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A New Zealand-US FTA? — A Reality Check

Rob Salmond

New Zealand governments, both Labour and National, have been aggressively pro-free trade for the past twenty years. New Zealand is one of the very few countries in the world *unilaterally* to tear down many of its tariff and other barriers to international trade — not demanding anything from anybody in return. Its domestic economy stands on the foundation of one of the most productive and efficient agriculture sectors in the world, and its value-added manufacturing and services industries, on the whole, continue to grow and prosper. Surely, given this background, New Zealand is an excellent Closer Economic Partnership (CEP — Kiwi politically correct-speak for Free Trade Agreement (FTA)) partner for anybody. Why would anybody *not* want to do a deal with them?

In recent months many have agonised about the FTA that New Zealand wants to sign with the US. Why are the Americans not responding to their increasingly desperate overtures? Is it their nuclear policy? Is it because New Zealand didn't support the war in Iraq? Simply, the public do not know. Until one of the principals admits to such a policy connection, the public can never be sure. Even if it could be shown that these factors are influential for some in the US system, it would be another thing entirely to show that they have been decisive.

If it is assumed for the purposes of argument that the US does make trade decisions based partially on non-trade issues, then a trading gain to the US ceases to become a sufficient condition for the negotiation of an FTA. But it remains a necessary condition. The US has not made a habit of handing out FTAs to countries just because they are foreign policy friends. There are, of course, a handful of exceptions to this rule. The US signed an FTA with Israel in 1985 without an overwhelming trade-policy interest being present. And in the 1960s, the US reduced duties on Japanese and South Korean goods without demanding that those countries reduce protection of their key domestic industries. In each of these cases, however, there was an important military-strategic element in play that the US felt was more important than the trade policy 'dis-interest'. Indeed once the military imperative for closer relations with North Asia became less salient, US enthusiasm for unilateral trade liberalisation evaporated very quickly. Given that no such military interest could conceivably exist in relation to New Zealand, these counter-examples are of no relevance to the New Zealand case. This paper argues that the necessary trading interest does not exist for the US, and therefore that a New Zealand-US deal is, in practical terms, almost overwhelmingly improbable.

Rob Salmond is a PhD Candidate in the Department of Political Science, University of California at Los Angeles. Email: rsalmond@ucla.edu.

This paper will demonstrate that countries like the US have no bilateral incentive to deal with New Zealand and its already-liberalised trading arrangements. The essence of this argument is to ask the question: 'why negotiate with somebody who's already given you everything you want?' The paper then goes on to show that the purported strategic benefits forming the bulk of New Zealand's public case for an FTA do not flow towards the US in sufficient quantities to overcome the institutional hurdles standing in the way of an agreement.

It is possible that New Zealand's geography is actually the key factor preventing it from gaining an FTA with the US. After all, why would the world's only superpower make concessions to a small and essentially powerless country that is the gateway to nowhere? Despite this factor, New Zealand officials have made strong representations to successive US administrations about the possibility of a deal and have amassed a non-trivial stable of support from both the public and private sectors within the US. For the purposes of this paper, therefore, it will be the maintained assumption that New Zealand was not doomed from the *very* start, and that a country in its geographic position does have at least some potential as a free trade partner with the US.

The analysis proceeds as follows. First, two perspectives on trade that have been advanced in the academic community are outlined, showing also which theoretical camp New Zealand and American officials have sided with. Next the paper considers the reasons why the US wouldn't sign an FTA with New Zealand given *only* bilateral considerations. Third, the strategic benefits that flowed from the Singapore-US FTA are compared and contrasted with those that might flow from a New Zealand-US FTA, showing how and why the New Zealand deal cannot pass based on strategic considerations. In this section the different situations facing Australian and New Zealand negotiators are also examined. Finally the paper presents some conclusions and related consequences.

If readers agree with the analysis here, they will leave with a pessimistic view of New Zealand's chances of a bilateral FTA. Even if New Zealand retroactively supported the war in Iraq, allowed in nuclear armed and powered ships, rejected the International Criminal Court or the Kyoto Protocol, or engaged in any other foreign policy chumming-up to the US, there would likely still be no deal. This pessimism, however, is balanced by the consequent realisation that New Zealand can continue to pursue an independent foreign policy without worrying about the impact it may have on its trading prospects with the US.

Academic Perspectives on Trade

The two academic disciplines that have thought most about the issue of trade negotiations are economics and political science. They have not, however, seen eye-to-eye.

The dominant view among economists is that trade liberalisation is a good idea for any country, whether its trading partners liberalise or not. They argue that tariffs, subsidies, quotas and other technical barriers to trade cause deadweight

loss to the domestic economy. This is because they force everybody to pay higher taxes so that the government can enforce the rules, cause the misallocation of productive resources in the economy, and force up prices for consumers through the support of uncompetitive industries. Removing barriers to trade solves all of these problems, regardless of others' actions. Perhaps the best statement of the economists' position comes from noted Princeton economist Paul Krugman (1997:113):

> If economists ruled the world, there would be no need for the World Trade Organisation. The economist's case for free trade is essentially a unilateral case: a country serves its own interests by pursuing free trade regardless of what other countries may do. Or, as Frederic Bastiat put it, it makes no more sense to be protectionist because other countries have tariffs than it would to block up our harbors because other countries have rocky coasts.

Other interesting commentaries on the economists' position on trade are found in Krugman (1987) and Baldwin (1992). For a summary of the economists' perspective, see Krugman (1993) or your favourite macroeconomics textbook.

The economists' prediction is that governments will race to liberalise their country's trade policy as fast as their domestic political institutions will allow. This will occur regardless of the actions of any other country — although clearly mutual free trade is preferred to unilateral liberalisation. Thus economists believe that a country's preferences should be (in terms of a bilateral model) mutual liberalisation first, followed by unilateral liberalisation by the self, unilateral liberalisation by another country, and mutual protectionism last.

Political scientists, on the other hand, have argued that the benefits to a country of FTAs come from liberalisation on the part of the other country. The act of opening up your own markets is just the price that has to be paid in exchange for your new market access. Political scientists often model bilateral trade negotiations as real world applications of the prisoners' dilemma game. Good examples of this kind of research are Keohane (1986) and Yarbrough and Yarbrough (1987). The structure of this game is that Country A's dominant strategy is to not liberalise regardless of Country B's position, but that joint liberalisation is preferable to mutual protectionism. Political scientists therefore believe that the preference ordering for the government of Country A is unilateral liberalisation by Country B first, followed by mutual liberalisation, mutual protectionism, and unilateral liberalisation by the Country A last. The prediction of this model is not that trade liberalisation will never occur, but rather that any freeing up of trade policy will occur only in the context of reciprocal and enforceable trade agreements. The competing perspectives of economists and political scientists are illustrated in Figure 1.

Figure 1: Two Perspectives on Trade Policy

ECONOMISTS

	They liberalise	They don't
We liberalise	**Best**	**2^{nd} best**
We don't	**3^{rd} best**	**Worst**

POLITICAL SCIENTISTS

	They liberalise	They don't
We liberalise	**2^{nd} best**	**Worst**
We don't	**Best**	**3^{rd} best**

In this paper, it is not important or necessary to evaluate the strengths and weaknesses of these two academic positions. It is, however, possible and useful to infer from a government's actions which perspective it agrees with. Governments that unilaterally tear down trade barriers have clearly sided with the economists. Governments that only liberalise their trading arrangements as part of a reciprocal agreement with other governments, on the other hand, are behaving exactly as the political scientists would predict.

Economists are the first to admit that very few governments have taken their trade advice:

> International trade seems to be a subject where the advice of economists is routinely disregarded. Economists are nearly unanimous in their general opposition to protectionism, but the increase in US protection in recent years in such sectors as automobiles, steel, textiles and apparel, machine tools, footwear and semiconductors demonstrates that economists lack political influence on trade policy. (Baldwin, 1989:119)

Three of the few countries that have sided with the economists, however, are of critical importance to this paper. New Zealand, Australia and Singapore have at different times engaged in wide-ranging unilateral trade policy reform away from protectionism and towards very open markets. While several other countries such as Chile, Brazil and Thailand have also engaged in some unilateral trade liberalisation, their post-reform trade policies were not characterised by consistently low tariff rates and other barriers, and therefore those countries can only be said to have partially sided with the economists. Outside of the countries under direct study in this paper, only Hong Kong's trade policy seems fully to fit the economists' prescription.

Most readers will be familiar with the New Zealand and Australian policy of unilateral tariff reductions over the past ten or fifteen years, and therefore a review of the rationale behind the reforms is not provided here. Suffice to say that the New Zealand Ministry of Foreign Affairs and Trade (MFAT) talks glowingly

about the benefits in terms of manufacturing and consumer choice and prices that it claims have flowed from this one-sided free trade policy — 95 per cent of goods entering New Zealand now do so free of any tariffs or duties. New Zealand has demanded nothing of its trading partners in return for this liberalisation, which has brought increased sales and profits to importers and foreign suppliers at the expense of New Zealand's domestic car manufacturing and apparel industries among others. More extensive discussion of the differences between the Australian and New Zealand approaches follows is provided below.

Singapore's one-sided liberalisation occurred in the 1960s, when it rejected the import substitution policy of the other Asian tigers. Lacking natural resources and hinterland labour, Singapore opened its economy to international firms in the hope of attracting foreign capital to its shores. Over the next decade, this capital flowed into Singapore at a rapid pace, providing for much of the employment in the newly-rejuvenated port city. Although the investing firms had at least as much to gain from the trade liberalisation as Singapore did, the Singaporean government made no demands of the countries of registration of these firms.

Most countries in the world, however, behave as the political scientists predict, freeing up their trading arrangements only when their trading partners do too, liberalising a small amount at a time, and ensuring that any particular round of tariff cuts shares the benefits reasonably equitably among the parties. In the absence of these reciprocal FTA deals, existing protections for domestic producers remain.

The fourth country important to this article, the US, falls squarely into this second category. There simply are no significant unilateral tariff reductions in the US's recent history. Further, the US has been able to use its status to negotiate deals that in many cases keep significant protections for key US industries. To illustrate this, consider the position of the US agriculture sector — a part of the US economy that many argue is critical to the country's overall self-sufficiency. Despite multiple rounds of the GATT, the establishment of the WTO, NAFTA (an agreement with two countries with large agricultural sectors of their own), and other bilateral FTAs, on average American farmers still receive over half of their income from various organs of the US government, generally in the form of subsidies. These subsidies are allowed for in the agreements mentioned above despite the fact that subsidies are generally seen as antithetical to free trade. To take Mayhew (1974) out of context: if you were to design a country that best embodied the trade policy preferences outlined by the political scientists, you couldn't do much better than the US.

A Bilateral Model of Trade Negotiations

Two types of governments were outlined above, the few who believe unambiguously in the principle of free trade, and the many who are ready to believe in free trade but only if their friends do too. (There is also a third type of government, one which unambiguously rejects free trade, but that type of government is not of interest to the discussion in this paper.) This section briefly

shows what the result of any negotiation between any combinations of the two types of governments would be if *only* bilateral trading considerations were taken into account. The predictions are based on simple game theory, but the game theoretic tables are not presented here in order to keep the paper non-technical. Readers wanting an accessible introduction to simple game theory should see Dixit and Nalebuff (1991).

Any pair of countries involving a unilateralist free trader is rare — but the result of any negotiation between such a pair is easy to predict. If ever two unilateralist countries meet to negotiate an FTA, the negotiations should be quick, successful and largely non-controversial. Two countries with no trade barriers shouldn't need to talk for very long before agreeing that they won't charge each other any tariffs! Such was the case with the recently signed New Zealand-Singapore FTA.

If a unilateralist meets a contingent free trader, then the results are equally easy to determine. The unilateralist will want to liberalise no matter what. Knowing this, the contingent free trader is able to pick between their favourite outcome (protectionism on their side, liberalisation on the other) and their second favourite outcome (mutual liberalisation). This is not a difficult choice, and so the predicted result would be no FTA, but unilateral liberalisation on the part of the unilateralist. A possible US-New Zealand deal falls into this category.

The third potential meeting is of two contingent free traders. As alluded to earlier, this is an application of the prisoners' dilemma game, where each player has a dominant strategy of protectionism (producing a Nash equilibrium of mutual protectionism), but the players are both better off if an enforceable agreement calling for mutual liberalisation can be reached. Such an agreement cannot always be reached, but sometimes it is. Almost all FTAs in the world fall into this category, where the participant countries agree to liberalise conditional upon the agreement of other participants to do likewise, and conditional also upon the FTA agreement being enforceable.

Careful readers will have noticed an apparent contradiction. An FTA between unilateralist and a contingent free trader would be very unlikely according to the above analysis. Yet earlier sections talked about Singapore's unilateralist behaviour in the 1960s, and Singapore and the US have recently signed an FTA. How could this be?

The above predictions were based on the consideration of only bilateral benefits that might flow from any FTA, and in the ideal-type analysis in that section it was assumed that the unilateralist player had no remaining trade barriers. Despite Singapore's unilateral liberalisation activity in the 1960s significant trade barriers remained, especially in the financial services sector — a sector of strong interest to American firms. US businesses identified these barriers as impediments to their full engagement in the Singaporean economy. The removal of these remaining barriers would provide strategic trade benefits (see below) to US business interests, which induced them to encourage the US Administration to negotiate with Singapore, treating them as a contingent free-trader rather than a unilateral free-trader. The following sections demonstrate decisive differences

between the Singapore and New Zealand cases, and later between the Australian and New Zealand cases.

The Singapore-US FTA

In early 2003, the governments of Singapore and the US signed an FTA. It was not a model-FTA, as the US had negotiated transitional import tariffs on Singaporean apparel through 2013, but it was comprehensive in scope. In line with the theory advanced above, the deal did not raise a large amount of controversy in Singapore. In the US, however, there was strong support for the deal from larger corporations, but limited opposition from workers and their unions in the apparel industry.

There are three key elements that came together to ensure passage of the US-Singapore FTA. First, American corporate interests saw the FTA as an important first step towards a US-ASEAN FTA, which would open up huge new markets to American firms and end the protection of key Asian firms that grew from 'infant industry status' within some ASEAN nations. This formed an important part of the rationale presented by the US-Singapore FTA Business Coalition for supporting the agreement (USSFTA Business Coalition, 2003). Second, the prospect of an end to the significant remaining Singaporean barriers to entry into the banking and financial sectors were very attractive to US companies, especially in view of the first element above. Gaining a financial presence in Singapore would provide a great base from which to launch into the wider ASEAN market. Third, the apparel sector was not united in its opposition to the agreement. While the American Textile Manufacturers' Institute was adamantly opposed to the FTA, arguing that it would bring ruin to the domestic industry, the American Apparel and Footwear Association felt that Singapore would never become a significant player in the American apparel market, and therefore did not oppose the agreement.

In deciding whether to pass the Singapore FTA Bill, members of the US Congress faced strong support from local business interests and limited and divided opinion from the apparel sector. Importantly, these two constituencies tend to live in the same Congressional districts, located in large urban areas in industrial States. This meant that members of the House and the Senate weighed up support and opposition *on their own* before declaring a position, and before taking this position to Washington. The fact that Representatives and Senators did not need to negotiate *with each other* over this Bill significantly lowered the associated transaction costs and achieved smoother passage of the legislation.

The success of the US-Singapore deal was dependent on strategic trading benefits flowing to the US and Singapore's agreement of to eliminate immediately its remaining trade barriers. Its passage was further assisted by the geographic concentration of the affected groups in certain US Congressional districts.

A New Zealand-US FTA?

Some have attempted to mount a bilateral case for a New Zealand-US FTA, despite the gloomy predictions of the formal analysis above:

> New Zealand is very small compared with the United States so the economic impact of an FTA would be quite modest for the United States and considerably larger for New Zealand. However, US merchandise exports to New Zealand would rise by about 25 percent and virtually every US sector would benefit. The inclusion of Australia would increase the magnitude of these results substantially; US exports would rise by about $3 billion. The adjustment costs for the United States would be minimal: production in the most impacted sector, dairy products, would decline by only 0.5 percent and any adverse effect on jobs would be very small (Bergsten and Scollay, 2003:1).

These empirical claims are based on 'The Case for a Model Free Trade Agreement between the United States and New Zealand', prepared by Fred Bergsten and Robert Scollay at the Institute for International Economics for the US-New Zealand Council. The question to be asked is: 'how likely is it that this report will convince the right people in the US?' The answer is a reluctant 'not very'.

First, the dataset for the empirical estimates is flawed. The dataset is from 1997 (the latest available), and New Zealand has since reduced or eliminated important tariffs (for example in the forestry sector). Consequently, the current impact on US exports to New Zealand would be much less than that estimated with the 1997 dataset. For example, the dataset listed the New Zealand tariff on wood products as 6.3 per cent. In fact, the trade-weighted tariff on US wood products flowing into New Zealand was 3.4 per cent in 2003, and due to further New Zealand tariff reductions will reduce to 0.6 per cent on January 1, 2004. Thus the predicted 30 per cent increase in US wood products exports to New Zealand is overstated by a factor of almost two, and in 2004 that overstatement will increase to a factor of about ten.

In a similar vein, Bergsten and Scollay (2003:11) say that a 'noteworthy feature is the increase in US exports to New Zealand of milk products…' (Bergsten and Scollay,). The report estimates that US exports of milk products would increase by 63 per cent, which amounts to about US$100,000 at 2002 commodity levels and exchange rates. The data are again flawed, however, overstating New Zealand tariff levels (as at 2002) by a factor of over three. Thus the 'noteworthy feature' actually amounts to about US$35,000 per annum once the data errors are corrected.

Second, the Computable General Equilibrium (CGE) model on which the estimates were based contains some assumptions that are not innocuous in terms of driving the results. For good summaries of the CGE modelling process, see Scollay and Gilbert (2001), Bandara (1991) or Francois and Reinert (1997). It is

assumed in the CGE model that factors of production move costlessly between sectors of the economy in response to changes in relative tariffs. And it is also assumed that there is no inertia in any industry in a country's economic system. These assumptions help to drive the equilibrium results in the model. If the assumptions are false, then it is likely that the equilibrium state outlined in MFAT's summary will never be reached and therefore that the model mis-states the real world impact of an FTA. In this case, the assumption that giant US industries will be nimble enough to take up all the modest new opportunities offered in a small and far-away market is certainly open to question.

Also, the model only examines the impact of an FTA on exports and imports in equilibrium, without taking into account any of the side-payments to affected industries, costs occurred in realigning production factors, transfer payments made by governments to temporarily displaced workers and so forth. A model showing the net effect of an FTA on the US and New Zealand economies as a whole must take account of these costs. Further, the Report and MFAT's press treatment of it do not note that it is estimated to take some 10-12 years for the predicted changes in trade levels to take place. This result, which flows directly from the quite reasonable assumptions in the CGE model of mobile capital but non-mobile land resources, is a significant part of the result and it is surprising that the authors chose not to mention it.

For those, such as the US dairy industry, who believe they have a vested interest *against* the passage of an FTA, the above points are likely to have some resonance. A further question arises as to whether the US dairy industry, for example, actually needs to be won over for a New Zealand-US FTA to proceed. In answering that question, it is useful to adopt Putnam's (1988) persuasive logic that international relations decisions are two-level games, and therefore that one must consider both the international and domestic environments to predict a government's actions.

Given the structure of US decision-making institutions, the support (or non-opposition) of the dairy industry is in fact crucial. Consider the position of the US Senate in deciding whether to pass a New Zealand FTA. First, it needs to be remembered that in the US, 'all politics is local' and Members of Congress are extremely reticent about voting against their district's preferences (see Mayhew, 1974 or Fenno, 1978). Second, there aren't any Congressional districts in the US that place a particular priority of gaining an FTA with New Zealand — as most firms that deal with New Zealand already get tariff-free access, so it is difficult to *excite* them over an FTA. Third, note that: (i) large sections of the US agriculture industry are strongly opposed to a New Zealand FTA; (ii) the agriculture industry is the dominant source of employment in many of the small Midwest and Great Plains States in the US; and (iii) these States, by virtue of their small population, are over-represented in the US Senate. Once these facts are taken into consideration, it becomes clear that strongly antagonistic forces, in the absence of strong protagonists, are likely to result in no passage of an FTA through the Senate. Placating the Senate is costly, and it is questionable whether any US

presidential administration would be prepared to pay any such side-payments in order to secure a deal of very limited bilateral and strategic value.

One objection that may be raised to this argument is to point to the significant number of members of the US Congress (over 50) who have already declared their support of a New Zealand FTA. To take these declarations at face value is, however, naïve. One of the most widely agreed observations in the study of US Congressional politics is how willing Members of Congress are to make any costless statement put in front of them, no matter how sure they are that a proposal will come to nothing (Fenno, 1978:Ch 5). If, for example, a constituent wants a new highway built through a Senator's State, the Senator will always say: 'That's a great idea. I support that and will lobby for it in Washington'. Once it becomes clear in Washington that the project will not succeed, then the Senator can say: 'I tried, I tried very hard, but the others didn't see the brilliance of your proposal. They must be idiots'. Some have attributed the regular finding that Americans hate Congress but love their Member of Congress to this process (see for example Fenno, 1978:Ch 5; Smith, Roberts and Vander Wielen, 2003:Ch 1). The statements made thus far by Members of Congress fit this pattern very closely, and therefore should be taken with a large grain of salt.

Now it remains to be considered whether New Zealand can pitch an FTA based on strategic considerations. Some believe it can:

> The largest gains, especially for the United States, would come from the strategic benefits of such an FTA with New Zealand. It would help restart and accelerate the momentum of trade liberalisation. It would help induce other trading partners to participate effectively in that renewed liberalisation process. It would contribute toward the accomplishment of APEC's goals of achieving 'free and open trade and investment in the (Asia Pacific) region by 2010', with their important political as well as economic implications. By doing so, it would reduce the risk of polarisation of the Asia-Pacific region between competing blocs in East Asia and the Americas, a development that would push the world toward a tripolar configuration that could be extremely dangerous in security as well as economic terms (Bergsten and Scollay, 2003:1).

Large portions of this argument, which has been repeated by New Zealand Ambassador to the US, John Wood (2003), rely on the concept of a 'demonstration effect', the same concept that underlay New Zealand's unilateral tariff reductions of the 1990s. Four points should be made in response to the claim of 'demonstration effect' strategic benefits:

First, the strategic benefits as framed in the Bergsten and Scollay report are grossly overstated. It is very difficult to argue, for example, that the role of a US-New Zealand FTA in avoiding 'a tripolar configuration [in the world] that could be extremely dangerous in security as well as economic terms' would be anything more than entirely trivial. New Zealand may box above its weight in international affairs, but its initial weight is low.

Second, the United States does not make a habit of engaging in demonstrative-but-not-beneficial behaviour. Even if New Zealand could convince the executive branch of the US government that this demonstration effect could be successful, it is another matter entirely to convince the legislative branch, where ‘all politics is local’. Localised politics leaves very little room for future-oriented trade posturing.

Third, the US does not *need* to engage in demonstrative behaviour in the same way that New Zealand does. New Zealand uses demonstrative behaviour to try and induce other more powerful countries to engage in similar behaviour. The US *is* one of these powerful countries, and it does not need to demonstrate the benefits of free trade to anyone. If the US wants to quicken the pace of global trade negotiations, then it does so. No demonstration needed.

Fourth, the audience for the ‘demonstration’ — which appears to be the governments and peoples in the ASEAN and NAFTA trade blocs (who may at some point consider combining their FTAs, which would be the single most important step towards APEC achieving its Bogor goal of region-wide free trade) — are far more likely to be watching developments in the US-Singapore case than in the US-New Zealand case. The US-Singapore deal gives the US direct entrée into an ASEAN nation, whereas a New Zealand deal does not. Along similar lines, if for some reason it *were* decided that a demonstration was needed of the workability of an FTA between the US and a non-NAFTA non-ASEAN nation, then the recently signed deal with Chile or any future agreement with Australia should suffice.

This section has only considered the strategic benefits put forward thus far by New Zealand officials, especially the purported benefit of providing a catalyst to wider liberalisation within both APEC and the WTO. The response argued here has been that the potential of this deal to fulfil the role of a catalyst is overstated, that the US has more effective means of providing such a catalyst than a New Zealand FTA and that the US does not traditionally engage in catalyst-like demonstrative behaviour. In contrast with the Singaporean deal, it also appears that a New Zealand FTA would not serve any strategic purpose for US firms trying to open up other markets using the FTA as leverage.

On the basis of the above observations, the prospect of strategic benefits from a New Zealand FTA appears not likely to convince US decision makers.

In September 2003, New Zealand further undermined its FTA negotiating position by announcing further unilateral cuts in its already low tariff schedule. The highest tariffs will fall from 19 per cent to 10 per cent over the next five years. In announcing the cuts, however, trade minister Jim Sutton said: ‘The government is not prepared … to move to a zero tariff regime at this time. We will still retain some trade negotiating coin’. (Dalziel 2003) Although it is an open question whether New Zealand could ever have accumulated enough ‘negotiating coin’ to interest the US in a deal, this section has shown that New Zealand didn’t have enough currency to elicit a deal even before the latest round of unilateral cuts, and these new cuts simply serve to reinforce that position.

The New Zealand and Australian Cases Compared

Some in New Zealand have made the claim that '[Prime Minister] Helen Clark's criticism of the US during the Iraq war … cost us a Free Trade Agreement' (English, 2003), pointing for evidence to Australia — a supporter of the war that now has FTA negotiations with the Bush administration. Implicit in such a claim is the notion that the two cases appear otherwise the same from an American standpoint. There is some appeal to this claim. Both countries are (compared to the US) small, are wealthy, are located deep in the South West Pacific, pursued a policy of unilateral trade liberalisation in the 1980s and 1990s, hold a broadly 'western' perspective on foreign affairs, and have economies with a significant agricultural base and relatively efficient production methods. The claim of similarity cannot, however, be sustained in the face of more thorough analysis.

First, and central to the argument made in this paper, the positioning of Australian tariff policy is different from New Zealand's. In 2000, the Australian Productivity Commission published a 'Review of Australia's General tariff Arrangements' in which it recommended that both the 5 per cent general tariff, which is applied to over 50 per cent of Australia's total imports, and the unpopular 3 per cent special tariff on business inputs be reduced to zero (Australian Productivity Commission, 2000:139). The Australian Treasurer (Hon Peter Costello), however, specifically rejected the recommendations of the Productivity Commission in December 2000. Costello (2000) said that the retention of both tariffs was beneficial to achieving 'trade objectives' and that the combination of Australia's past liberalisation record with current remaining tariffs would provide it with a 'powerful bargaining position in future trade negotiations'. While the tariffs may appear small, they have been big enough to cause a political struggle within Australia and to catch the eye of the private sector (and consequently the trade negotiators) in the US. This strategy of deliberately keeping a trade bargaining chip, even if a relatively modest one, differs significantly from New Zealand's strategy of promoting almost completely free trade through demonstration (Hon Jim Sutton's recent comments mentioned above notwithstanding).

Second, Australia is more important than New Zealand to US exporters. Australia is the thirteenth largest importer of American goods in the world, providing over seven times the foreign exchange revenue to the US than does New Zealand. Additionally, the US States that benefit most from Australian exports including Iowa, Illinois, Kansas, and Wisconsin (for whom Australia ranks among the top ten export destinations) are also those that would stand to lose from an increase in Australian agricultural products entering the US. Australia imported approximately A$540million worth of farm machinery from the US in 2002, including over A$200million worth of tractors (Department of Foreign Affairs and Trade, 2003:308-311), much of which was manufactured in the States mentioned above. New Zealand imported comparatively very little of these items. This fact may serve to dull the opposition of some farming-State legislators to a possible Australia FTA, because what some of their constituents lose through increased

commodity competition, others gain through increases in machinery sales. Thus the negotiating problem facing Australia in relation to the US Congress seems to have more similarities to Singapore's than it does to New Zealand's. In addition, the US has consistently exported to Australia about double the amount of goods as it imports from it, while the balance of trade with New Zealand has declined for the US in recent years, becoming essentially balanced at the end of 2001.

Third, the foreign policy differences between New Zealand and Australia are not limited to the 2003 Iraq war. New Zealand has taken a different position from the US on many international issues of note, including nuclear weapons and ships, the International Criminal Court and the Kyoto protocol on climate change. Indeed, some New Zealand officials stated privately that they are still confronted with the nuclear ships policy during discussions with some US legislators and officials, almost twenty years after its adoption. Australia, on the other hand, has carefully avoided offending the US on any of these issues. Prime Minister John Howard's infamous declaration of his desire that Australia be America's 'Deputy Sheriff in the Pacific' evidently extended to more than just military matters. Thus even if the trade policy postures of the two countries were the same (which they are not), and the two countries were of equal importance to the US (which they are not), New Zealand would need to change much more than its policy on Iraq before the cases would be indistinguishable in the eyes of the US.

Some New Zealand officials have suggested that an Australia-US FTA should come with an extension of the agreement, along the terms negotiated by Australia and the US, to New Zealand. The argument here is that the addition is natural (given the CER relationship) and costless to the US given that the terms would be unaltered from the bilateral agreement. The analysis above, however, suggests that such an extension would have gloomy prospects because it would be unlikely to be seen as beneficial or costless by the US agriculture lobby and therefore by a significant number of US Senators.

In addition, it is worth noting that the terms of an Australia-US FTA are likely to be far from the terms considered in Bergsten and Scollay case for a 'model FTA' between New Zealand and the US. The Australia-US negotiations are seeking to secure for US business lengthy adjustment periods in terms of tariffs, or in some politically sensitive cases zero change from the status quo, while requiring Australia to dismantle not only its remaining tariffs but also certain quarantine laws, producer boards, and even health bureaucracies. It seems that Australia and the US may be negotiating not an FTA in the full sense of the term, but rather an fTA, an (F)TA, or even just a TA. New Zealand officials have stated on many occasions that they are interested in trade agreements only if they are comprehensive (with the agriculture sector fully on the table), and the US has continually signalled that it isn't prepared to enter into model FTAs, especially when it comes to agriculture. This set of circumstances either calls into question the New Zealand government's willingness to sign such a watered-down agreement, or alternatively further calls into question the empirical findings of Bergsten and Scollay, given that they are based on a 'model' agreement when the prospects of such an agreement being negotiated are dim.

Conclusion

What is to be done about this situation? It has been shown that a US-New Zealand FTA is most unlikely given the trade policies of the two countries. Can this be changed somehow? Unfortunately not.

The first option open to New Zealand is to continue its policy of persuasion, hoping to convince the affected US legislators and their constituencies that a New Zealand FTA will not be as harmful as they might fear. For it to succeed, this policy would need to convince the powerful US agricultural lobby to take an enormous risk. History has shown that US farmers are very happy with their current privileged position, and that they have the political clout to ensure that their position remains intact. This paper has shown that current efforts to persuade them to relinquish this position to some extent are unlikely to succeed.

A second option that some might consider is for New Zealand to threaten to re-impose tariffs (up to the legally permissible WTO Bound Rates) if others do not negotiate with them for FTAs. Such a threat would, however, be entirely non-credible. The purpose of market distorting tariffs is to protect inefficient locally owned industry from foreign competition. Once a significant period goes by without tariff protection the size of such local industry falls significantly, often to zero. The demise of the New Zealand car manufacturing industry, and the decline in the locally owned apparel and computer operations are good examples of this phenomenon. In this situation, the re-imposition of tariffs serves to increase prices to consumers (thus lowering their quality of life) without the countervailing benefit of protecting local industries. Put simply, there aren't many uncompetitive local jobs to protect any more. Knowing this, other countries would view any threat to impose tariffs with contempt.

Some contend that a number of US trade liberalisation strategies are *consistent with* an FTA with New Zealand. This paper has shown, however, that no such strategy *relies on* a New Zealand FTA, that strong domestic political incentives provide formidable barriers to the passage of an FTA, and that there is very little bilateral trading interest in such a deal from the US-side.

The main conclusion of this paper, that New Zealand will probably not get tariff-free access to American markets until a WTO- or APEC-wide deal is struck, will come as a blow to many in New Zealand. Kiwi exporters would have much to gain from a New Zealand-US FTA, and they will be rightly disappointed at this finding.

None of this, however, is intended to make the argument that unilateral liberalisation was a mistake. In order to attempt such an argument, one would need to take into account not only the negotiating costs outlined here (with the caveat that it is always possible that the US wouldn't have dealt with New Zealand in any event), but also the costs in terms of lost jobs in previously protected industries. In addition, one must consider the enormous benefits in terms of the decreased price and increased quality and choice of goods and services available post-liberalisation to New Zealanders. This topic (framed in more general terms) is one of the most controversial and complicated facing the field of international

political economy, and is certainly beyond the scope of this narrowly focussed paper. Some of the leading technical contributions on this general question are Frankel and Romer (1999), Lindert and Williamson (2002), Dollar and Kraay (2001) and Rodrik and Rodriguez (2001). Leading non-technical contributions include Stiglitz (2002) and Easterly (1999).

There is, however, a silver lining to this paper's gloomy finding in relation to a New Zealand-US FTA. For many years, New Zealand has held an independent foreign policy. It does not take orders from large powers on questions of international peace and security, and it takes justifiable pride in that. In recent times, however, some senior National Party politicians have questioned whether New Zealand can afford such an independent stance, given the economic ramifications it may have. What this paper has shown is that trading relations with the US cannot advance on a bilateral basis much past where they are now, regardless of New Zealand's foreign policy position. This should, in fact, give policy makers some solace. New Zealand can continue to take a strong stance abroad, opposing aggression and injustice whatever its source, without worrying too much about its economic impact at home. Obviously, this does not give New Zealand policy makers absolute license to upset the US or any other powerful country — the current levels of trade access that New Zealand enjoys can ultimately be taken away if New Zealand foreign policy goes completely feral. But the realisation that foreign policy friendliness cannot lead to FTA gains significantly broadens the range of feasible foreign policy positions available to New Zealand governments.

One positive but unintended consequence of New Zealand's recent trade policy has been to insulate the other areas of its foreign policy from our trading relations with other western countries. While the lost economic opportunity stemming from New Zealand's recent trade policy should be mourned, the other foreign policy gains are worth celebrating.

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