

Strengthening trans-Tasman economic relations

Valentine's Day presentation to the Government Economics Network

14 February 2013

The Productivity Commission

- Independent crown entity
- Three Commissioners, approx. 20 staff
- Two inquiries per year, topics chosen by Government
- Dedicated focus on productivity
- High-quality, evidence-based analysis
- Extensive engagement / submission process
- Real-world, practical advice to government

Context

- 2013 marks the 30th anniversary of CER
- In March 2012 the Prime Ministers requested the two Commissions jointly conduct a '*scoping study*'
- Prime Ministers held a bilateral meeting in Queenstown, 8-10 February 2013
- This presentation will cover:
 - the Commissions' approach, assessment of CER to date, the study's recommendations for future progress; and
 - behind-the-scenes economic issues that came up in the study
- Starting point - Australia and NZ already closely integrated

The terms of reference in brief

- Identify further initiatives to strengthen trans-Tasman relations and improve economic outcomes for both countries, taking into account:
 - areas where joint net benefits would be highest
 - how reforms might be implemented
 - any significant transition and adjustment costs.

The Commissions' approach

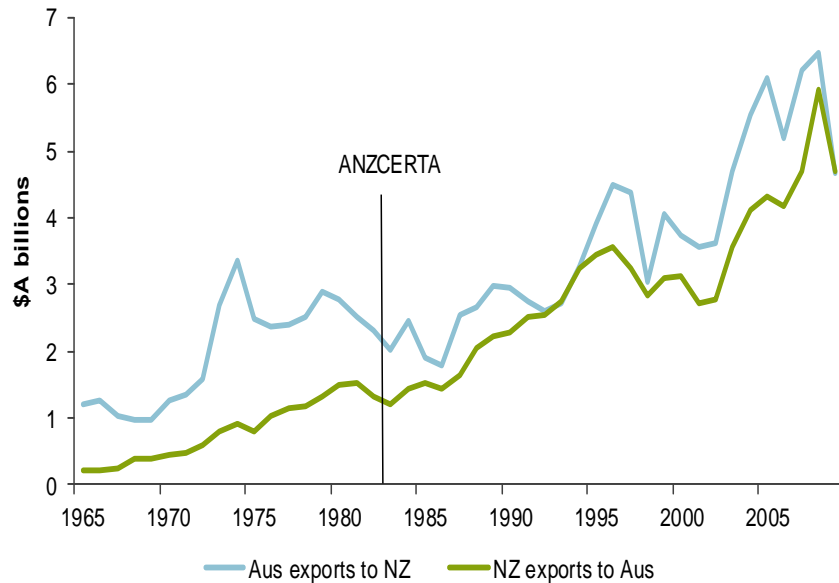
- Economic integration is about the freedom of exchange - and actual flows - of goods, services, capital, technology, knowledge and people.
- The Commissions' approach centred on:
 - looking for opportunities to further lower barriers
 - gleaning insights from the 30-year experience with CER
 - addressing unfinished business
 - identifying new initiatives with potential net benefits
 - considering governance arrangements for the future agenda.

What has CER achieved?

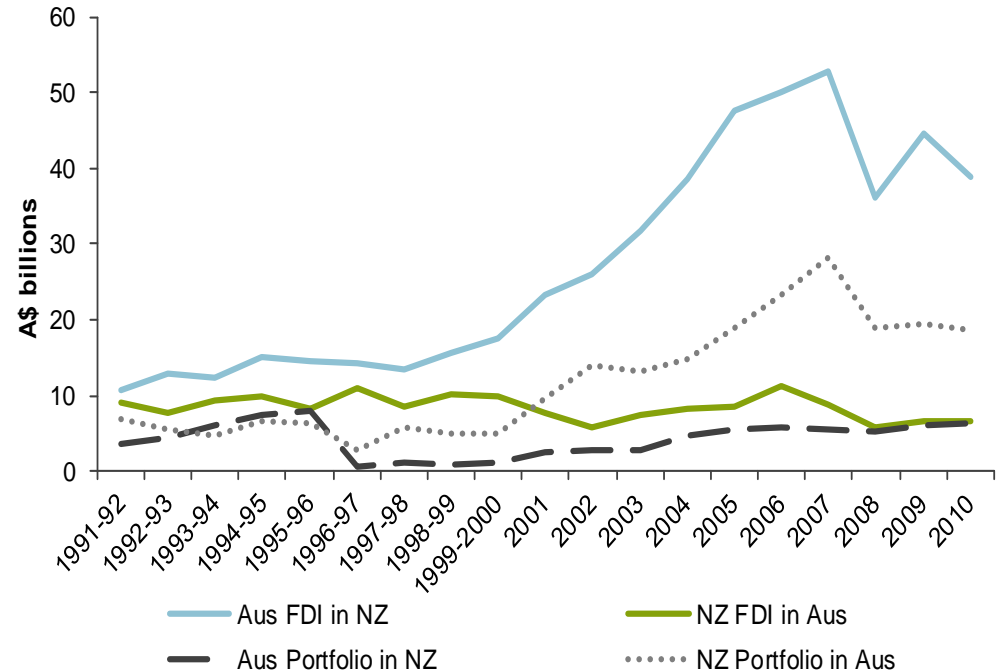
- Trade in goods largely liberalised – subject to Rules of Origin
- Trade in services partly liberalised – exclusions and impediments remain
- Investment flows have increased substantially
- People move freely between the two countries
- Inter-government cooperation is extensive
- CER a ‘building block’ rather than a ‘stumbling block’
- Overall, CER has produced benefits for both countries - even if magnitudes uncertain

Significant increase in trade and investment

Trans-Tasman merchandise trade, 2010 prices



Stocks of trans-Tasman investment, 2010 prices



Key themes in further integration

- ‘Closer’ but still politically separate
- Deeper integration requires careful assessment
- The ‘direction of travel’ matters more than the destination
- The bigger regional picture is important
- Domestic policy has trans-Tasman effects
- Good policy process matters

Some recommendations already acted on ...

- Trans-Tasman retirement savings portability scheme – legislation recently passed by both Parliaments, comes into force from 1 July 2013
- CER investment protocol will come into force from 1 March
- Action on trans-Tasman mobile roaming charges

And action on others announced:

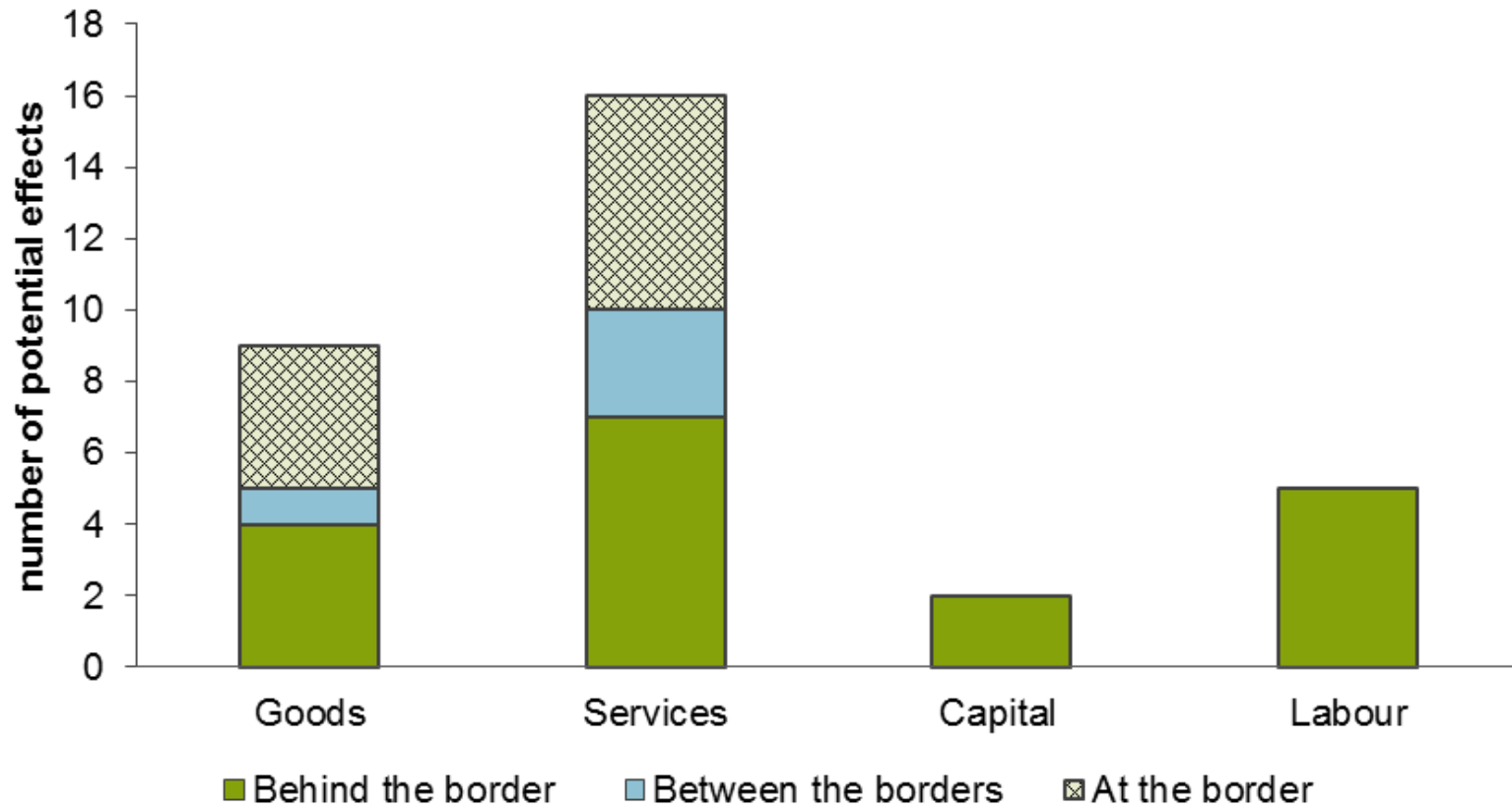
- Smart gate upgrading for faster travel
- Student loan debt recovery

Some unfinished business remains

- Three other areas in which the Governments have committed to beneficial policy initiatives that have yet to be completed:
 - business law
 - mutual recognition of occupational licensing
 - therapeutic products regulation

Recommended 28 new policy initiatives

Areas potentially affected by recommendations



‘First freedom’: trade in goods

- CER Rules of Origin (RoO) create distortions and compliance costs
- When tariffs are 5 percent or less there’s little incentive to engage in re-exporting, so little value in continuing with RoO
- The Australian and New Zealand Governments should:
 - waive CER RoO 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

‘Second freedom’: trade in services

- CER Protocol on Trade in Services: a review of the current exclusions should be conducted
- Transport: there are opportunities to enhance efficiency of air and sea freight services
- Telecommunications: future reviews of regulatory frameworks should examine barriers to trans-Tasman trade

‘Third freedom’: capital flows

- **Foreign direct investment**: CER Investment Protocol likely to have only limited effects.
- **Banking**: continue the collaborative approach to supervision of trans-Tasman banks
- **Taxation**: participants have raised the lack of **mutual recognition of imputation credits (MRIC)** on trans-Tasman investment as a key concern for business.

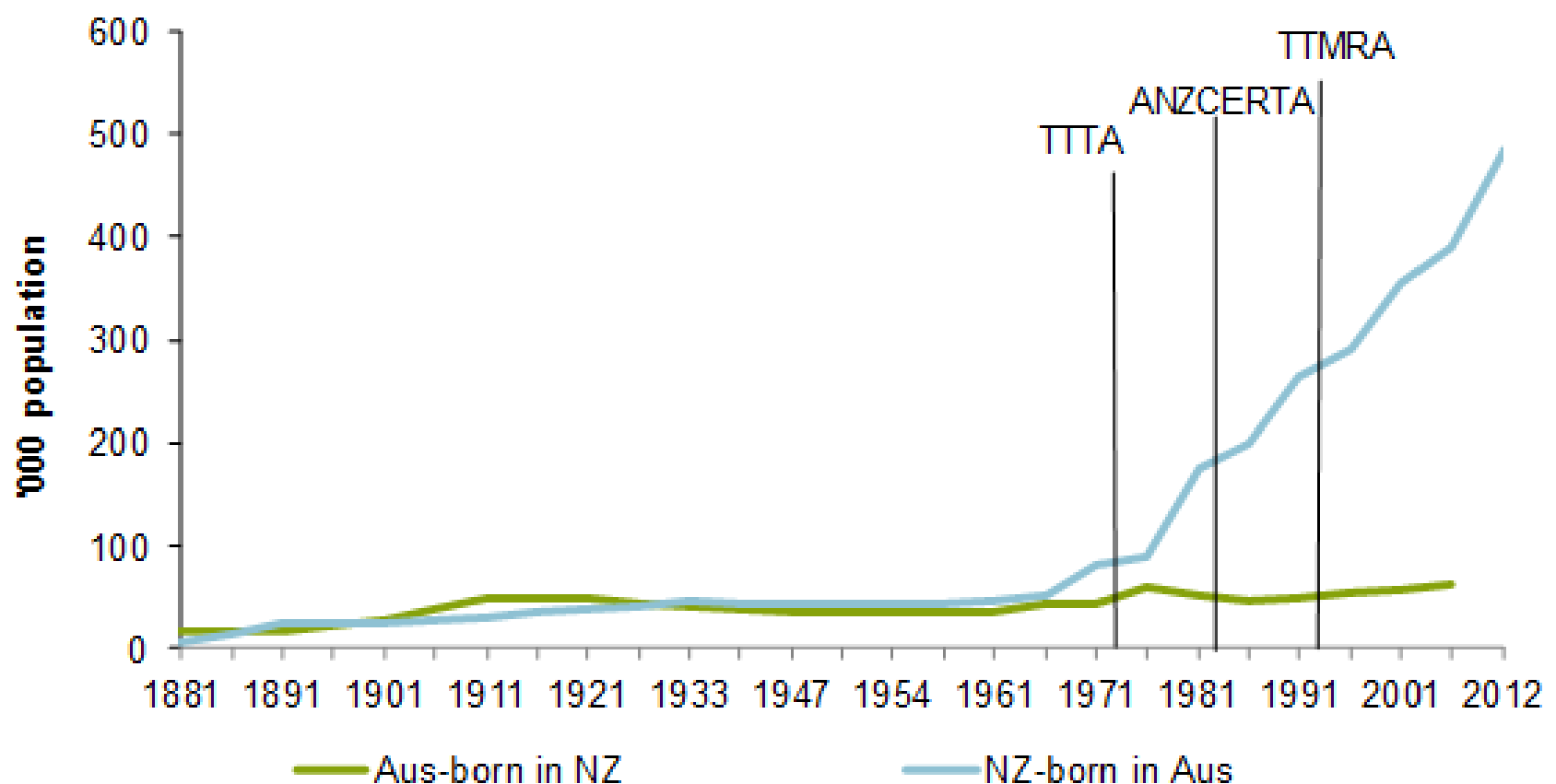
The twists and turns of MRIC

- 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, as well as a likely net flow of economic income from Australia to New Zealand, producing a net loss for Australia.
- 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.

‘Fourth freedom’: people movement

- Potential to improve ease of short-term travel across the Tasman:
 - progress the further roll out of SmartGate and associated systems where cost effective
 - consider a ‘trans-Tasman tourist visa’ for citizens from other relevant countries who wish to travel to both countries.

Sharp increase in Australia's New Zealand-born population



Improving outcomes for long-term residents

- Addressing issues faced by a small but growing number of non-Protected Special Category Visa holders living long term in Australia including :
 - provision of 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
 - development of a pathway to achieve permanent residency and/or citizenship
 - improving 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
 - reviewing and making more explicit the principles governing access to social security
 - further developing bilateral engagement on migration policies.

Government services

- Already extensive coordination and cooperation. Government agencies should continue to consider opportunities for coordination on a case-by-case basis.
- Beneficial opportunities to undertake joint benchmarking
 - eg. New Zealand's participation in the Report on Government Services produced under the auspices of COAG, and in regulatory benchmarking studies undertaken in Australia.

Options that should not proceed

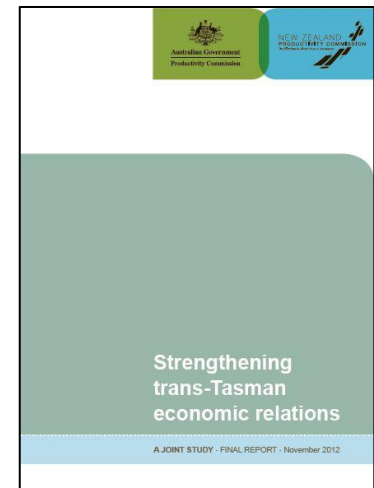
- Monetary union - has often been raised in the past and was discussed in a number of submissions.
- Customs union

Making it happen

- The current light-handed and pragmatic governance approach has been reasonably effective.
- However, there are opportunities for improvement through:
 - clearer leadership and oversight arrangements
 - requiring new regulatory proposals to account for trans-Tasman implications, where relevant
 - continuing coordinated action to achieve beneficial regional and multilateral integration
 - formal five-yearly public reviews of CER.

Post final-report steps

- Final report released Thursday 13 December 2012
- Supplementary papers (greater depth on key topics) released on the joint website
www.transtasman-review.productivity.govt.nz
- Prime Ministers met in Queenstown last weekend and announced a few small steps – useful but rather small beer and nothing very new
- Full response expected during 2013



Key economic issues in the study

- Bilateral vs multilateral integration
- Alesina et al and the 'shower model'
- Scale – a more important issue for NZ
- Direction of travel vs final destination
- Level of ambition
- Counting static vs dynamic gains

Bilateral versus multilateral integration

- CER by definition is bilateral but open and outward-looking
- APC tend to be sceptical of bilateral reforms
- Do you take what you can get?
- Diversion arguments fade when third-country barriers are low
- Multilateral may be ideal but not always so, or may be unattainable

Alesina and Spolaore ‘The Size of Nations’

- Two opposing and inter-acting forces determine the optimal size of countries
- Provides a framework for generating ideas about where integration makes sense, and where it doesn't
 - Trans-Tasman therapeutics product agency and FSANZ – probably yes
 - Common competition and banking regimes – less clearcut
 - Common currency – probably no
- Did not explicitly adopt the framework in this study

Scale – a more important issue for New Zealand

- NZ firms face serious obstacles to achieving scale
- Exporting to Australia is best opportunity for many NZ firms to achieve scale
- These potential scale gains much more ‘front of mind’ for NZ PC than APC
- Standard comparative-advantage trade models don’t take account of gains from scale

Direction of travel vs final destination

- What principles should guide integration reforms, eg CBA on each initiative or an end-state vision of, say, seamless trans-Tasman commerce?
- Compromise was agreement on the Rudd-Key SEM principles as ‘direction of travel’
- But subject to a CBA on each potential initiative.

Counting static vs dynamic gains

- MRIC issue illustrated an important Australia-NZ difference in perspective (beyond the income transfer and fiscal aspects)
- Used quantitative modelling to estimate the size of the allocative efficiency gains from MRIC
- Dynamic gains from competition, scale, innovation real but hard to quantify
- APC approach - regard them as 'icing on the cake', not part of the cake.

Concluding remarks

- Useful small steps towards greater integration can still be taken
- Larger steps possible on people and MRIC
- Wait and see for full response to recommendations by the two Govts
- Australia is main chance for NZ firms to achieve scale
- Different perspectives on important economic issues