries are taking steps to strengthen the thresholds for granting patents.

As evident in the contrasting opinions raised in submissions, the impact of a joint application and examination process on the rate of patent filing is difficult to predict — particularly given that many other factors also influence the decision to seek patent protection. The extent to which innovation opportunities might be constrained by increased patent filing in either country is also unclear.

On balance, given the potential operational benefits from closer collaboration between the Australian and New Zealand Intellectual Property offices, the Commissions consider that this reform should be completed within the current TTOIG process and timeframes. As noted in chapter 5, arrangements to review the effectiveness of major programs are an important part of good governance and, as a general rule, significant trans-Tasman initiatives should include a commitment to cost-effective evaluation. The trans-Tasman intellectual property reforms, particularly those relating to patents, should be evaluated within three years of implementation to assess their economic impacts and to identify lessons that can be drawn from this collaboration.

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|  | **R4.1** |  | The remaining outcomes in the business law single economic market program should be completed on time, unless it can be demonstrated that they would no longer generate net benefits. |
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|  | **R4.2** |  | The Australian and New Zealand Governments should proceed with the implementation of a single application and examination process for patents. The trans-Tasman intellectual property reforms, particularly those relating to patents, should be evaluated within three years of implementation. |
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### Mutual recognition schemes

The trans-Tasman Mutual Recognition Arrangement (TTMRA) seeks to promote economic integration by reducing regulatory impediments to the movement of goods and provision of services across the Tasman. In the case of goods, mutual recognition enables goods produced in or imported into one jurisdiction, and that may lawfully be sold in that jurisdiction, to be sold in a second jurisdiction without meeting additional regulatory requirements in that jurisdiction. In the case of services provided by a range of occupations, mutual recognition means that registration in an occupation in one jurisdiction is sufficient grounds for registration in the equivalent occupation in another jurisdiction (PC 2009b). Mutual recognition principles do not apply in circumstances that are covered by provisions for exclusions, exceptions and exemptions (temporary and permanent).

The Australian Commission reviewed the TTMRA in 2009, in line with a requirement in the TTMRA that it be reviewed every five years. The Commission’s overall assessment was that:

Mutual recognition — under both the MRA and TTMRA — has served the Australian and New Zealand economies well. … However, many of the gains have been captured and fulfilment of the full potential of the schemes is now stymied by ambiguities and omissions in the Acts, and by weaknesses in their implementation. There is also a strong case for extending the coverage and scope of the schemes, given the many changes that have occurred in the goods and labour markets over the past decade or so (PC 2009b, p. xxxviii).

The Commission recommended a number of ways to improve the TTMRA (box 4.1).

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| Box 4.1 Key Australian Productivity Commission’s recommendations for improving the TTMRA |
| The Commission recommendations included:   * Changes should be made to the exemptions of some occupations and goods from mutual recognition. For example: * the exemption for medical practitioners should be removed for those who have gained their medical qualifications within Australia or New Zealand * some categories of goods subject to special exemptions from mutual recognition across the Tasman should be mutually recognised. Others should continue to be special exemptions, while the remainder should be converted into permanent exemptions. * Amendments to the mutual recognition legislation are urgently needed to remedy ambiguities and omissions in the Acts. In particular: * mechanisms for regulators and stakeholders to seek advice and declarations from the Trans-Tasman Occupations Tribunal should be clarified and/or created * requirements for the use of goods, insofar as they prevent or restrict the sale of goods, should explicitly be brought into the scope of mutual recognition. * Australia and New Zealand should take into account the possible impacts that international agreements will have on the mutual recognition framework when negotiating future initiatives with third countries. * The Cross Jurisdictional Review Forum (the joint Australia–New Zealand government body with carriage of mutual recognition) should report annually to COAG on its program and achievements. |
| *Source*: PC (2009b). |
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The joint response of the Commonwealth, State and Territory Governments of Australia and the New Zealand Government to these recommendations has not been published. However, the Commissions understand that the situation is as follows.

* The Governments decided that the special exemptions that previously applied to five categories of goods should become permanent exemptions. This was effected in 2010.
* As noted in chapter 3, in June 2011 the Governments of Australia and New Zealand agreed to establish a joint Australia New Zealand Therapeutic Products Agency (ANZTPA). Therapeutic products were previously subject to a special exemption from mutual recognition.
* In April 2010, the Australian Parliament passed the *Health Insurance Amendment (New Zealand overseas trained doctors) Act 2010*, which relaxed restrictions on New Zealand citizens and permanent resident doctors who gain their first medical degree from a New Zealand or Australian university.
* Some of the recommendations for legislative change have been rejected and others (for example, use of goods requirements and new judicial remedies) are still being considered. In some cases, the Governments considered that the recommendations could be taken up without recourse to legislation through, for example, updating *the User’s Guide to the Mutual Recognition Agreement and Trans-Tasman Mutual Recognition Arrangement*. This work is underway and will include case studies and other relevant examples, where they are available, to help avoid any remaining ambiguity about how to implement the TTMRA (MBIE, pers. comm., 5 November 2012).
* Advice was taken on possible changes in approach to streamline the legislative process, as currently legislation has to be enacted in 10 legislatures. This advice has not been acted upon to date, given other priorities.
* The Cross Jurisdictional Review Forum considered the five-yearly review process provided the appropriate means for reporting to COAG on progress with mutual recognition matters. In between, reporting to COAG senior officials should be on an as-needed basis.
* Amongst the jurisdictions, there is interest in the review’s recommendations to broaden mutual recognition to the direct provision of services in regulated occupations (so that registration in one jurisdiction would permit provision of services across jurisdictions). Proposed work in this area by the New Zealand Government was put on hold pending the conclusion of this joint scoping study.
* There has been little progress on trans-Tasman occupational mutual recognition, pending development of national licensing arrangements for a number of occupations in Australia. It was felt that any changes needed to be advanced in Australia before their implications for trans-Tasman mutual recognition were further explored. That said, examples such as the recent mutual recognition of financial advisers suggest that the TTMRA continues to generate benefits, and the Commissions did not come across evidence of firms lacking access to adequate information about mutual recognition. Occupational licensing is discussed further in the next section.

In summary, some changes have been made following the recommendations of the 2009 review but it appears that, with the exception of work on ANZTPA, other priorities on both sides of the Tasman have prevented non-essential work involving the TTMRA from being undertaken.

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|  | **R4.3** |  | The Australian and New Zealand Governments should give priority to implementing those recommendations of the Australian Commission’s 2009 review of the Trans-Tasman Mutual Recognition Arrangement that were accepted by Governments. |
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It would be unsatisfactory for the next review of the TTMRA, due to begin in 2013, to proceed without stakeholders in that review knowing the Governments’ response to the 2009 review and any impediments to implementing those recommendations that were accepted. To enable stakeholders to contribute effectively to the upcoming review, a report outlining progress since the 2009 review should be published.

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|  | **R4.4** |  | Governments should publish a progress report on implementing accepted recommendations of the 2009 review of the Trans-Tasman Mutual Recognition Arrangement before the next review, scheduled in 2013. |
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#### The national system of occupational licensing

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 labour mobility being lower than otherwise.

While agreement on a national occupational licensing system within Australia would address inter-jurisdictional differences within Australia, it will be some time before such regimes are developed across all occupations. Moreover, it may not be worth developing licensing regimes for less significant occupations or where licensing is only required in a few jurisdictions, or when there is little cross‑jurisdiction movement (PC 2009b).

Even when there is an Australia-wide licensing scheme, 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 2009b, p. 110)

COAG continues to work on a national occupational licensing system, and the New Zealand Government is undertaking a scoping study of occupational regulation. Ongoing consultation across the Tasman would allow regulators to harness synergies from these separate national developments without undermining trans-Tasman mutual recognition.

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|  | **R4.5** |  | 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 occupational licensing systems in the other country. |
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### The Australia New Zealand Therapeutic Products Agency (ANZTPA)

The ANZTPA — the first trans-Tasman authority to enforce regulation as well as set standards — should be fully operational by 2016 (box 4.2).

Given the difficulties that have been experienced in progressing this project since it was first contemplated in 1999 (chapter 3), regular publication of progress reports (similar to the six-monthly report published by the TTOIG) would assist stakeholders to plan and would signal the need for remedial action if implementation schedules slip.

After the ANZTPA has been set up, it would be useful to review: why this project has taken so long; how the barriers to establishing ANZTPA were overcome; and whether other approaches could have achieved similar outcomes more quickly. Insights from this review should help to channel future efforts towards initiatives with the largest net benefits and improve their implementation.

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| Box 4.2 Towards the Australia New Zealand Therapeutic Products Agency |
| A three stage approach has been adopted to progressively achieve, over a period of up to five years, the goal of a single regulator.   1. The two countries' regulators, the Therapeutic Goods Administrator (TGA) and Medsafe, will immediately begin sharing work and doing more operations jointly. This is intended to enhance each country’s regulatory system, through sharing data, information and 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. Business should benefit from having to comply with only one set of requirements to operate in the two countries.   1. As operations become increasingly integrated and following a review of progress, the single regulator will be established. |
| *Source*: Department of Health and Ageing (2011). |
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|  | **R4.6** |  | 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, the Governments should review the lessons for other potential regulatory harmonisation initiatives. |
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### CER Investment Protocol

Australia and New Zealand signed a CER Investment Protocol in 2011, but have not yet enacted it. The Protocol lifts some investment screening thresholds and establishes a legal framework of investor rights. However, various exclusions will limit its liberalising effect.

Despite this, the Protocol offers joint net benefits and should be implemented as soon as practicable (supplementary paper C). Section 4.4 discusses the case for further liberalisation of trans‑Tasman investment restrictions.

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|  | **R4.7** |  | The CER Investment Protocol should be enacted as soon as practicable. |
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### Portability of retirement savings

In 2009 the Australian and New Zealand Governments agreed to legislate to enable residents of either country to transfer their retirement savings across the Tasman if they emigrated permanently to the other country (ATO 2011). In New Zealand, the *Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver and Remedial Matters) Act 2010* enables trans-Tasman portability of retirement savings.

In the draft report, the Commissions noted that the relevant Australian legislation had not been enacted. On 22 November 2012, the Australian Parliament passed the *Superannuation Legislation Amendment (New Zealand Arrangement) Bill 2012*, to establish a trans-Tasman retirement savings portability scheme.

### Standards

Standards Australia and Standards New Zealand have a working relationship that the latter considers is ‘unique in the world’ (sub. 52, p. 1). The formal relationship dates back to an Active Cooperation Agreement signed in 1992 and a subsequent memorandum of understanding, which recognises joint standards as a means to assist trade harmonisation between Australia and New Zealand and between both countries and the rest of the world (Standards New Zealand, sub. 52). Joint standards now account for 35 percent of the Australian catalogue and 80 percent of the New Zealand catalogue (Standards Australia, sub. 44). Standards New Zealand contends that the development of robust joint standards for therapeutic products could have created the conditions for a smoother transition to harmonised regulatory arrangements, and so accelerated the introduction of ANZTPA.

Work is underway in the international standards community to consider how standards could contribute to emissions trading schemes. Telstra has argued that Australian and New Zealand networks should adopt international standards where possible (sub. DR108).

There is not unfinished business in the standards area in the sense of a government commitment that has not been completed. However, development of standards is an ongoing process that needs to continue to contribute to economic integration between Australia and New Zealand and between both countries and the rest of the world.

## 4.**2** ‘First freedom’: trade in goods

### 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. Through the CER agenda, imports from the partner country enter duty free, provided they are deemed to have originated in the partner country under the CER rules of origin (RoO).

Both countries also have a range of preferential trading agreements (PTAs) with other countries (with overlaps, but also some differences).

The upshot is that a sizeable proportion of imports into both countries enter duty‑free, and the protective value of remaining tariffs will continue to be eroded as further free trade deals take effect.

However, tariffs in both Australia and New Zealand continue to generate costs. These include administrative costs borne by the customs services, compliance costs borne by 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 distortions and compliance costs that arise from the CER RoO. As the Australian Commission found in recent reports, the cost of re-exporting typically exceeds 5 percent of the value of imports (PC 2004b; 2010). Thus, when tariffs are at 5 percent or less, there is little incentive for third parties to engage in re-exporting, and so little value in requiring compliance with the 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 or less. This would reduce economic distortions as well as compliance and administrative costs for a significant proportion of trans-Tasman trade.

Following the discussion draft, some participants expressed concern that waiving the CER RoO requirements would have adverse side-effects on the administration of other government functions, including the application of anti-dumping measures and quarantine requirements. As discussed in supplementary paper A, the CER RoO are not necessary for these purposes. Another concern was that the waiver proposal might enable re-exporting for some items, including high value-added products and bulk, homogenous commodities, where the cost of doing so is less than the 5 percent average. However, even if some re-exporting were to occur, the Australian and New Zealand Governments could respond in a variety of ways (supplementary paper A), including by simply welcoming the lower prices and added competition that it could bring.

Building on the waiver initiative, each country could also reduce tariffs that exceed 5 percent down to that level (by, say, 2015), which would allow the trans-Tasman RoO to be waived for these items too. The additional elements of this proposal would mainly affect the New Zealand textiles, clothing and footwear industries and imports of second hand cars into Australia, to the benefit of consumers of those products. The implications for these activities, and related policy issues, could be reviewed first. The Commissions see merit in this option, which is discussed further in supplementary paper A.

The Commissions considered, but do not support, the formation of a customs union. 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. A customs union could bring about reductions in tariffs and abolition of the RoO. However, depending on its implementation, tariffs on some items could rise and disparities in assistance could widen. It would also 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 could be large. Some supporters of a customs union consider that it would increase the countries’ combined bargaining power in trade negotiations, but they can already negotiate together.

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|  | **R4.8** |  | The Australian and New Zealand Governments should:   * waive CER Rules of Origin for all items for which Australia’s and New Zealand’s Most Favoured Nation tariffs are at 5 percent or less * consider reducing any tariffs that exceed 5 percent to that level. |
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### Quarantine and biosecurity

While biosecurity functions are administered by separate national agencies, there is a long history of trans-Tasman cooperation (box 4.3). Indeed, New Zealand’s 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).

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| Box 4.3A cooperative approach to biosecurity |
| Biosecurity measures were excluded from ANZCERTA and the Trans-Tasman Mutual Recognition Arrangement.  However, Australia and New Zealand agreed to a Protocol on the Harmonisation of Quarantine Administrative Procedures in 1988, 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 to create a barrier to trade, where this is not scientifically justified (Australian and New Zealand Governments 1988).  A Consultative Group on Biosecurity Cooperation was established in 1999 to provide impetus and direction for trans-Tasman biosecurity harmonisation (CGBC 1999). Comprising Australian and New Zealand officials, it reports annually to 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. |
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Despite sharing some similarities, Australia and New Zealand have different environments and biosecurity risks. These limit integration and rule out options such as adopting the same quarantine standards for imports from third countries and removing quarantine restrictions on a trans-Tasman basis.

The issue, therefore, is how much additional cooperation is beneficial, given that differences in biosecurity restrictions will inevitably remain. Formal and informal cooperation, sharing of information and resources, and some collaboration in risk analysis, benefit both countries and should continue. The relationship needs to 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. The two agencies 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 review risk assessments carried out by their counterparts. The New Zealand Customs Service points out that the two customs agencies already consider opportunities for trans-Tasman coordination on a case-by-case basis (sub. DR114, p. 2).

The ACTU and NZCTU (sub. DR118, p. 12) suggest that collaboration will generate a reasonable balance of benefits in both directions. As the smaller partner, New Zealand stands to gain significantly from access to the greater scale and capacity of Australia’s biosecurity agencies. For Australia, access to staff with complementary experience and knowledge of different environments could be worthwhile, while New Zealand also offers ‘flexibility and smaller scale to test initiatives and do research’. Both countries are also likely to benefit from pooling biosecurity resources, particularly for costly new technology such as testing and laboratory equipment.

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|  | **R4.9** |  | Where cost effective, quarantine and biosecurity agencies in Australia and New Zealand should continue to develop common systems and processes, and enhance their joint approach to risk analysis. |
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### Emissions trading

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

The cost of reducing emissions is likely to be different between the two countries. Opportunities for trade should therefore enable emissions to be reduced at a lower cost 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 mechanisms, given that other countries may have less costly abatement opportunities. 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 has a mandate from both governments to work towards linking the CPM and the NZETS. It is well positioned to assess the compatibility of the schemes and to deal with the complicated legal and practical issues that would result from either country pursuing multilateral harmonisation, or more binding treaty arrangements.

## 4.3 ‘Second freedom’: trade in services

The CER Protocol on Trade in Services aims to strengthen the relationship between Australia and New Zealand through, for example, both Governments treating providers of services from the other country in the same way as providers from their own. The Protocol covers all services except those that are explicitly excluded.

### Exclusions from the CER Protocol on Trade in Services

In the case of Australia, the exclusions are: some intrastate air services; limits on foreign ownership of broadcasting and television (as set out in the *Broadcasting Services Act 1992)*; broadcasting and television (short wave and satellite broadcasting); compulsory third-party motor vehicle insurance; specified postal services, and coastal shipping cabotage policy. Air services and coastal shipping are excluded in the case of New Zealand.

The impact of the New Zealand exclusions is unlikely to be large. As explained below, a Single Australia-New Zealand Aviation Market (SAM) has been in place since 1996 and restrictions on coastal shipping in New Zealand have been largely removed. Australian exclusions cover a larger number of significant service industries, and so may have greater impact.

The practical impact of exclusions is that Australia’s market access and national treatment obligations under the Protocol do not apply in respect of the excluded services sectors or sub-sectors.

The intention of excluding a service from the Protocol is to support a domestic policy objective. For example, specified postal services in Australia have been excluded from the Protocol not to limit competition specifically from New Zealand suppliers. Rather, exclusion is required because of a policy decision to provide Australia Post with a statutory monopoly on specified services, to enable it to provide a letter service that is reasonably accessible to all people in Australia on an equitable basis.

The rationales for other exclusions are also founded in Australian domestic policy considerations.

* As a matter of policy, the Australian Government carves out air services from all broad-based trade agreements.
* Compulsory third party motor insurance is excluded from all of Australia’s free trade agreements, because state governments have jurisdiction over these markets.
* The Australian Government regulates access to the Australian coastal shipping trade.
* The broadcasting and television exclusion was intended to ensure that New Zealand firms and individuals continued to be bound by the then foreign investment restrictions under the Broadcasting Services Act 1992. These restrictions on foreign investment in Australia’s media sector were removed in 2006. However, the media remains a ‘sensitive sector’ under the Foreign Investment Policy that operates under the Foreign Acquisitions and Takeovers Act 1975 (DFAT, pers. comm., 7 November 2012).

Key questions, therefore, are whether the domestic policy objectives continue to be important to the Australian Government and whether the objectives can only be achieved by restricting competition. If an objective continues to be important and can only be achieved by restricting competition, the restrictions should apply equally across Australia and New Zealand. If the restrictions are not warranted, they should be removed.

From this perspective, it is important to consider whether exclusions from the Protocol that were justified on domestic policy grounds when they were included on the list, remain justified today, given any subsequent policy changes or market developments. Article 20 of the Protocol provides for regular review of the operation of the Protocol. The latest published review (exchange of letters) on the official website is dated 1995 (DFAT nd), although further reviews were undertaken in 1997 and 1999. The exclusions from the Annex have not been amended since 1999.

However, the 2007 CER Ministerial Forum Joint Statement noted that a further review would be timely and the 2008 Statement commented that:

… both countries should continue to look for opportunities to remove or liberalise those services still exempted from coverage under the Protocol. (Crean and Goff 2008).

Exclusions from the Protocol — while possibly justified on domestic policy grounds — do have costs in so far as they restrict the gains from trans-Tasman trade in services that were seen as justifying the negotiation of the Protocol in the first place. Given the potential benefits from trans-Tasman competition, services should be removed from the exclusions list unless there are demonstrated net benefits from retention. The current review should be completed and published as soon as possible.

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|  | **R4.10** |  | The Australian and New Zealand Governments should complete the review of the exclusions from the Trade in Services Protocol, to consider whether retaining each exclusion would generate net benefits. The review should be published. |
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### Air services

The close links between the two economies are evident from the more than 40 000 flights across the Tasman each year (BITRE 2012).

#### Air service regulation

International air services arrangements are governed by a complex system of negotiated bilateral rights between countries, contained in air services agreements. The air services arrangements between Australia and New Zealand are relatively liberal. However, there remains potential for reforms that would provide joint net benefits (supplementary paper B).

##### Single Australia-New Zealand Aviation Market

Even though air services are excluded from the CER Services Protocol, major steps have been taken to integrate and liberalise the Australian and New Zealand air services markets. A Single Australia-New Zealand Aviation Market (SAM) has been in place since 1996 and the Australian and New Zealand Governments signed an Open Skies Agreement in August 2002. This agreement enables airlines from either country to operate between Australia and New Zealand without regulatory restrictions on capacity, frequency and routes. It also enables them to operate without these regulatory restrictions within both countries and to third countries on routes with an origin or destination in the home country. For airlines to take advantage of this agreement, they must meet certain ‘designation’ criteria relating mainly to the ownership and control of the airline (NZ PC 2012).

The Open Skies Agreement makes the trans-Tasman air transport market one of the most liberal in the world (Vowles and Tierney 2007). The routes between New Zealand and the eastern seaboard of Australia are among 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 and LAN airlines, also provide trans-Tasman services using separate bilateral agreements with their home countries. Extensive code sharing arrangements also exist on flights across the Tasman. However, Qantas and Air New Zealand carry the dominant share of trans-Tasman passengers. Australian airlines (such as Jetstar and previously Qantas and Virgin Blue) have also entered the New Zealand domestic market.

Two remaining measures restrict the market.

* ‘Seventh freedom rights’ for the movement of passengers are denied. These would 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.) Granting seventh freedom rights would provide benefits by enabling improvements in the range and quality of services from Australia and New Zealand to third countries and by exerting downward pressure on airfares.
* The current airline designation requirements (which determine the airlines that can fly under an air services agreement) limit carrier entry to the trans‑Tasman market and thereby lessen competition. The requirements are inconsistent with the policy positions taken recently by the Australian and New Zealand Governments. Liberalising designation requirements, including the requirements for ownership and control under the Australia-New Zealand Open Skies Agreement, would enable airlines to pursue broader commercial opportunities and more tailored ownership structures. The community would also benefit from increased competition.

Removing these restrictions is unlikely to have a major impact on the trans‑Tasman route, given that competition is already strong. However, the restrictions do not serve a worthwhile purpose, and fully liberalising the market should produce benefits, particularly on international routes to and from Australia and New Zealand.

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|  | **R4.11** |  | The Australian and New Zealand Governments should remove the remaining restrictions on the single trans-Tasman aviation market. |
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##### Beyond the Single 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. Both Governments have committed to pursuing more liberal aviation arrangements and would gain from working together, given the international nature of the necessary reforms.

Policy objectives for air services should be clearly defined and focus on improving the wellbeing of the community as a whole. At present, Australia’s policy goal for international aviation balances the interests of the Australian aviation industry and of the broader community (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.

Negotiating liberal air services agreements continues to offer benefits, given the constraints of global air services regulation. Both countries should re‑commit to pursuing the most open air services agreements possible, by negotiating reciprocal open capacity and all air freedoms, including cabotage where appropriate. Governments should also seek to remove any remaining regulatory impediments to accessing regional airports. Further liberalisation will reduce constraints on market entry, and loosen controls on airlines’ rights to service particular routes. Greater flexibility and contestability would enhance economic efficiency by encouraging airlines to innovate and expand services and/or minimise their costs, including by operating their networks more efficiently. Under these circumstances, consumers could benefit from greater choice of carriers and/or services, and lower airfares.

Both countries have committed to seeking a designation criterion of ‘incorporation and principal place of business’ in their bilateral agreements. This is in contrast to the more restrictive approach of limiting airline designation to airlines that are ‘substantially owned and effectively controlled’ by nationals of the designating country. In practice, the more liberal designation approach has not always been possible. However, both countries should continue to adopt it as their default position in negotiations.

In addition to continuing to revise designation requirements, Australia and New Zealand could review their ownership restrictions for national airlines, including for Qantas and Air New Zealand. 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 change these sub-limits, and in the case of Air New Zealand to review them in the context of a mixed government/private ownership model. Restrictions on foreign direct investment are discussed in section 4.4.

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|  | **R4.12** |  | The Australian and New Zealand Governments should:   * ensure that the objective of air services policy is explicitly directed at promoting net benefits for the community * pursue the most liberal air services agreements possible, by negotiating reciprocal open capacity and all air freedoms, including cabotage where appropriate * revise designation and ownership requirements. |
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#### Passenger movement charge

Introduced in July 1995 to replace the Departure Tax, the Australian Passenger Movement Charge (PMC) was intended 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 2012-13 (with around 8 percent from trans-Tasman travel), rising to over A$1 billion in 2015-16.

Several study participants called for the removal, restructure or reduction of the PMC on Australia-New Zealand routes. The PMC forms part of the cost of the ticket of a person departing Australia for any other country. Participants highlighted the potentially disproportionate impact of the charge on trans-Tasman travel, as a short and otherwise low-price flight. Reducing or removing the charge for flights to New Zealand would see them treated more like an Australian domestic flight.

There are issues associated with the PMC that go beyond its impact on the trans‑Tasman route. Legally, it 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 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).

As a result, the PMC should be replaced with a user charge for services provided. While some stakeholders raised concerns about moving to a user charge arrangement, this would have benefits. It would:

* provide greater transparency through requiring border agencies to clearly identify the costs of services provided
* increase users’ awareness of the costs of the service they pay for, increasing pressure for efficiency in service delivery
* be more equitable, as it would require those who use a service to pay for its costs.

Whether the level of the charge should be higher or lower than the current PMC — and the consequent impact on travel costs — would depend on whether the efficient cost of service provision exceeds or is less than the PMC.

The New Zealand Government funds the costs of providing biosecurity and customs passenger clearance processes out of 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 through user charges. The New Zealand Government should review the appropriateness of current arrangements for funding passenger clearance services, given the potential advantages from moving to a cost recovery model.

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|  | **R4.13** |  | 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. |
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### Sea freight

Ships carry nearly all of Australia’s and New Zealand’s international trade (by volume), including trade across the Tasman.

#### 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 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 2005b). 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 exemptions for ratemaking agreements. The Australian and New Zealand Governments should also examine the potential costs and benefits of further action, particularly in light of ongoing changes in international practices. This may occur in New Zealand through the Government’s current consultation on the changes recommended by the New Zealand Commission, and in Australia through the scheduled review of Part X, due to occur in 2014. The opportunity and potential benefits of trans-Tasman co-ordination are strong reasons to bring forward this review.

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|  | **R4.14** |  | 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. |
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#### Coastal shipping

Australian coastal shipping regulations currently require foreign-flagged vessels to obtain a licence and to employ crew under Australian conditions and rates of pay while engaging in coastal trade in Australian waters. Until recently, if licensed ships could not meet all coastal shipping demand, the responsible Minister could issue single or continuous voyage permits (lasting up to three 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, restrictions on coastal shipping have largely been removed in New Zealand. 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 National Bulk Commodities Group Inc (sub. DR93) and the Cement Industry Foundation (sub. DR94) both argued that the new Australian coastal shipping regulations will increase freight costs and reduce the competitiveness of local industries. 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 an independent body to undertake a comparative review of the impacts of the two approaches on each economy and on trans-Tasman trade.

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|  | **R4.15** |  | 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. |
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#### Ports

While the performance of Australian and New Zealand container ports has improved significantly since the early 1990s, large variations within and between each country point to scope for further productivity improvements. For example, the Australian Commission found that full implementation of the National Reform Agenda could improve productivity of container ports by, for example, 3 percent in South Australia and 10 percent in New South Wales and Western Australia (PC 2006b).

A range of issues impeding port efficiency in Australia and New Zealand remain. For instance, the ACCC and the New Zealand Commission found that limited competition, restrictive work practices and behaviours and difficulties in resolving multiple objectives in publicly owned ports are impeding productivity and innovation (ACCC 2012; NZ PC 2012).

Given that many factors contribute to efficient port operation, collaborative monitoring, data collection and benchmarking of ports’ performance across the Tasman would help to identify opportunities to improve productivity. (The benefits of benchmarking are discussed in section 4.6.)

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|  | **R4.16** |  | Governments should undertake systematic monitoring, data collection and benchmarking of ports’ performance in Australia and New Zealand, building on existing initiatives. |
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### Telecommunications

Australia and New Zealand have significantly liberalised their telecommunications markets, but there remain five potential barriers to integration:

* differences in regulation and technical standards
* deficiencies in regulation
* high prices in Australian and New Zealand mobile roaming markets
* restrictions on foreign direct investment
* regulation of information services over the internet.

#### Differences in regulation and technical standards

Differences in regulations and technical standards between the telecommunications markets in Australia and New Zealand can discourage integration by increasing compliance and transaction costs for telecommunications businesses operating in both markets. It can also be more expensive for governments to administer two regulatory systems 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 there had been significant harmonisation and that the regimes were not significantly impeding businesses operating in Australasian markets (PC 2005a). The report noted that a transitional approach to further integration could yield some 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]](#footnote-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). Telstra suggested that a telecommunications chapter in the CER could be one way to ‘lock in’ the current alignment in telecommunications regulation and to minimise future deviation between the regulatory regimes (sub. 56). However, Telstra also identified some remaining differences in existing telecommunications regulation and technical standards that they argued may impose costs or impede trans-Tasman operations (sub. 56). Table 4.1outlines some of these differences.

Table 4.1 Examples of differences between Australian and New Zealand telecommunications regulation**a**

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| 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. |

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

*Source*: Telstra (sub. 56).

Telecom NZ concurred with Telstra’s view that the existing regulatory approaches in the two countries were broadly aligned (sub. DR102). It stated that it was unclear whether the continuing differences were material, noting that they ‘likely reflect the different circumstances of the different markets’ (Telecom NZ, sub. DR102, p. 1).

Telstra (sub. 56) identified potential future barriers to trans-Tasman trade in telecommunications (and other) services delivered over the broadband networks currently under construction in both countries (the National Broadband Network (NBN) in Australia and the Ultra-fast Broadband Network in New Zealand). Telstra argued that the builders of the networks do not appear to be coordinating technical standards that would allow interoperability between networks for access services.

… the Local Fibre Companies (LFCs) [in New Zealand] on the one hand, and NBN Co [in Australia], on the other, appear to be developing their networks and operational support systems (OSS) including wholesale technical interfaces without reference to each other. Ideally, the new fibre networks should be deployed to the same or interoperable technical standards, thus lowering barriers to developers in both countries. (sub. 56, p. 5)

Telstra argued that alignment should be encouraged through consultation rather than by regulation and that this could be undertaken ‘within the context of a CER work program’ (sub. DR108). They also noted that as ‘technology takers’ the Australian and New Zealand networks should adopt international standards where possible. The potential for a lack of coordination in other standards and regulations to create barriers to trade in services over the internet is discussed below.

#### 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 other.

Participants in the 2006 Australian parliamentary inquiries mentioned above 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.

Government policies and regulatory settings in both countries will also have a dramatic impact on competition. 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.) In addition, governments in both countries are funding the construction of fibre optic broadband networks and have committed to restrict the network operators to wholesaling basic connectivity services.

Telstra noted that an agreement between the two countries that entrenched this ‘wholesale only’ commitment would improve certainty for investors wishing to provide telecommunication (and other) services over the networks, and would ‘underpin the development of a trans-Tasman market’ in such services (sub. 56).

This scoping study has been presented with little evidence that differences or deficiencies in the current regulatory arrangements are significantly impeding trans-Tasman integration of telecommunications markets. In recent years, there has been substantial trade in telecommunications services across the Tasman, primarily through commercial presence.[[2]](#footnote-2)

However, this trade likely represents a relatively small proportion of total telecommunications activity in the two countries — estimated to be more than A$20 billion in 2010 (ABS 2012c; Statistics NZ, Wellington, pers. comm., 5 June 2012). In terms of SEM principles (such as creating a seamless, ‘domestic‑like’ experience), Australian and New Zealand telecommunications services continue to be produced and consumed largely in segmented markets.

Telstra and Telstra Clear have proposed that the Australian and New Zealand Governments investigate opportunities for further harmonisation of telecommunications regulations that could lead to a ‘SEM in telecommunications services’ (sub. 48, p. 4). Telstra noted that such a study would require:

… comprehensive research and consultation with telecommunications providers and other stakeholders on both sides of the Tasman. (sub. 108, p. 3)

Net benefits may be available from further harmonisation in telecommunications regulation. However, a thorough review of the frameworks in both countries would be needed to assess where such opportunities exist. To capture any potential welfare gains, the Australian and New Zealand Governments should include in the next reviews of their respective telecommunications regulations a term of reference to examine barriers to trans-Tasman trade in telecommunications service and options for their removal.

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|  | **R4.17** |  | The Australian and New Zealand Governments should include in the next reviews of their respective telecommunications regulatory frameworks a term of reference to examine barriers to trans-Tasman trade in telecommunication services and options for their removal. |
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#### 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. Research has found that international roaming charges paid by users in many countries were ‘unreasonably high’ compared with the underlying costs of provision, including for Australian and New Zealand users roaming in third countries (OECD 2009a; 2011b; ACCC 2005).

A joint Australia-New Zealand 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 discussion draft in August 2012. It found that there is limited competition in the trans-Tasman retail and wholesale roaming market, and that while prices and margins have been trending down since 2009 (particularly for data roaming), they are still high (DBCDE 2012).

The two departments are now consulting on a range of options to reduce roaming prices including continued monitoring of the markets, requiring more transparent provision of price information, requiring operators to provide local-access services to roamers, and the imposition of wholesale and/or retail price caps. A final report is expected to be released at the end of 2012. The Australian and New Zealand Governments have announced that they will consider and respond to the report’s findings.

#### Foreign investment restrictions

Both Australia and New Zealand restrict foreign direct investment in telecommunications markets (through 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.

#### Trade in services over the internet

Rapid changes in information technologies and the spread of high speed internet have dramatically changed the economics of data transport, storage and processing in recent years. For example, data centres have become the central nodes of the internet, exploiting economies of scale to deliver a ‘utility’ model of computing that enables businesses and households to access computing services and digital content on demand.

These changes have created opportunities for cross-border trade in many services that have traditionally been delivered locally through other means. Opportunities include trade in information services (such as data storage and cloud computing), information processing services (such as financial, accounting, and health services), and entertainment services (such as the provision of digital content including television, movies, music and computer gaming). In principle, these services can be supplied from any location where it is efficient or convenient to do so and consumed anywhere with a sufficiently fast internet connection.

These types of trade in services can be impacted by a myriad of existing rules that regulate the transmission, storage and use of data and digital content (in addition to the telecommunications specific rules discussed above that apply to the delivery platforms themselves — the broadband networks). For example, governments can impose data security requirements on the storage of financial information, privacy requirements on the use of health records or restrictions on the types of content that can be accessed. While these regulations exist to achieve specific benefits (such as avoiding fraud, protecting privacy, or maintaining cultural standards) some submissions noted that they can also impose costs and restrictions that limit or prevent services trade.

Telstra (sub. 56) argued that non-telecommunications specific regulations in Australia and New Zealand will limit future trans-Tasman trade in services over the broadband networks under construction in both countries.

… there are a range of regulations which may be well outside the ambit of traditional telecommunications regulation, for example privacy and confidentiality protections for medical records, which could be harmonised … to reduce barriers to the development of applications and services that would scale across the Tasman … (sub. 56, p. 6)

Fujitsu Australia and Fujitsu New Zealand (sub. DR79) noted that privacy and financial regulations in both countries limit the offshore transmission and storage of commercial trading, financial and citizens’ data, and that this restricts trans‑Tasman trade in data storage and ‘cloud computing’ services. Fujitsu argued that trans-Tasman harmonisation of these regulations would facilitate trade in this area.

Existing domestic regulation designed when trade in services tended to occur locally and through more traditional means may not be well suited to addressing trade in services over the internet. Differences in regulation between countries that were previously of little importance when cross border trade was more limited may now act as barriers to such trade. Regulation that does not appropriately adapt to services trade over the internet may lead to new barriers to trans‑Tasman and wider trade and prevent countries from capturing potentially substantial gains from emerging trading opportunities.

To avoid this, governments should ensure that the regulatory settings applying to data and digital content (and other relevant areas) achieve domestic policy objectives without unnecessarily impeding internet-based services trade. Chapter 5 includes a recommendation that regulatory proposals at the national level in Australia and New Zealand should consider opportunities for trans-Tasman collaboration that would lower costs and deliver benefits. Regulations that affect trans-Tasman trade in services over the internet should be included in such collaboration.

### Insurance

Submissions from the insurance industry raised four issues, which are discussed, in turn, below.

#### Regulatory harmonisation

The Insurance Council of New Zealand (sub. 49, and sub. DR96) argued that governments need to re-think trans-Tasman regulatory differences, although differences in market size and scope mean that ‘Australian regulations and market conditions may not be workable, or even appropriate in New Zealand’. In spite of these market differences, the Council noted that if the two Governments ‘are seriously considering integrating New Zealand and Australia’s insurance markets, they need to completely rethink these regulatory differences’ (sub. DR96, pp. 1–2).

The Commissions have not been able in this scoping study to review the advantages and disadvantages of further integrating regulation of the insurance industry. However, worthwhile integration would be fostered if future regulations affecting the insurance industry that are the subject of national regulatory impact statements in either country take account of trans-Tasman impacts (see chapter 5).

#### Solvency standards

In both Australia and New Zealand, standards are in place requiring insurers to hold enough capital so that, taking into account the probability of certain risks (such as those relating to claims, investments and assets, and catastrophic events), the insurer can continue to meet its obligations to its policyholders as they fall due.

The Insurance Councils of Australia (sub. 36) and New Zealand (sub. 49) consider that the decision by the Reserve Bank of New Zealand (RBNZ), to increase the catastrophe risk capital charge for non-life insurance to a 1 in 1000 years loss return period compared with the 1 in 250 year requirement of the Australian Prudential Regulation Authority (APRA), has created a material difference between the Australian and New Zealand regulatory environments. This difference, they suggest, exceeds the difference in catastrophe risk profile between the two countries, and will make New Zealand less attractive to international insurers and discourage diversified insurers in both markets. Insurance Australia Group (sub. 23) made a similar point and added that this difference is exacerbated by differences across the Tasman in definitions, immaterial prudential requirements and documentation, and overly prescriptive compliance and governance requirements. Vero (sub. DR76) considers that the disparity in solvency standards should be reviewed.

New Zealand’s higher catastrophe risk capital charge may discourage Australian firms from providing catastrophe insurance in New Zealand. However, the 1 in 1000 year loss return period has been set in regard to the risks of earthquakes, which are a more significant risk in New Zealand than in Australia. Moreover, different solvency standards across the Tasman may reflect different attitudes to risk as well as differences in the risks themselves. The regulatory impact statement that assessed this requirement pointed out that calibrating the catastrophe risk at a prudent level is ‘judgmental’ (RBNZ 2012b, p. 22).

The Commissions are not qualified to comment on solvency standards, but note that the reasons for choosing the 1 in 1000 year loss return period have been set out in a regulatory impact statement.

#### Taxation

Insurance Australia Group (sub. 23) supports eliminating or reducing insurance taxes and charges (fire services levy and stamp duty in Australia and fire services levy and earthquake commission levy in New Zealand). The Insurance Council of New Zealand (sub. 49) supports reducing the general levies and taxation placed on insurers.

The fire services levy and stamp duties on insurance in Australia are the responsibility of state governments. Other commentators have supported removing taxes on insurance. For example, the review of Australia’s Future Tax System (Commonwealth of Australia 2010, section E8–1) recommended that:

… specific taxes on insurance products, including the fire services levy, should be abolished. Insurance products should be treated like most other services consumed within Australia and be subject to only one broad-based tax on consumption.

Some state governments are already moving to modify their insurance taxes. This decentralised approach may well be more effective than bringing the issue within a trans-Tasman framework, and seeking a coordinated approach between governments.

#### Disclosure requirements

The Insurance Council of New Zealand (sub. 49) suggests that New Zealand should require insurance brokers to declare their remuneration, as is the case in Australia.

The website of the Insurance Council of New Zealand indicates that most persons advising on insurance products are deemed to be financial advisers, because they offer ‘financial advice’ on contracts of insurance. Financial advisers are regulated under the *Financial Advisers Act 2008.* Sections 22 and 23 (2) (f) of this Act require financial advisers to disclose their remuneration to a client before providing a service to a retail client or as soon as practicable afterwards. This suggests that only insurance brokers who do not provide financial advice are not legally obliged to disclose their remuneration.

Insurance brokers who are members of the Insurance Brokers Association of New Zealand are guided by a Code of Professional Conduct that covers: minimum standards of ethical behaviour; client care; competence knowledge and skills; and professional training (Insurance Brokers Association of New Zealand Inc 2011). The Code does not require disclosure of remuneration. This implies that the disclosure requirement issue raised by the Insurance Council of New Zealand could be addressed by the industry choosing to amend its Code of Professional Conduct.

Alternatively, the New Zealand Government could consider regulation. Before regulating, the benefits and costs of requirements for disclosure of remuneration would need to be assessed in the context of the market and prevailing regulatory conditions of New Zealand. While the assessment should have regard for disclosure requirements in Australia, it should also recognise that these requirements have been determined in a different regulatory and market environment, and may not necessarily be appropriate in New Zealand.

## 4.4 ‘Third freedom’: capital

### Foreign direct investment

Australia and New Zealand both restrict foreign direct investment (FDI) 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 — primarily by raising the monetary thresholds below which some investments will no longer require screening. Equity limits in both countries are not affected by the Protocol.

Under the Protocol, Australia is to apply more lenient 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.

New Zealand’s approach to screening sensitive land appears to be unduly restrictive and creates unnecessary uncertainty for Australian and other foreign investors. This is because the definition of ‘sensitive land’ captures land that may not actually be ‘sensitive’, and screening criteria permit a high degree of discretion as to how relevant costs and benefits are weighted. There is scope to improve this aspect of New Zealand’s foreign investment policy.

Given that the effects of the CER Investment Protocol are likely to be limited, the two Governments should consider the costs and benefits of further foreign investment liberalisation. Restrictions on FDI can bring several types of economic costs.

* 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 the services sector, 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 local culture in the host country. However, domestic policies (for example, competition policy, environment regulation or targeted support for cultural activities) 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 2012b). While there is debate about the methodology and 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.

An option 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 consistent with the outward-looking approach outlined in chapter 2 and would follow the historical precedent of Australia and New Zealand liberalising trade restrictions with each other first and then with other countries.

In the context of the trans-Tasman relationship, there is considerable scope to move beyond the limited changes in the CER Investment Protocol. The ‘direction of travel’ should be towards a broader application of national treatment of investors from the other country. There may be legitimate reasons for retaining some restrictions (for example, relating to national security or the Treaty of Waitangi), but the reasons should be made clear.

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

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|  | **R4.18** |  | The Australian and New Zealand Governments should consider removing remaining restrictions on trans-Tasman foreign direct investment. The policy rationale and the costs and benefits of any restrictions, including exceptions to national treatment left in place, should be made clear. |
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### Taxation

Differences between the tax systems of Australia and New Zealand may influence the character and location of economic activities across the Tasman in many ways. Study participants pointed to the absence of mutual recognition of imputation credits (MRIC) across the Tasman; costs of having to be familiar with two different systems (AiGroup, sub. 38); issues with dividend and interest withholding tax (Australian Bankers’ Association, sub. 37); and tax residency issues (Fielding, sub. 41), taxation of non-resident employees and tax base integration (The Corporate Taxpayers Group (New Zealand)) (sub. DR65).

#### Mutual recognition of imputation credits

The lack of trans-Tasman recognition of imputation credits was the biggest concern for a number of participants, including: the Australia New Zealand Leadership Forum (subs. 58, DR70 and DR120); Australian Bankers’ Association (sub. 37); Corporate Taxpayers Group (sub. 35); New Zealand Venture Capital Association (sub. 32); Temperzone Holdings Limited (sub. DR63); Auckland Chamber of Commerce (sub. DR63); Contact Energy (sub. DR63); and Peter Ferguson (sub. DR63). They support the introduction of mutual recognition of imputation credits, and some also acknowledge the complexities involved and that the issue has been on the agenda for more than 20 years.

##### What is the issue?

In both Australia and New Zealand, shareholders are entitled to ‘imputation’ (in New Zealand or ‘franking’ in Australia) credits on dividends, when companies have paid corporate income tax. When tax is paid on corporate income at the company level, dividend recipients can credit this tax against their personal (or institutional) income tax liability. 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 arising from company income earned and taxed in New Zealand.

This means that the overall 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.

This has adverse consequences for investment allocation between Australia and New Zealand, creating:

… a home bias in investment decisions: even though from a pure economic perspective an investment opportunity looks a better bet in the destination economy, the impact of the tax policy determines that it makes sense to forego that opportunity and put money into a potentially less efficient investment domestically.

As a result, trans-Tasman resource decisions are distorted: resources are not being allocated to their optimal locations. (ANZLF sub. 58, attachment, p. 4)

The combined effect of taxing company and personal income in this way creates incentives to minimise tax through choice of business organisational form (incorporated or unincorporated); financial structure (debt or equity), and distribution policies (earnings retention or distribution). While such arrangements can lessen tax-induced investment misallocation, setting up these structures involves some costs. They can also unnecessarily complicate management of businesses and reduce financial resilience.

The lack of mutual recognition of imputation credits is unlikely, however, to affect the investment decisions of all firms. Many large firms in both countries can access global capital markets for equity finance. For such firms, dividend imputation does little to affect their cost of capital and hence their incentive to invest:

For companies with access to the international stockmarket, an imputation system has no impact on the cost of corporate capital and hence no impact on investment incentives. … Indeed, on those assumptions the only effect of the system is to transfer ownership of shares in domestic companies from foreign to domestic shareholders. (Sorensen and Johnson 2009)

In other words, the absence of MRIC may only affect the investment choices of those firms in Australia and New Zealand without access to global capital markets that are or are contemplating operating across the Tasman, and is less likely to affect the cost of capital for large firms with such access. There would, however, be a shift in the ownership of such firms toward shareholders who can benefit from MRIC. In the short term, there would be upward pressure on share prices brought about by increased demand from those shareholders.

##### A possible solution: mutual recognition of imputation credits

One possible solution to the challenges facing smaller companies that cannot access global equity markets is to extend the imputation system described above across the Tasman (see supplementary paper F). Each country would recognise the imputation credits attached to the dividends distributed by companies in the destination country to shareholders resident in the home country. Shareholders would then face the same marginal tax rate on income generated by equity investments in both countries. For those firms whose cost of capital is not set in global capital markets, this would remove the tax-induced incentive to invest in the home economy. This could result in efficiency gains as investment funds are allocated between Australia and New Zealand on their economic merits, rather than according to their taxation consequences. As under current arrangements, equity investments to and from third countries would not benefit from trans-Tasman recognition of imputation credits.

More two-way investment, and penetration by the firms of each economy of the markets of the other, could also deliver dynamic efficiency gains through, for example, increased competition or technology transfer. It would also reduce the costs of tax mitigation arrangements, outlined above.

##### MRIC also involves trans-Tasman income transfers

The full consequences of introducing MRIC would, however, be more complicated than these static and dynamic efficiency effects. An evaluation of MRIC needs to take account of other potential effects.

The initial effect of introducing MRIC would be to increase returns to existing owners of trans-Tasman capital and reduce tax revenues in the countries recognising the imputation credits. The share prices of companies in each country that do not have access to global equity markets would rise, reflecting the increase in the expected after-tax income from dividends. Before allowing for the effects of any capital movements induced by MRIC or possible changes in company distribution policies, using Australian Bureau of Statistics data on trans-Tasman investment, the reduction in tax revenues might be in the vicinity of NZ$135‑NZ$220 million for New Zealand and NZ$190‑NZ$750 million for Australia. Based on Statistics New Zealand data, the reduction in tax revenues might be in the vicinity of NZ$100‑NZ$160 million for New Zealand and NZ$275‑NZ$1015 million for Australia (supplementary paper F). The larger reduction in Australian tax revenue occurs because Australian investment in New Zealand is larger than New Zealand investment in Australia.

These changes are, however, only the initial impacts. MRIC can be thought of as the combination of the unilateral application of imputation credits by each country. For example, introducing imputation credits in Australia for company tax paid in New Zealand would increase the after-tax returns to Australian owners of capital invested in New Zealand. Some Australian capital would relocate to New Zealand in search of higher returns.

By making investment across the Tasman more attractive, MRIC would transfer some of the benefit of the tax reduction from one country to the other. This happens because the movement of capital shifts a part of the company tax base from one country to the other. The movement may also affect the relative returns to capital and to other factors (such as labour and land) in each country. In turn, this will have second-round effects on revenues from company and income taxes. The asset price impacts of MRIC would be instantaneous; the impacts on real investment and associated relative prices would take more time. Box 4.4 describes the channels through which these effects would operate. In addition, introducing MRIC would require each Government to increase other taxes, reduce spending or increase debt.

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| Box 4.4 **Allocative and distributional effects of MRIC** |
| The effects of MRIC can be explained by considering unilateral recognition by either Australia or New Zealand of the tax credits of the other. MRIC is simply the combination of unilateral recognition by both countries.  Firms accessing domestic equity markets  For firms that cannot access global equity markets, additional equity from the trans–Tasman partner would tend to drive down their cost of capital, and thus encourage additional investment. This reallocation of capital to higher valued uses across the Tasman would generate efficiency gains. The changes in relative prices that induce this shift would have a series of distributional consequences.  In the destination economy:   * increased returns to complementary factors as the increase in the capital stock increases their productivity, mirrored by a reduction in returns to substitutable factors (notably capital, both domestic and foreign owned) * an increase in company and income tax revenue from the increased output and income.   In the source economy:   * decreased returns to complementary factors as their productivity decreases with reduced capital |
| (Continued next page) |
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| Box 4.4(continued) |
| * a decrease in company and income tax revenues as output and income falls and imputation credits are recognised.   Therefore, unilateral recognition of imputation credits results in a gain to the destination economy and a loss to the source economy.  Firms accessing global equity markets  For firms whose capital costs are set in global equity markets, an increase in after-tax returns to trans-Tasman investors would simply result in an increase in their trans-Tasman ownership relative to ownership by third-country investors, but would not induce additional net national investment. Hence, it is possible that increased trans-Tasman capital flows would not affect the total stock of capital in the destination economy, because new capital replaces existing capital. Similarly, it is possible that the reduction in capital in the source country would be replaced by capital from other sources. If this happens, economic activity and factor returns would remain unchanged and there would be no efficiency gains from MRIC. There would, however, be an increase in post-tax returns to equity holders.  The net effects  The effects of MRIC in practice, therefore, will depend on the pre-existing levels of trans-Tasman investment, the share of firms with access to global equity markets, the relative magnitudes of investors’ and firms’ responses to changes in after-tax returns, and the extent to which those responses shift returns in each country between capital and other factors. Assessing the balance of these forces needs to be explored through quantitative analysis. |
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Unilateral recognition of imputation credits almost certainly would reduce the income of the country adopting it and benefit its partner (Benge and Slack 2012). How the effects outlined in box 4.4 net out when there is mutual recognition depends on the existing amount of investment owned by each country and located in the other, and the magnitude of changes in incentives (returns to capital owners and cost of capital for firms) and reactions to them, all of which are uncertain. There are also potential gains from dynamic effects associated with the net increase in investment and avoidance of tax mitigation costs and complexities. In principle, each country could gain or one could gain while the other loses.

##### What can modelling indicate about the effects of MRIC?

For this study, the Commissions used modelling to gain insights into the efficiency and inter-country distributional effects of MRIC and to understand the key drivers of these effects.

Model results hinge on model structure, with different models invariably giving different ‘answers’. For these reasons, the Commissions drew on two models and conducted extensive sensitivity and scenario analysis given uncertainty about parameter values and crucial behavioural responses such as the:

* investment responses of firms when their cost of capital changes. If investment by firms is not responsive to changes in the cost of capital, there will be little change in output or income
* responsiveness of capital owners to changes in post-tax returns across the world. This is related to the share of firms that have access to global capital markets. When the responsiveness is low, imputation credits largely result in domestic transfers to the owners of capital, and output effects are small, consistent with a large share of firms with access to global equity. A high responsiveness is consistent with a low share of firms with access to global equity
* substitutability between capital and other inputs in production processes. The more substitutable they are, the less will relative prices change and the larger the investment responses and efficiency gains. Conversely, the lower the scope for substitution, the smaller the efficiency gain and the larger the change in relative prices
* share of profits that is distributed as dividends to shareholders and the share of credits claimed by taxpayers, which are affected by imputation credit policies. The larger the proportion of dividends, and the greater the eligibility of taxpayers to claim imputation credits, the larger the impacts on output, income and taxation revenue.

The modelling analysis was particularly helpful for tracing through the static or ‘allocative’ efficiency impacts from these behavioural responses. The Centre for International Economics (CIE) undertook modelling on behalf of the Australian New Zealand Leadership Forum, which suggested that under a particular set of assumptions, MRIC would improve the allocation of trans-Tasman capital and in turn increase gross domestic product (GDP, a measure of economic activity within a country) by NZ$94 million per year in Australia, NZ$196 million per year in New Zealand and NZ$290 million per year for both countries combined (sub. 58). The CIE did not report the impacts on gross national income (GNI, a closer proxy for national economic welfare).

The Commissions also explored the economic impacts of MRIC on GNI, GDP and tax revenues in both countries and, in particular, the sensitivity of MRIC impacts to key parameters and assumptions. For this purpose, the Australian Commission developed the SMRIC model (PC 2012) (supplementary paper G) and the Commissions conducted a technical workshop (PC 2012c).

The Commission’s modelling indicated that, to the extent MRIC drives down the cost of capital for investment across the Tasman, it unambiguously improves the allocation of capital, producing trans-Tasman efficiency gains. This leads to an increase in trans-Tasman economic activity as measured by GDP, ranging from zero to in the order of US$300 million per year, depending on assumptions about investors’ responses to MRIC and assumptions about data, dividend distribution and credit redemption rates. Increases in trans-Tasman GNI are of the same order of magnitude as the GDP gains. In both the CIE and Commission modelling, the dynamic efficiency gains, given their nature, were not quantified.

The Commission’s modelling also provided insights into the distribution between Australia and New Zealand of the gains and losses from MRIC. These impacts are especially sensitive to model parameters and assumptions for, inter alia, corporate profit distribution policies and imputation credits claimed. Other major drivers are the initial stocks of Australian capital in New Zealand and vice versa, and the investment responses to MRIC in each direction.

The modelling analysis offers several useful observations about the broad distributional impacts of MRIC. Firstly, it shows that the larger the gains to one country the larger the losses to the other. This simply reflects that trans-Tasman efficiency gains from MRIC are the sum of the gains and losses generated by each country’s unilateral recognition of imputation credits. Secondly, in most scenarios modelled in SMRIC, Australia would incur a larger reduction in tax revenue than New Zealand and a net loss of GDP and GNI. This outcome reflects Australia’s relatively larger existing stocks of capital in both Australia and New Zealand, the larger amount of Australian capital that shifts to New Zealand in response to MRIC and hence its correspondingly larger tax-revenue and factor-income losses. Thirdly, for MRIC to lead to increased GNI in both countries, there would need to be markedly asymmetric responses in each country.

Supplementary paper G offers an in depth sensitivity analysis of the gains and losses from MRIC in each country, based on the SMRIC model.

Models are a tool for providing insights by capturing many of the effects of policy changes in a stylised way. By their nature they do not replicate all of the complex interactions in and between economies. For example, as noted, the modelling abstracts from the potential dynamic effects of increased net investment flows. Hence, in forming their judgement on MRIC, the Commissions have taken account of a broad range of factors, some included in the modelling and some not.

#### Conclusions

MRIC would be expected to lead to a more integrated capital market and improved trans-Tasman allocative efficiency. The analysis undertaken for this study supports this finding. It also concludes that the allocative gains from more efficient capital allocation may be relatively small. MRIC is more likely to reduce the cost of capital for smaller than larger firms, as the latter already access global capital markets.

There are also potential dynamic efficiency gains associated with MRIC, to the extent that additional investment across the Tasman results in increased penetration of the markets of each economy by the firms of the other. The size of these gains depends on the extent to which competition and innovation would increase. These effects, by their very nature, are virtually impossible to quantify.

The Commissions’ analysis demonstrates that MRIC could lead to net income transfers between Australia and New Zealand, and that these are likely to be larger than the allocative efficiency gains.

A possible outcome is for one country to experience a loss in its GNI at the same time that there is a greater gain for the other, leading to a trans-Tasman gain overall.

Principally because Australian investment in New Zealand is larger than New Zealand investment in Australia, it is probable that Australian income transfers to New Zealand would be greater than transfers the other way. It is possible that both Australia and New Zealand's GNI would rise, but this would require markedly asymmetric investment responses.

This study’s analysis of MRIC, to the best of the Commissions’ knowledge, is more comprehensive than any undertaken in the 20 years that this issue has been debated. Nevertheless, uncertainty about the distribution of the welfare effects of MRIC for the two countries remains and is unlikely to be resolved by further economic analysis.

MRIC would entail significant tax transfers within each country, from governments to shareholders. These would require increased taxes or reduced government spending, irrespective of the size of efficiency gains.

As explained in chapter 2, in cases where a policy initiative would provide trans-Tasman net benefits but would likely involve a net cost for one country, the Commissions’ approach is not to recommend that initiative, but to report the finding for consideration by Governments.

Such considerations could include whether there are means by which the efficiency gains of MRIC can be captured, while both countries experience an increase in GNI. As noted, it is not possible to predict precisely the distribution of the welfare effects.

One approach would be for the two Governments to share the fiscal cost of the credits recognised. This would acknowledge that the problem MRIC is trying to resolve is two governments each claiming taxing rights to what is a single pool of ‘trans-Tasman’ income.

The Commissions have not been in a position to design, or test the feasibility of, these kinds of approaches. This would need to be undertaken by the two tax agencies and Treasuries. Other aspects of the trans-Tasman tax arrangements could be considered in parallel.

In the Commissions’ view, the long-standing debate about MRIC needs to be settled. Achieving that will depend importantly on resolving the distributional questions.

One option is for the Governments to initiate a process, preferably with a clear deadline, for determining whether there is an efficient, equitable and robust mechanism that would ensure an acceptable distribution of the gains from MRIC.

On the other hand, if Governments conclude that such a mechanism is infeasible, they should announce that MRIC will not go ahead, rather than allow ongoing debate on an issue that cannot be resolved, and could complicate progress on other business taxation improvements.

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|  | **F4.1** |  | Mutual recognition of imputation credits (MRIC) would be expected to result in a more integrated capital market and improve trans-Tasman economic efficiency.  However, MRIC would lead to a greater fiscal cost for Australia than New Zealand and to some income transfers between Australia and New Zealand. Australian transfers to New Zealand could be expected to be greater than transfers the other way, although their precise magnitude is impossible to predict. A probable outcome would be a net income loss for Australia. |
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|  | **R4.19** |  | The Australian and New Zealand Governments should either:   * initiate a process, preferably with a clear deadline, for determining whether there is an efficient, equitable and robust mechanism that would ensure a satisfactory distribution of the gains from MRIC; or * if they consider that such mechanisms are infeasible, announce that MRIC will not go ahead. |
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#### Other tax issues

The Corporate Taxpayers Group (New Zealand) (sub. DR65) considered that the tax implications arising from the presence of employees providing services in the other trans-Tasman jurisdiction is a significant barrier to the conduct of business across the Tasman. Issues arise when the presence of a company and its employees triggers the rules for classifying an Australian business or its employees as having a taxable presence in New Zealand, thereby requiring the filing of New Zealand income tax returns (and vice versa for a New Zealand company and its employees in Australia). As a result, companies have a purely tax-driven incentive to move staff in and out of both countries to try to ensure they remain within specified exemption periods. Fonterra (sub. 14) and Australian Industry Group (sub. 38) also noted the taxation-related costs to business of transferring staff across the Tasman.

This issue relates to the double taxation arrangements between Australia and New Zealand. Any changes to these arrangements would need to be made on a reciprocal basis and would therefore be a matter of negotiation and agreement between Australia and New Zealand. The next review of the arrangements is due to commence by March 2015.

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|  | **R4.20** |  | Taxation of non-resident employees should be considered when the double taxation arrangements between Australia and New Zealand are next reviewed. |
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Corporate Taxpayers Group also considered that current taxation law provides incentives for Australian investors to take 100 percent ownership of New Zealand businesses, rather than a lower level of ownership. It suggested that this can result in the ‘crowding out’ of New Zealand minority investment and that, from a tax policy perspective, a tax system should be neutral regarding the level of ownership that investors acquire.

Despite this issue having some connection with imputation credits, it is not specifically a trans-Tasman matter. The Commissions note that the Inland Revenue Department is talking to Corporate Taxpayers Group about the issue in a broader context.

The Australian Bankers’ Association (sub. 37) expressed concerns about New Zealand dividend and interest non-resident withholding taxes. Neither of these is specifically a trans-Tasman issue; however they do relate to the division of taxing rights between the country from which the income is sourced and the country of residence of the taxpayer. As previously set out, this is a core issue in the mutual recognition of imputation credits. There may be opportunities in the next review of double taxation arrangements between Australia and New Zealand to make an overall assessment of the balance of this division and, at the same time, consider the issues raised by the Australian Bankers’ Association.

### 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 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 *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 *Companies Act 1993*. New Zealand does not have a depositor preference regime. The RBNZ's supervision is intended to complement and not duplicate APRA’s oversight of the New Zealand operations of Australian-owned banks.

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 national interests could differ. The Australian depositor preference regime means that without some form of ‘ring-fencing’, New Zealand depositors could be disadvantaged. Whether or not to use taxpayer funds to support a distressed bank is a matter for the respective governments to decide.

So that each country has some ability independently to manage a bank failure, 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).

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 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, while maintaining the safety, stability and efficiency of both financial systems. This ongoing work has led to significant progress.

On the advice of the TTCBS, in 2006 each country passed legislation that requires the respective prudential regulators to consider the impact of their actions ‘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 harm 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 the arrangements.

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. Commercial banks noted that current and proposed differences in approaches to prudential regulation and bank failure management create additional operational costs, while also increasing the costs of raising funds from overseas and the ability of Australian banks to invest in New Zealand. Examples provided included New Zealand’s open bank resolution and outsourcing policies, differences in each country’s implementation of the Basel III reforms and APRA’s proposed changes to related party exposure limits and related entities (Australian Bankers’ Association, sub. 37; ANZ, sub. 50; New Zealand Bankers’ Association, sub. 24).

The RBNZ (sub. 12) noted that harmonising New Zealand’s regulatory regime with Australia’s is an ongoing task. While there may be benefits from integrating approaches to prudential regulation, there are also important benefits from New Zealand being able to pursue a regime suited to its own circumstances. In particular, the RBNZ (sub. 12) considers that New Zealand needs the capacity to manage bank failures and 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.

Prudential regulation is constantly evolving, with significant developments occurring in multilateral fora in response to the global financial crisis. The most notable case is the Basel III capital reforms. While there are differences in the proposed implementation of these reforms in Australia and New Zealand (Australian Bankers’ Association, sub. 37 and sub. DR11; ANZ, sub. 50; New Zealand Bankers’ Association, sub. 24), regulators in both countries are working to align regulatory rules and supervisory practices where sensible. They have also improved information sharing, crisis preparedness and cooperation considerably in recent years (RBNZ, sub. 12).

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|  | **F4.2** |  | The Trans-Tasman Council on Banking Supervision is well positioned to progress any work relating to the further integration of Australian and New Zealand prudential regulation. |
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#### Banking: international transfer fees

Some submissions (Cole, sub. 4; Fonterra Co-operative Group, sub. 14) 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 transfers occur across different national payments systems.

The standard fee for sending funds by bank telegraphic transfer appears to be between NZ$20 and NZ$25 (possibly with 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) are 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 facilities that enable funds to be transferred cross-border from person to person using stored value cards, and internet-based payment channels.

These developments suggest that technology and competition may reduce the fees for trans-Tasman payments over time.

#### Financial services

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

Australian and New Zealand financial sector regulators have broadly similar principles and objectives, but with some differences. Regulators in the two countries share a strong commitment to remove or reduce regulatory barriers that unnecessarily inhibit the flows of capital between the two countries (ASIC 2010).

Integration has been pursued through unilateral initiatives and 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 them to work in both countries — subject to their qualifications and experience (ASIC 2012).
* The Financial Markets Authority (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 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 FMA (sub. 57) noted that differences in institutional arrangements impede further trans-Tasman integration of financial services, and that more comprehensive integration is desirable. For example, it supports cross-membership of the FMA and ASIC (sub. 57).

## 4.5 ‘Fourth freedom’: cross border movement of people

### Short term travel across the Tasman

#### Trans-Tasman travel by Australian and New Zealand citizens

There are over 2 million trips per year across the Tasman by Australian and New Zealand residents, and trans-Tasman arrivals are the largest source of visitors to both countries. Fast-track border entry processes can reduce the costs and waiting times of trans-Tasman travel for eligible Australian and New Zealand citizen passengers. The Australian and New Zealand Governments have introduced reciprocal fast-track entry for Australian and New Zealand ePassport holders, under their SmartGate systems (ACBPS 2012a, b and c).

The Australian Customs and Border Protection Service and the New Zealand Customs Service have undertaken a trans-Tasman trial at 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 two countries’ SmartGate systems would simplify customs and immigration checks for eligible travellers. Australia could usefully adopt SmartGate for departures as well as arrivals. 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, as well as other operating costs, should be factored into decisions about how widely and when it is implemented.

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|  | **R4.21** |  | 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 major regional airports. |
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#### Trans-Tasman travel by other citizens

Many foreign visitors to this region travel to both Australia and New Zealand. 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). More than four in every ten arrivals into New Zealand travel from Australia, according to the Tourism and Transport Forum (sub. 25).

A single trans-Tasman tourist/visitor visa, enabling travel to both Australia and New Zealand, would reduce the inconvenience and cost, and thereby increase the attractiveness, of such travel for people who currently require separate visas to visit the two countries (for example, nationals from the People’s Republic of China). The Tourism and Transport Forum (sub. DR107) also submitted that such a visa would encourage higher international tourist numbers for trans-Tasman major sporting events (for example, the 2015 Cricket World Cup).

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.) The two Governments would also need to agree on an appropriate sharing of the costs and revenues.

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|  | **R4.22** |  | The Australian and New Zealand Governments should consider a ‘trans-Tasman tourist visa’ for citizens from other relevant countries who wish to travel to both countries. The charges for this visa should be based on a cost-recovery model, with agreed sharing of revenue and costs. |
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### 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. 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 often bring back additional skills and know-how (Coppel, Dumont and Visco 2001). Box 4.5 illustrates the effect of a 1 percent increase in trans-Tasman migration to Australia from New Zealand on gross national product and gross national product per worker in both economies.

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| Box 4.5 Modelling the effects of trans-Tasman migration |
| The ANZEA model (box 2.9) was used to simulate the effects of 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 is similar). The new demand for goods and services (for example, schools and health) generated by the migrants is assumed to be 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 does not account for the impacts on other sources of migration. The modelling does not allow for replacement migration or 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 | | Gross National Product (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. |
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#### Long term residents in Australia

While migration can improve the 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, the Australian Government has limited the access of various cohorts of New Zealand migrants to social security and Australian permanent residency and citizenship, in response to various developments. 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 can access 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 a safety net. They have the same social security entitlements as New Zealand citizens, provided waiting periods (generally around 2 years) have expired. Moreover, they have immediate access to publicly funded health and disability services if they can demonstrate an intention 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 they also face various limitations on access to social security (supplementary paper D), which were introduced to limit the cost to taxpayers.

The result is that social security treatment of New Zealand citizens in Australia sits somewhere between the treatment of temporary residents and of newly-arrived permanent residents. For example, non-Protected Special Category Visa (SCV) holders (generally New Zealanders who arrived in Australia after 26 February 2001; box 4.6 and box D.2 in 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.

Because non-protected SCV holders have no or restricted access to some Australian welfare payments (namely Newstart, Youth and Sickness Allowances and Special Benefit) they have limited options if they require such support. They can return to New Zealand, or seek permanent Australian 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 other applicants for permanent residency and citizenship (DIAC 2011). In Australia, permanent residency is a prerequisite for citizenship, and permanent residency visas are subject to selection criteria and quotas.

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| Box 4.6 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 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 are automatically granted a residence visa. |
| *Sources*: DIAC (2010); Immigration New Zealand (nd). |
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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). Also, for some individuals and employers, the A$3060 application fee may be 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 when 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.

As at 30 June 2011, there were around 240 000 New Zealand citizens in Australia who had arrived after 26 February 2001 (DIAC, pers. comm., 13 April 2012). Based on its analysis of passenger cards, the Australian Department of Immigration and Citizenship (sub. DR126) estimated that between 40 and 60 percent of adult, New Zealand citizen, permanent and long term arrivals would be eligible to apply for a permanent visa. This suggests that the remaining non-Protected SCV holders (that is, between 100 000 and 144 000 people) would be ineligible for a number of safety net payments and social policy supports. In addition, Protected SCV holders are not eligible to access some types of state and territory government social support (for example, HECS-HELP loans and disability supports) (see below).

The Commissions have not been able to quantify the number of people who have been unable to access safety net payments. However, submissions from a considerable number of individuals and community groups have provided many examples of difficulties to this and other studies (boxes D.4 and D.5 in supplementary paper D). A particular concern is that SCV holders are eligible for Commonwealth supported higher education places but are not eligible for the accompanying student loan arrangement (known as HECS-HELP) and the associated study-related social security payments. Similarly, within the vocational education and training system, SCV holders are not eligible for student loans (known as VET FEE-HELP).

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 transparent and readily understood. 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. Some submissions suggested that many non‑Protected SCV holders were unaware before and after arrival of limitations on access to some Australian benefits. There are various options for improving the information available to new arrivals from New Zealand.

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|  | **R4.23** |  | The Australian and New Zealand Governments should give clear and coordinated, whole-of-government advice to Special Category visa holders in Australia, and New Zealand citizens contemplating residence in Australia, both before and after arrival, on their obligations and entitlements. |
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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.

Analysis of the fiscal risks from trans-Tasman movements need to account for offsetting tax revenues as well as other considerations. For example, in 2001 social security outlays directed to New Zealand citizens living in Australia were estimated to be 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). And based on a partial analysis in 2000, the NZIER (2000) estimated that New Zealand citizens living in Australia generated direct fiscal benefits for Australia of around A$3000 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. It 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. For many SCV holders living long term in Australia, access to citizenship is the key to gaining access to social policy payments and supports and the ability to vote across all Australian jurisdictions. Moreover, the undesirable social outcomes experienced by a small but growing share of these ‘indefinite temporaries’ may develop into a point of irritation within the trans-Tasman relationship.

The Commissions understand that both Governments are aware of the situation and that the Australian Government is working towards a resolution (Gillard 2012).

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|  | **R4.24** |  | The Australian Government should address the issues faced by a small but growing number of non-Protected Special Category Visa holders living long term in Australia, including their access to certain welfare supports and voting rights. This requires policy changes by the Australian Government, including the development of a pathway to achieve permanent residency and/or citizenship. |
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#### Student loans

New Zealand citizens resident in Australia have access to Commonwealth-assisted university places but not to HECS-HELP. Hence, even if an alternative pathway to Australian permanent residency and/or citizenship were developed for long term resident New Zealand citizens, there would remain a cohort of young New Zealand citizens whose access to HECS-HELP, VET FEE-HELP and other study-related assistance would depend on their parents obtaining Australian permanent residency and/or citizenship. This process inevitably takes time and money. In some cases, parents will not seek to obtain permanent residency and citizenship for themselves and their children.

One option — suggested in many submissions — could be to give the children of New Zealand citizens, who have been living in Australia for a minimum period of time, access to HECS-HELP (and VET FEE-HELP). However, it may be problematic for the Australian Government to provide access for HECS-HELP to New Zealand citizens ahead of Australian permanent residents, who are not able to access HECS-HELP unless they become Australian citizens. That said, the barriers to HECS-HELP (and VET FEE-HELP) are lower for Australian permanent residents than for non-Protected SCV holders.

Student loan arrangements in both countries also have debt collection arrangements. Broederlow (sub. DR88) suggested that both Governments ‘… allow each other’s countries to pursue outstanding debts whereby residents return to their country of origin’ (p. 10). Green (sub. DR85) also suggested that a bilateral agreement could be developed to enable student loan repayments to be collected in both countries.

Subject to the usual cost-benefit analysis, the Commissions support this approach within the context of an international tax agreement with New Zealand.

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|  | **R4.25** |  | The Australian Government should seek to improve access of New Zealand citizens to tertiary education and vocational training through the provision of student loans, subject to a waiting period and appropriate debt recovery provisions. |
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#### A single trans-Tasman labour market?

The free mobility of labour within a single economic market enables labour resources to work where their marginal product is highest. At the same time, it is important to limit incentives for government transfer shopping and the negative social consequences arising from long term residence without citizenship in another country.

Any formal agreement to a single labour market should optimise net benefits for the participating countries, taking into account a broad range of considerations and factors affecting the wellbeing of their communities. These include the benefits of labour mobility, access to social security and social policy supports and voting rights. Moreover, as migration is a significant component of a single labour market (as are occupational licences), participating countries have a mutual interest in each other’s policies in these areas.

Given the previous Australian and New Zealand Governments’ agreement to a single trans-Tasman labour market (through the TTTA which subsequently underpinned the CER and the SEM), some new principles governing access to social security would seem appropriate along with arrangements governing migration policy. These inter-related issues are discussed, in turn, below.

##### A new framework for access to social security

Principles might usefully be developed to guide the treatment of New Zealand citizens who are long-term resident in Australia. Based on European Union experience and certain characteristics of an integrated labour market (supplementary paper D), some possible principles are:

* Policy independence — the country in which a person lives should determine the social security legislation under which the person is 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 — individuals should have the same rights and obligations as citizens or permanent residents in the host country, subject to the relevant waiting periods or other initial conditions.
* Portability — each country should have its own portability rules for the payments that each country covers.

Historically both Australia and New Zealand have benefited from labour mobility, both informally as well as formally through the TTTA, CER and SEM. There is a risk, however, that this arrangement may become increasingly problematic for both countries. While the Commissions’ recommendations have the potential to ameliorate the anomalous economic and socially marginal outcomes for some long term trans-Tasman residents, a ‘watching brief’ remains important. Accordingly, the Commissions support the development of a broad framework around which to determine access to social security within the context of the CER, the SEM and the TTTA.

##### Migration policy

The above principles nevertheless contain inherent tensions. For example, in principle, equal treatment could only be implemented if Australia’s and New Zealand’s migration and citizenship programs were aligned 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, although there is evidence that New Zealand’s current policy settings may be effectively managing the risks of such migration (DIAC, sub. DR126). While fully aligning migration policies to achieve a single trans‑Tasman labour market may be desirable, in practice it would be possible to implement the principle of ‘equal treatment’ without this alignment, provided that there is ongoing cooperation, trust and engagement over migration and citizenship policy with respect to nationals from third countries.

The Commissions understand that there is considerable engagement between immigration officials of the two nations, including an annual formal bilateral forum (ANZIF), and project and program activity under the auspices of the ‘Five Country Conference’ (which also includes the UK, Canada and the United States). In addition, officials engage regularly in dialogue and cooperation on both policy and operational issues and areas of interest.

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

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|  | **R4.26** |  | Within the context of CER, the Single Economic Market (SEM) and the Trans-Tasman Travel Arrangement (TTTA), the Australian and New Zealand Governments should:   * review, and make more explicit, the principles governing access to social security * further develop bilateral engagement on migration policies. |
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#### Fiscal risks for New Zealand Superannuation

New Zealand Superannuation (NZS) is the New Zealand Government’s flat-rate, non-means tested basic age pension. Eligibility is conditional on an age and residency requirement — one must have reached 65 and have lived in New Zealand for at least 10 years since the age of 20, with at least five of these after the age of 50. There are no specific contributions or work-related requirements.

Dale et al. (2011) noted the fiscal risks to NZS 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.

## 4.6 Government and regulatory 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.

In the private sector, the profit motive drives innovation, inter-firm cooperation and decisions about firm size and scope. In government agencies, however, the profit motive is typically absent, so 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.

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|  | **R4.27** |  | The Australian and New Zealand Governments should encourage government agencies to consider opportunities for trans-Tasman coordination in service delivery and regulation on a case-by-case basis. |
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### 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 may reduce the cost of representations or increase 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 (see chapter 5). For example, Australia and New Zealand could work together to promote a multilateral air services reform agenda.

### Performance benchmarking

#### Government services

Regular monitoring and reporting of government service and program results is a key component of evidence-based public management and identifying opportunities to improve public sector performance (Wholey and Hatry 1992). Performance monitoring can:

* provide transparent indicators of policy performance, enabling assessment of whether and how well program objectives are being met
* promote analysis of the effectiveness of relationships between agencies and programs, enabling governments to better coordinate policy within and across agencies
* help clarify government objectives and responsibilities and inform the wider community about government service performance
* encourage ongoing performance improvements in service delivery and effectiveness, by highlighting improvements and innovation (SCRGSP 2010).

Both countries separately undertake performance monitoring, benchmarking and reporting. Examples are New Zealand’s quarterly reports on the performance of District Health Boards (Ministry of Health 2012), the performance measurement framework developed for Auckland Metropolitan Crime and Operational Support (Alach and Crous 2012) and the Department of Infrastructure and Transport’s (2011) ‘Waterline’ report, which measures performance in Australia’s five main ports. Both countries also participate in international reports such as OECD’s *Education at a Glance* (OECD 2012a).

Benchmarking may enable governments to learn from or adopt the practices of their counterparts, as was suggested above in the case of ports. Where one country already benchmarks a particular service, it may be cost effective for the other government to ‘borrow’ or adopt their data collection and reporting mechanisms, rather than develop entirely new methods.

Trans-Tasman benchmarking may be particularly useful:

* for government services for which there are potentially significant gains from improved effectiveness or efficiency
* when New Zealand and Australian government service providers have similar objectives, against which performance can be compared using the same performance indicators
* when data for performance indicators is already collected in both countries or, if it is not being collected, the cost of doing so would be less than its value.

##### Report on Government Services

The Report on Government Services (RoGS) is an important source of performance data in Australia. This annual publication (prepared since 1995 under the auspices of COAG) compares the efficiency and effectiveness of Commonwealth and State/Territory government services such as education, health, justice, emergency management, community services and housing. The Australian Commission compiles the report and chairs a Steering Committee comprised of senior representatives from Australian, State and Territory Governments.

There is evidence that RoGS has contributed to improved equity, efficiency and effectiveness of government services, and the accountability of service providers to governments and the public. It does this by providing meaningful, balanced, credible, comparative information about government services, which can facilitate the development of improved policy or management practices (box 4.7).

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| Box 4.7 Improving government services through benchmarking |
| There is evidence that the information in RoGS has played a significant role in informing policy development across a broad range of services.  In the education sector, RoGS was instrumental in the introduction of standardised national testing of student learning outcomes.  In the health sector, RoGS illustrated the beneficial impact of the introduction of ‘case mix’ funding by Victoria on the average cost of hospital separations. Over time, other jurisdictions introduced some form of activity based costing of hospital services, and the approach is now being adopted at a national level.  In the justice sector, RoGS illustrated the significant efficiency gains associated with Victoria’s use of electronic courts for minor traffic infringements, which has been adopted by other jurisdictions. |
| *Source*: Productivity Commission and Forum of Federations (2012). |
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New Zealand produces *The Social* *Report* annually, which reports 43 indicators in ten key policy areas such as health, economic standard of living, and safety and social connectedness (Ministry of Social Development 2010). *The Social Report* includes a similar set of information to RoGS, although RoGS includes a more detailed range of indicators in a wider range of policy areas.

Given that similar information in each country is published separately, both countries would benefit from greater integration of performance reporting. Publication of comparable information, in the same format, with a single source would enable direct comparison between jurisdictions. Three main reasons for reporting comparative performance information across jurisdictions are:

* to verify high performance and identify agencies and service areas that are successful
* to enable agencies to learn from peers that are delivering higher quality and/or more cost effective services
* to generate additional incentives for agencies and services to improve performance (SCRGSP 2010).

For New Zealand, RoGS presents a well-established performance monitoring system, which is more detailed and comprehensive than most current reporting in New Zealand. Australia would also benefit from New Zealand’s participation in RoGS, as an additional benchmark would create the potential for State and Federal Governments to learn from policies and programs delivered in a different context.

The costs of producing RoGS include the Australian Commission’s expenditure (approximately A$2.8 million per year), and part-time assistance from around 20 Steering Committee members, 180 working group members and over 200 data providers.

While these costs can be exceeded by the benefits from even small improvements in the service areas covered by the RoGS — because the areas covered are so large — the costs of performance benchmarking are not trivial. Hence, it is important that the additional benefits from New Zealand’s participation in the RoGS — additional to the benefits already generated from other regular reports — exceed the additional costs. Focusing on a small number of areas — initially at least — may be prudent. Options include New Zealand independently expanding its own parallel report to include areas not covered in *The Social Report,* and becoming involved in benchmarking some or all of the government services covered by the RoGS. The Australian experience through RoGS has been that a mix of policy and pragmatism has guided the selection of service areas for reporting.

The benefits of trans-Tasman benchmarking within the RoGS are strong in principle, and more detailed work should be undertaken to determine how best to proceed. Factors for consideration include the extent to which RoGS performance indicators are applicable in both jurisdictions, the availability of robust data, and a suitable approach for New Zealand to participate in the existing RoGS governance structure.

##### Regulatory benchmarking

In February 2006, COAG agreed that all governments would aim to adopt a common framework for benchmarking, measuring and reporting the regulatory burden on business. Since that time, the Australian Commission has undertaken benchmarking studies of seven regulatory regimes.

Such benchmarking can shed light on where and how differences in the costs of complying with regulation might be reduced.

The increased transparency afforded by benchmarking would also increase government accountability for the design, administration and enforcement of regulation. Indeed, it could help promote greater ‘yardstick’ competition among jurisdictions, whereby there is more careful assessment of regulation to ensure that it is efficient and does not disadvantage a jurisdiction’s performance. (PC 2007, p. xx)

In its exploratory study of the scope for regulatory benchmarking, the Australian Commission suggested that in the longer term, the benchmarking program could potentially include New Zealand for some areas of regulation, given the similarity in institutional arrangements between the two countries and the emphasis on trans-Tasman harmonisation. This would facilitate greater benchmarking of regulation, including at the Commonwealth level (PC 2007, p. xxx).

The only study involving New Zealand so far has been of food safety regulation (PC 2009a). Benchmarking against agreed performance targets was able to be undertaken because amendments to the food standards code in Australia and New Zealand are managed by the same regulatory agency (Food Standards Australia New Zealand) (PC 2007, p. 71).

Some regulatory benchmarking topics would not be suitable for a trans-Tasman approach; for example, when regulatory objectives differ between Australia and New Zealand. However, there will be instances where a trans-Tasman approach will provide insights for both countries about opportunities to improve regulation. COAG’s Business Regulation and Competition Working Group should take into account opportunities for trans-Tasman cooperation when developing topics for regulatory benchmarking studies.

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|  | **R4.28** |  | The Australian and New Zealand Governments should seek beneficial opportunities to undertake joint benchmarking. In particular, they should determine an appropriate approach for New Zealand to participate in the *Report on Government Services* produced under the auspices of COAG, and also in regulatory benchmarking studies undertaken in Australia. |
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## 4.7 Options that should not proceed

The Commissions have identified some areas where 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 require adherence to common political and policy positions, such as common monetary and fiscal policies.
* 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 do not support a customs union.
* The TTOIG has determined that some components of the business law reform program are not worth pursuing.

Regulatory areas where there are significant differences among Australian states are also unlikely to be promising candidates for integration with New Zealand, although the Commissions would not permanently rule out such areas.

### Monetary union

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 available research provides only an overview of the benefits and costs entailed (RBNZ, sub. 12).

On the benefits side, monetary unions remove the exchange rate risk on trade between member countries and permit easier 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 would probably be the case for Australia and New Zealand, since Australia accounts for only 23 percent of New Zealand’s merchandise exports (table 1.1), and New Zealand accounts for a much smaller share of Australia’s trade.

On the costs side, in forming a monetary union, a country surrenders autonomy over monetary policy and exchange rate flexibility, which are important tools for macroeconomic stabilisation. 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. Instead, adjustment would need to occur 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 depends in part on the frequency of asymmetric shocks and on how synchronised are 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 their resilience to economic shocks.

Studies of whether to form 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 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 increased volatility.

Further, 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).

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|  | **F4.3** |  | The prerequisite conditions for a trans-Tasman monetary union do not exist. |
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| 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) |
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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. [↑](#footnote-ref-1)
2. For trans-Tasman commercial presence trade, in New Zealand, Telstra owned 100 percent of Telstra Clear (the second largest provider of fixed line and internet services in New Zealand) until its sale to Vodafone New Zealand in October 2012, while in Australia, Telecom NZ owns 100 percent of AAPT (a provider of business and wholesale telecommunication services). For trans-Tasman cross-border trade, two way trade was estimated at around A$120 million in 2011 (ABS 2011b). [↑](#footnote-ref-2)