

The trans-Tasman relationship

- 2.1 The delegation met with a number of non-government officials who discussed the nature of the Australia-New Zealand economic and cultural relationship.
- 2.2 Australia has a strong relationship with New Zealand. This stems from being antipodeans, having similar historic backgrounds as Commonwealth countries and the strong bonds forged almost a century ago during the ANZAC alliance.

Closer economic relations

- 2.3 The Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) came into effect on 1 January 1983. The agreement is a bi-lateral agreement covering trade; working relationships regarding quarantine; customs; regulatory standards; transport and commercial law matters.
- 2.4 The Closer Economic Relations agreement was discussed at a number of meetings the delegation attended.
- 2.5 Since its inception, trade between the two countries has expanded exponentially.¹ ANZCERTA contains rules of origin (ROO) which allow duty-free access for goods meeting the ROO requirements. Almost all goods meet these requirements now.

1 An average annual growth of nine per cent per annum. Department of Foreign Affairs and Trade, *New Zealand Country Information*, July 2007, p. 6. Website viewed 24 August 2007, <http://www.dfat.gov.au/geo/new_zealand/nz_country_brief.html>.

- 2.6 The growth in trade is reflected in New Zealand being Australia's sixth largest world market, accounting for around six per cent of Australia's exports.² Australia is New Zealand's number one import and export market accounting for around 20.3 per cent of its imports and around 20.4 per cent of its exports.³ The European Union is New Zealand's second biggest export market at 15 per cent of exports, followed by the United States at 13 per cent, Japan at 11 per cent and China at six per cent.
- 2.7 Trans-Tasman merchandise trade was valued at \$15.3 billion in the year to December 2006.⁴
- 2.8 Not only has ANZCERTA contributed to the growth in merchandise and service trade between the two countries but it has also opened the way for considerable two-way investment. Total foreign investment stocks from New Zealand amounted to \$24.3 billion to June 2005. New Zealand is the seventh largest foreign investor in Australia. Similarly, New Zealand rates highly with Australian investors, being the third largest foreign investment destination.
- 2.9 Australia is the largest foreign investor in New Zealand, most of this is foreign direct investment. The total stock of Australian investment in New Zealand was \$58.9 billion as at year ended 2005.⁵ There was a significant increase in Australian foreign direct investment into New Zealand between 2004 and 2005 with stocks increasing by \$19.5 billion. Much of the increase in foreign direct investment since 2003 has been in New Zealand infrastructure and the banking sector.

Single trans-Tasman economic market

- 2.10 Since the inception of ANZCERTA both the New Zealand and the Australian Governments have been committed to working towards a single economic market between the two countries. The Australian Treasurer, Mr Peter Costello MP and the New Zealand Minister of Finance,

2 Department of Foreign Affairs and Trade, *Trade at a Glance 2007*, Canberra, p. 12.

3 Department of Foreign Affairs and Trade, *New Zealand Fact Sheet*, May 2007. Website viewed 24 August 2007, <<http://www.dfat.gov.au/geof/fs/nz.pdf>>.

4 Department of Foreign Affairs and Trade, *New Zealand Country Information*, July 2007, p. 7. Website viewed 24 August 2007, <http://www.dfat.gov.au/geo/new_zealand/nz_country_brief.html>.

5 Department of Foreign Affairs and Trade, *New Zealand Country Information*, July 2007, p. 7. Website viewed 24 August 2007, <http://www.dfat.gov.au/geo/new_zealand/nz_country_brief.html>.

Dr Michael Cullen MP have meet on four occasions between January 2004 and January 2007 to progress this agenda.

- 2.11 In these meetings the Ministers have agreed to work towards a single market regulatory framework. As a result of these meetings there has already been a reduction in the regulatory barriers involved in doing trans-Tasman business including in the areas of business law and business and financial services.
- 2.12 There is already legislation facilitating joint co-operation between the countries' banking and prudential supervisory bodies and the central banks. There has also been a memorandum of understanding signed on Business Law Coordination which has included the recognition of certain cross-border business law issues and a protocol of information sharing about mergers between the Australian Consumer and Competition Commission and the New Zealand Commerce Commission.
- 2.13 The January 2007 meeting sought to progress single market patent application processes, double taxation legislation, retirement savings portability and cross-border court proceedings and judgement recognition.
- 2.14 The suggestion of a currency union is often debated within the countries. The Reserve Bank of New Zealand (RBNZ) included a chapter on the economic merits of a single currency with Australia in their December 2005 Reserve Bank Bulletin.⁶ The delegation did not have any in-depth discussions on this issue during meetings.

New Zealand economy

General

- 2.15 The New Zealand economy has undergone significant structural reforms since the mid 1980s which freed-up a highly regulatory regime and a rigid macro-economic framework. The program of reforms was extensive.⁷ As a result of these reforms New Zealand now has a largely deregulated market and one of the most liberalised market economies in the developed world. New Zealand currently enjoys the enviable second position in the World

6 Reserve Bank of New Zealand, *Reserve Bank of New Zealand Bulletin Volume 68 No. 4*, December 2005, p. 16. Website viewed 24 August 2007, <http://www.rbnz.govt.nz/research/bulletin/2002_2006/2005dec68_4.pdf>

7 Organisation of Economic Cooperation and Development, *The OECD Observer*, No. 212, June-July 1998, 'New Zealand Reform of the Financial Sector', Hans Suppanz.

Bank's 'Ease of doing business' study.⁸ The study assesses business friendly regulations.

- 2.16 With the spread of internet usage and the buoyancy of the Asian market, some of New Zealand's traditional impediments to global trade have been removed. The growing markets are now more accessible and closer than Europe.
- 2.17 Real Gross Domestic Product (GDP) to March 2007 was NZ\$128 billion⁹, with the services sector being the primary contributor to GDP, accounting for approximately two thirds.¹⁰ The primary sector accounts for around seven per cent and the manufacturing sector around 14 per cent.¹¹
- 2.18 The country's principle exports are dairy products; meat; forestry products; machinery; metals; fish; and fruit. Total merchandise exports amounted to NZ\$32.4 billion in 2006.¹² Services exports sit at around NZ\$11.8 billion.¹³
- 2.19 Economic growth has been strong since around 1999 (averaging 3.7 per cent to 2004), with a slight easing of growth since 2005, as shown in Figure 2.1. Real GDP growth was 1.2 per cent in the March 2007 quarter showing a strengthening.¹⁴ The key drivers of this growth have been service industries and household consumption.

8 World Bank and the International Finance Corporation, *Doing Business in 2007: How to reform, comparing regulation in 175 countries*, Washington, 2007.

9 New Zealand GDP is approximately one eighth of Australia's GDP. Invest New Zealand, *NZ Facts and Figures*, Website viewed 27 August 2007, <<http://www.investmentnz.govt.nz/section/14341.aspx>>.

10 Department of Foreign Affairs and Trade, *New Zealand Country Information*, July 2007, p. 5. Website viewed 24 August 2007, <http://www.dfat.gov.au/geo/new_zealand/nz_country_brief.html>.

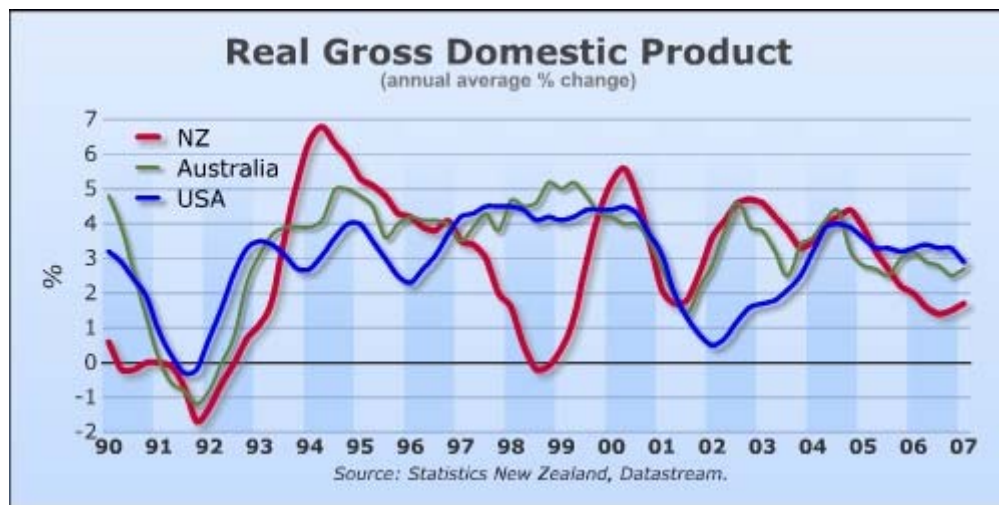
11 Invest New Zealand, *NZ Facts and Figures*, Website viewed 27 August 2007, <<http://www.investmentnz.govt.nz/section/14341.aspx>>.

12 Statistics New Zealand, *New Zealand in Profile: An overview of New Zealand's people, economy and environment*, 2007.

13 Statistics New Zealand, *New Zealand in Profile: An overview of New Zealand's people, economy and environment*, 2007.

14 Invest New Zealand, *NZ Facts and Figures*, Website viewed 27 August 2007, <<http://www.investmentnz.govt.nz/section/14341.aspx>>.

Figure 2.1 Real Gross Domestic Product New Zealand 1990—2007



Source Reserve Bank of New Zealand, *Key graphs, GDP Growth*, 2 July 2007

The 'white gold' boom

- 2.20 While Australia is experiencing a resources boom, the New Zealand economy is experiencing a dairy boom. New Zealand's top merchandise export is 'milk powder, butter and cheese' with a value of NZ\$5.8 billion in 2006 and accounting for 15 per cent of New Zealand exports.¹⁵ New Zealand has an impressive 25 per cent of the world trade in dairy products.
- 2.21 New Zealand's dairy production is very efficient. Livestock graze outside—they are not housed in winter as is the case in Europe—and are therefore grass-fed, not corn fed. Corn-fed stock are more expensive to feed and this has been exaggerated by increased demand for corn cropping for bio-fuel use.¹⁶ With increasing grain prices, dairy farming has become relatively uneconomic and thus the worldwide supply of dairy product has decreased. This has led to higher prices for dairy commodities. Australia's drought conditions, which have reduced Australian dairy export, have added to this environment.
- 2.22 The second part of the New Zealand dairy boom equation can be attributed to the rise in the standard of living in many highly populated Asian countries. As people become more affluent they demand more protein. Soy protein is becoming more expensive and thus the rise in the

15 Statistics New Zealand, *New Zealand in Profile: An overview of New Zealand's people, economy and environment*, 2007.

16 The emissions footprint of New Zealand livestock is less than European livestock but methane emissions remain an issue.

demand for dairy. This increase in demand has coincided with a worldwide reduction in supply, further boosting prices for dairy product.

- 2.23 Dairy is New Zealand's number one export and as such the increase in the commodity price has led to elevated terms of trade and an appreciation in the value of the New Zealand dollar.¹⁷ This has had a number of impacts on the New Zealand economy. These include the reduction in merchandise export competitiveness and reinforcing the high current account deficit of NZ\$13.9 billion for the year to March 2007.¹⁸ This is a slight reduction from NZ\$15.2 billion for the year to June 2006, which then represented 9.7 per cent of GDP.¹⁹
- 2.24 The New Zealand dollar has been steadily appreciating, approximating US75c and AUS89c in June 2007. Concern over the level of the dollar and the impact on New Zealand export performance led to the Reserve Bank of New Zealand intervening in the foreign currency market in 2007 to dampen the exchange rate.
- 2.25 The delegation heard that the high dollar is not so much the issue as is the volatility in the exchange rate which makes it difficult for exporters to plan an export program or strategy.

Inflation and interest rates

- 2.26 New Zealand's consumer price index rose 2.6 per cent in the year to December 2006 and had eased slightly to 2 per cent by the year ended June 2007.
- 2.27 The economy is at full employment with a record unemployment rate of 3.8 per cent to the March 2007 quarter.²⁰ This has led to labour and skills shortages in pockets of the economy.
- 2.28 As the New Zealand dollar appreciated imports became cheaper. Despite this, domestic inflation has increased. The inflation figures released on 16 July 2007 were higher than anticipated.

17 At the time of the visit the New Zealand dollar was around US78c and this was after currency intervention by the New Zealand Reserve Bank on 11 June 2007.

18 Reserve Bank of New Zealand, *Economic Indicators, A4 Labour Market and Balance of Payments*, March 2007 quarter.

19 This was the highest level of the current account deficit since the 1975 oil shock. Department of Foreign Affairs and Trade, *New Zealand Country Information*, July 2007, p. 5. Website viewed 24 August 2007, <http://www.dfat.gov.au/geo/new_zealand/nz_country_brief.html>.

20 Invest New Zealand, *NZ Facts and Figures*, Website viewed 27 August 2007, <<http://www.investmentnz.govt.nz/section/14341.aspx>>.

2.29 At the time of the delegation's visit the Reserve Bank of New Zealand (RBNZ) had moved the official cash rate (OCR) three times since 8 March 2007, each a 25 basis point move. Prior to that the rate had not been moved since 8 December 2005.

2.30 Following the delegation's visit a further 25 basis point rise occurred on 26 July 2007. In the RBNZ's press release on the day of the rise the Governor, Dr Alan Bollard stated:

The New Zealand economy is running strong. We are recording continued big increases in international commodity prices, especially dairy, reflecting solid world demand for our products. This is very good news for New Zealand. Given this positive situation, some of the negative commentary circulating about the economy is unwarranted. However, the continued tight labour market, high capacity use, and rising oil and food prices all point to sustained inflationary pressures. That is why we are increasing the OCR today.²¹

2.31 The cash rate now stands at 8.25 per cent—approximately 1.65 percent above Australia's official cash rate after the Reserve Bank of Australia's cash rate move on 8 August 2007.

Reserve Bank intervention in the foreign exchange market

2.32 The New Zealand dollar rose 3.2 per cent in June 2007 on the previous month, but was 18.1 per cent higher than June 2006. It was sitting at 25 per cent above purchasing power parity.

2.33 The Reserve Bank of New Zealand intervened in the foreign exchange market and for the first time bought foreign reserves (thus selling New Zealand dollars) to dampen the value of the dollar which they believed to be out of sync with the economy and unsustainable in the medium term.

2.34 In the RBNZ's recent press release on the raising of the official cash rate to 8.25 per cent the Governor, Dr Alan Bollard noted:

The New Zealand dollar has reached very high levels recently, driven by US dollar weakness and New Zealanders' heavy demand for borrowing. This level of the currency has been hurting exports. The high New Zealand dollar is not sustainable medium

21 Reserve Bank of New Zealand, *Reserve Bank raises OCR to 8.25 per cent*, 26 July 2007. Website viewed 27 August 2007, <<http://www.rbnz.govt.nz/news/2007/3074597.html>>.

term and investors should understand this. The higher OCR now gives strong incentives to New Zealanders to save.²²

Labour market

- 2.35 Despite the dairy boom not creating many extra jobs in New Zealand (as at March 2007 the agricultural sector employed 7.2 per cent of New Zealand's workforce) the country is enjoying full employment with unemployment at a record low of 3.8 per cent, being one of the lowest rates in the OECD.²³ The demand for labour has mainly come from service industries.
- 2.36 Wages and salaries are around 25 per cent lower on average than those in Australia.²⁴ As the cost of living is comparable to that in Australia and with easy work entry across the Tasman (including mutual recognition of qualifications), skilled labour has been migrating to Australia.
- 2.37 There are approximately 1 million New Zealanders working offshore. With a population of around 4.2 million this amount is considerable.
- 2.38 The delegation heard that New Zealand needs to move to global wage and salary levels to retain a quality labour force. This issue occurs in Australia, but the exodus is far smaller.²⁵ The tight labour market is leading to growth in labour incomes but with that comes inflationary pressures.

Productivity

- 2.39 New Zealand is experiencing a labour market conundrum of low unemployment but lower productivity than would be expected in an economy at or near full capacity. Multi-factor productivity fell 1 per cent in the measured sector to March 2006 while labour market productivity grew by 0.7 per cent in the same period. This is illustrated in Figure 2.2.
- 2.40 This productivity puzzle has also been raised by the Governor of the Reserve Bank of Australia, Mr Glenn Stevens, as a perplexing phenomena occurring in Australia as well.²⁶ However, New Zealand is confronted with

22 Reserve Bank of New Zealand, *Reserve Bank raises OCR to 8.25 per cent*, 26 July 2007. Website viewed 27 August 2007, <<http://www.rbnz.govt.nz/news/2007/3074597.html>>.

23 Invest New Zealand, *NZ Facts and Figures*, Website viewed 27 August 2007, <<http://www.investmentnz.govt.nz/section/14341.aspx>>. Also, OECD, Statistics Portal – Labour, *Unemployment Statistics*, 10 August 2007.

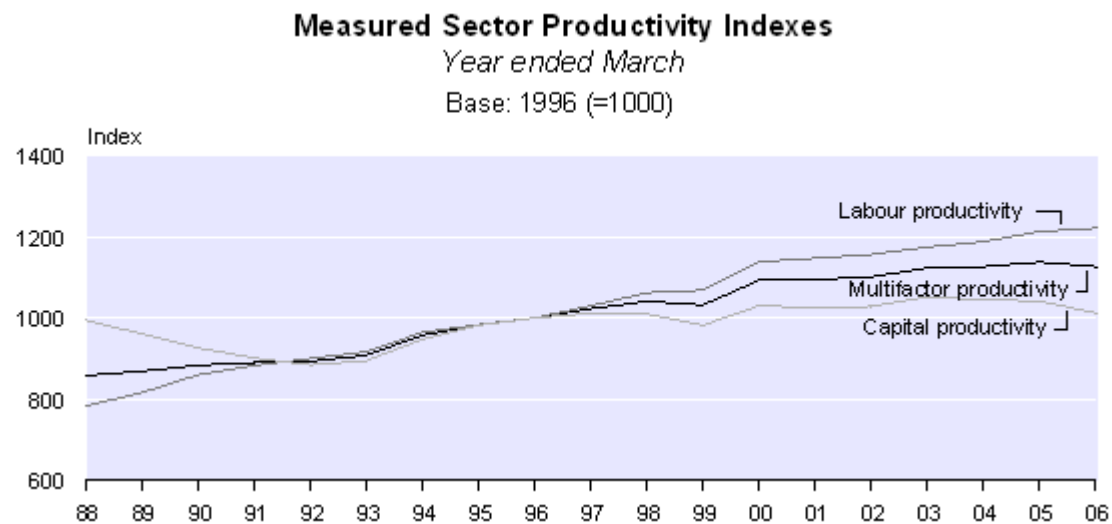
24 OECD, *Comparison of Wage Levels*, Gross Wage in National Currency, 2004. Website viewed 27 August 2007, <<http://www.oecd.org/dataoecd/33/28/34545117.pdf>>.

25 As examples, there are approximately 60 000 Australians working in Hong Kong and 10 000 in Dubai.

26 Mr G Stevens, Governor of the RBA, *Transcript*, 21 February 2007, p. 16.

this issue on a larger scale – Australian productivity averages 30 per cent more than New Zealand's.

Figure 2.2 Measured sector productivity indexes year ended March 2006: base 1996 = 1000



Source Statistics New Zealand, *Productivity Statistics 1998-2006 (revised)*

2.41 In the media conference release of the Budget 2007 papers in December 2007 the Minister of Finance, Dr Michael Cullen gave some possible reasons behind New Zealand's sluggish productivity:

The economy is clearly in good heart. Businesses are becoming more confident about the level of their own activity and the tight labour market suggests businesses are holding on to staff in anticipation of a recovery. Indeed, Treasury forecasts a considerable lift in labour productivity over the next two years. This is essential if we are to enjoy a higher sustainable level of economic growth in the future.²⁷

2.42 There is also suggestion that some of this problem is associated with skilled labour moving offshore, being replaced with semi and unskilled labour. Approximately 600-700 New Zealanders leave for Australia each week. Even though the country received net migration most of those leaving are single people who are participating in the workforce, whereas most immigrants were families and thus not all of these people participate in the workforce.

27 The Treasury, Budget 2007 Press Release, *New Zealand Economy Proves Resilient*, the Minister of Finance, the Hon Dr Michael Cullen, 19 December 2006. Website viewed 27 August 2007, <<http://www.beehive.govt.nz/ViewDocument.aspx?DocumentID=28128>>.

- 2.43 The delegation heard that improving productivity was a key challenge for New Zealand.

Fiscal policy and future fund

- 2.44 Fiscal surpluses have been run for the past 15 years. In 2001, in view of fiscal surplus accumulation, the Government chose to set-up a 'future fund' to provide partial funding for the New Zealand national pension scheme.²⁸ This fund is called the New Zealand Superannuation Fund and will be discussed in more detail in Chapter 4.
- 2.45 Fiscal policy has recently been more expansionary with greater expenditure on infrastructure, in particular roads and energy facilities and on social policy. The Minister of Finance noted on budget day 2007:

The improved fiscal position will allow the introduction of a significant business tax package to take effect from 1 April 2008 and improves our ability to tackle other priorities such as climate change. Budget 2007 will also continue our progress in building a unique national identity and meeting the aspirations of families, young and old, to be healthier and more secure through initiatives to enhance our world class education, healthcare and social services.²⁹

Capital market and infrastructure

- 2.46 As a small and geographically remote country it is important for New Zealand to have strong transport and telecommunications infrastructure. While some areas of infrastructure are robust, others need investment.
- 2.47 New Zealand ports and airports are very efficient. There were a number of reforms in the late 1990s which led to these improvements. However, the country is experiencing some infrastructure deficits; primarily in transport infrastructure. Investment is also required in utilities infrastructure, particularly energy and water.

28 The fund was established under the *New Zealand Superannuation and Retirement Income Act 2001*.

29 The Treasury, Budget 2007 Press Release, *New Zealand Economy Proves Resilient*, the Minister of Finance, the Hon Dr Michael Cullen, 19 December 2006.
<<http://www.beehive.govt.nz/ViewDocument.aspx?DocumentID=28128>>.

- 2.48 The delegation heard that tradeable water rights are an issue. In the Canterbury region 90 per cent of water resources are allocated and the demand for water is set to double over the next ten years.
- 2.49 High speed broadband internet penetration is seen as a way to connect New Zealand with the world market and therefore of high priority. This is a challenge due to the thin spread of homes in New Zealand and the economics of rolling-out broadband to homes. Broadband is considered a way to attract foreign direct investment and to enable creative services to be delivered.
- 2.50 New Zealand has experienced some issues raising capital for projects because of the low pool of savings in their domestic market. The economy is heavily reliant on foreign capital, much of which comes from Australia.
- 2.51 The need for a strong capital market has led to policies to encourage New Zealanders to save. The most important of these has been the development of KiwiSaver – an auto-enrolment superannuation savings scheme – which commenced on 1 July 2007. KiwiSaver is discussed in Chapter 4.

Household demand and housing affordability

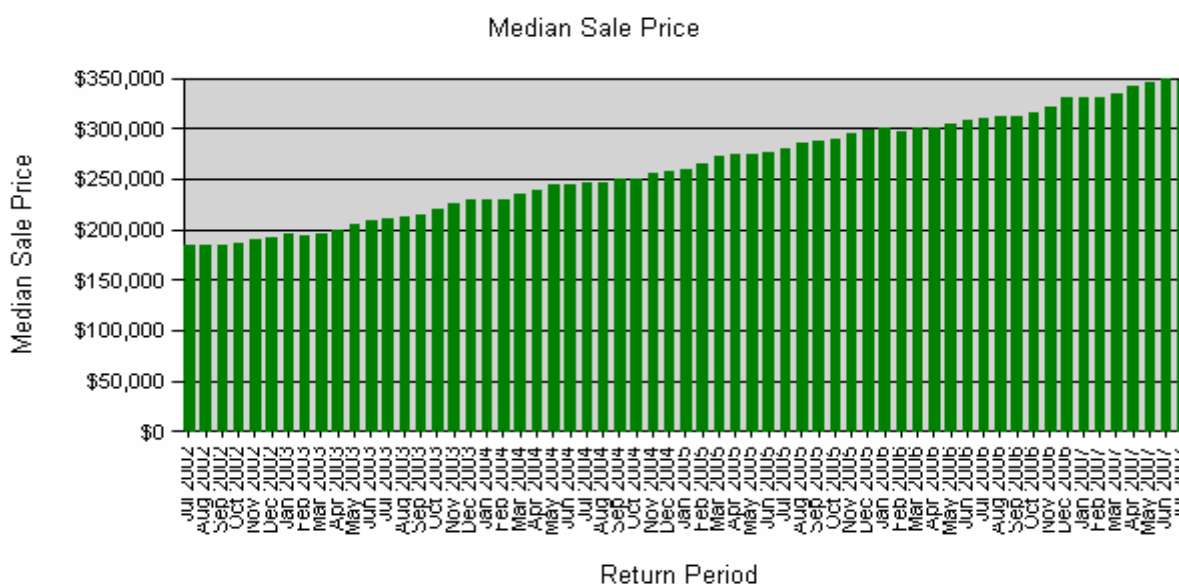
- 2.52 New Zealanders have a history of hesitancy to invest in the stock market. This may have been related to losses experienced in the stock market crash of 1987 which, on average, affected New Zealanders more than it did Australians.
- 2.53 Unlike in Australia, New Zealanders have not experienced the marketing and take-up of shares by ‘mums and dads’ when large, previously government owned bodies were publicly floated. Australians were introduced to the notion of holding shares in this way and through the de-mutualisation of well-known membership bodies (like NRMA Insurance Limited). Australians hold the highest share ownership in the world, at around 55 per cent total share ownership.³⁰ In comparison, New Zealand direct share ownership was around 23 per cent in 2005.³¹

30 Australian Stock Exchange, *International Share Ownership – Comparison of Share Owners: Key Highlights*, September 2005, p. 2.

31 Australian Stock Exchange, *International Share Ownership – Comparison of Share Owners: Key Highlights*, September 2005, p. 2.

- 2.54 New Zealanders have instead enthusiastically invested in real estate, which has created a property boom. Median dwelling prices have almost doubled in the past five years, as exhibited in Figure 2.3.³²
- 2.55 The investor-led boom has been exacerbated by lenient capital gains tax rules plus the ability to deduct rental losses against income. Capital gains tax liability is dependent upon whether the owner ‘intends’ to make a capital gain at the time of asset purchase. Additionally, New Zealand has experienced net migration and that has fuelled demand for housing.
- 2.56 Ironically, home ownership in New Zealand has fallen. The country once had the highest level of home ownership in the developed world. Home ownership has fallen from 74 per cent in 1991 to 68 per cent in 2006.³³ The fall in home ownership has been greater than the fall in home ownership in Australia.³⁴

Figure 2.3 Median selling prices of dwellings in New Zealand between July 2002—July 2007



Source Real Estate Institute of New Zealand, *Market facts: Median selling price July 2002-July 2007*

32 Real Estate Institute of New Zealand, *Market facts: Median selling price July 2002-July 2007*. Website viewed 27 August 2007, <<http://210.48.74.140/reportingapp/default.aspx?RFOPTION=Report&RFCODE=R100>>.

33 Housing New Zealand, Housing New Zealand Corporation, *New Zealand Housing Strategy – Homeownership*, 26 September 2006. Website viewed 27 August 2007, <<http://www.hnzc.co.nz/hnzc/web/research-&-policy/strategy-publications/nzhs/online-version/area-3---homeownership.htm>>

34 Absolute home ownership levels are similar. In August 2001 Australia had a home ownership rate of 69 per cent. Australian Bureau of Statistics, *Australian Social Trends 2003*, cat. 4102.0, ABS, Canberra, June 2003.

- 2.57 New Zealand household debt is very high while household savings are low. As previously mentioned this is a dual cause of monetary policy concern – reigning in household demand and yet encouraging savings. On average, New Zealand households are spending 15 per cent more than they are earning. Some of this has come from mortgage equity withdrawal.

New Zealand securities market

- 2.58 The average New Zealand sharebroker holds a quarter to a half of all portfolios in Australian equities. Australia is also the first country for New Zealanders to invest in after New Zealand. New Zealanders hold very little US stock. This situation is somewhat generated by the mineral stocks in Australia and the favourable tax treatment of New Zealand and Australian stock.
- 2.59 New Zealand is a massive recipient of foreign direct investment from Australia. In 2006 Australia contributed a substantial 46 per cent of all total foreign direct investment in New Zealand.³⁵ There is far more liquidity in Australia than there is in New Zealand. As a consequence, the New Zealand economy has a larger proportion of off-shore ownership than Australia.
- 2.60 Acquisitions and mergers are seen as more of a problem in New Zealand than in Australia because Australia has foreign ownership caps whereas in New Zealand there are no ownership caps, excepting New Zealand's Telecom. This makes New Zealand a private equity target. There have already been a number of private equity deals in New Zealand which have taken businesses off the New Zealand Stock exchange.

35 Inland Revenue Department, *New Zealand's International Tax Review: A direction for change – A Government discussion document*, Minister of Finance & Minister of Revenue, December 2006.