

New Zealand Business Roundtable

SUBMISSION ON THE POST-2005 TARIFF REVIEW

April 2002

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Executive Summary

- The New Zealand Business Roundtable submits that the best way for the government to eliminate uncertainty created by the current tariff freeze would be to announce that the programme of tariff reductions in place prior to the freeze is to resume in 2005.
- As with all policies with economy-wide implications, decisions regarding the future of tariffs should be made with regard to overall New Zealand interests rather than effects on particular regions or sections of the population. Tariffs are a tax on exporters, distort economic activity and reduce potential national income. Tariff reform should be viewed as part of a general strategy to foster more rapid economic growth and to deepen New Zealand's international linkages.
- New Zealand will benefit from removal of its tariff barriers even if other countries do not reciprocate. Tariff reductions should therefore not depend on reciprocal actions by other countries. Tariffs undermine New Zealand's international credibility as an opponent of protectionist policies, particularly in agriculture. It is in New Zealand's economic and diplomatic interests to adopt free trade unilaterally.
- Over the last 20 years, reductions in New Zealand's trade barriers have gone a long way toward removing an important impediment to economic growth. This reform needs to be completed to ensure that business decisions are made on the basis of prices that reflect the realities of the international trading environment, to eliminate costs associated with tariff administration and to discourage a waste of resources in lobbying activities.

- Liberalisation has been ongoing for over 20 years, including for the textile, clothing and footwear industries. New Zealand firms have had ample time to plan for the removal of protection, and the remaining adjustments facing some industries are not large by comparison with earlier requirements.
- Remaining tariffs should be removed rapidly to capture the earliest possible benefits of improved resource allocation and efficiency to economic growth. Free trade should be achieved well within the timetable adopted by APEC leaders for the removal of tariffs by developed country members by 2010.
- The program of tariff reductions should give priority to reducing the highest tariffs, since these are generally associated with the greatest distortion of resource use. In the interests of reducing administrative and compliance costs, tariffs should be eliminated when they fall below 5 percent.
- The tariff concession system should become a one-way street. Duty free entry should be allowed if local production of a good ceases and should remain in place until tariffs are eliminated.

1 Introduction

- 1.1 This submission is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound policies that advance overall New Zealand interests.
- 1.2 In announcing this review of tariff policy, the minister of commerce indicated that its purpose is "to give some certainty to business about the future". The NZBR is concerned that the review has potential to add to uncertainty rather than diminish it. The business community at large accepted the programme of tariff reductions that was in place prior to current tariff freeze. The best way for the government to eliminate uncertainty created by the tariff freeze would be to announce that the programme of reductions in tariffs in place prior to the freeze will resume after the freeze ends.
- 1.3 The views that the NZBR presents in this submission are essentially the same as it presented to the 1998 tariff review. Nothing that has happened in the intervening period warrants any change of view concerning the effects of tariff reductions or the appropriate timing and pace of tariff reductions.

2 Effects of tariff reductions

- 2.1 It is not possible for decisions made by individual firms to make the best use of resources, consistent with overall New Zealand interests, if those decisions are based on domestic prices that do not reflect the realities of the international trading environment. When governments impose tariffs, what they are doing, in effect, is to send instructions to businesses to respond to a set of prices that differ from those established in international markets. What is the rationale for this? Even the most ardent defenders of tariffs seem to be reluctant to claim these days that the price signals resulting from tariffs are superior to those that would otherwise guide

resource allocation. The continued existence of tariffs in New Zealand is merely a legacy of old policy mistakes that should be rectified as soon as possible.

2.2 Trade liberalisation since the mid-1980s has gone a long way toward removing a major distortion and impediment to economic growth in New Zealand. Industries are no longer given almost unlimited government assistance to produce for the small domestic market irrespective of cost, as was the case under import licensing. Firms no longer play the role of mendicants, looking to the government to protect them from international competition instead of seeking ways to improve their international competitiveness. Yet this transformation remains incomplete. Tariffs continue to distort incentives, misallocate resources and reduce per capita income levels.

2.3 As tariffs fall, their adverse effects on the allocation of resources among different industries tend to diminish more than proportionately. This might suggest that when tariffs are low there is not much to be gained from reducing them further. This view is mistaken, however. It ignores the costs of administering the tariff system, including costs to businesses as well as to the government. It also ignores the benefits of a zero benchmark in discouraging rent seeking, the waste of resources in seeking further government assistance. It is much more difficult for those who are tempted to seek tariff assistance to make a case when no other industry has it than to argue that one industry should be granted the same assistance as some other industry.

3 Timing of further tariff reductions

3.1 The NZBR submits that following the end of the tariff freeze all tariffs should be removed rapidly. As tariffs are now relatively low, the adjustments required by industries are not large. Firms would have two years' notice even if all tariffs were removed in 2005. Free trade should be achieved well within the APEC timetable for developed countries established at Bogor.

4 The question of reciprocity

4.1 New Zealand stands to benefit from unilateral tariff reductions, even if other countries do not follow suit. The benefits of unilateral free trade are analogous to the health benefits of giving up smoking. People benefit when they stop smoking unilaterally even when other smokers continue to pollute the atmosphere. Retaining tariffs in New Zealand does not alleviate the problems of New Zealand industries facing tariffs in overseas markets and, because tariffs are a tax on exports, imposes additional costs on them.

4.2 Furthermore, New Zealand does not gain 'negotiating coin' by retaining tariffs. There is no evidence that unilateral liberalisation has cost New Zealand access opportunities in other markets. New Zealand is simply too small for reciprocity to be a consideration in most other countries' policies. A move to full free trade would improve New Zealand's attractiveness as a candidate for free trade agreements with countries like the United States, and would remove irritants in negotiating such agreements such as rules of origin requirements. In a World Trade Organisation context, reciprocity hinges on bound tariff rates, not actual rates. Thus by proceeding with unilateral liberalisation, New Zealand gains the best of both worlds – domestic economic benefits plus recognition for its efforts in subsequent multilateral negotiations.

5 Should a uniform rate of tariff reduction apply to all industries?

5.1 As a general rule, an approach to tariff reductions in which high rates are subject to reductions that are at least proportionate to low rates is desirable in order to give highest priority to reducing the largest price distortions. In the interests of reducing administrative and compliance costs, however, it is desirable to eliminate tariffs in one step when they reach low levels (below 5 percent).

6 What should happen to tariff concessions?

6.1 The NZBR submits that when tariff reductions are resumed the tariff concession system should become a one-way street. If local production of a good ceases, duty free entry should be allowed under existing rules. This will enable firms which use

these goods as inputs to obtain them at international prices sooner than would otherwise be possible. In order to reduce uncertainty, however, once goods are subject to duty free entry they should remain subject to duty free entry until the relevant tariffs are eliminated.

7 The broader context of tariff reform

- 7.1 It is difficult to find anyone these days who is prepared to defend tariffs on the grounds that they are a good way to promote economic growth, equity in income distribution or any other national objective. There is ample evidence that free trade promotes economic and employment growth, including in many regions, and benefits the poorest section of the population. Tariffs such as those on textiles, clothing and footwear are regressive – they hurt low income people most. Arguments are still sometimes advanced that further tariff reductions are undesirable because of claimed adverse effects on some regions or the well-being of some section of the population. However, whether or not particular sectors are affected should not be the decisive factor in determining future tariff policies. When tariff and other policies that have economy-wide implications are decided in the interests of particular regions or groups, this is detrimental to the well-being of the population as a whole. The logic of providing tariffs to benefit particular groups extends easily to suggest, for example, that export subsidies should be provided to benefit other groups, that regulations should be used to protect particular firms from competition, and so forth. An approach to policy-making that puts the interests of particular groups ahead of the interests of the general community must inevitably end up stifling economic growth.
- 7.2 Further tariff reductions should be viewed as one of a range of policy measures required to foster more rapid economic growth and achieve the government's goal of restoring New Zealand to the top half of the OECD income rankings. Adoption of other policies to foster economic growth, for example reductions in government spending and regulatory reforms, would do a great deal to alleviate problems of adjustment for firms and individuals affected by tariff reductions.

7.3 Further tariff reductions should also be viewed as part of a general strategy to deepen New Zealand's international linkages with other countries, particularly the United States. The potential benefits of such linkages extend far beyond reductions in trade barriers. If New Zealand is clearly committed to reducing trade barriers and following other policies to foster economic growth, it is reasonable to expect that it will be seen as a more desirable candidate for strengthening business and investment linkages than if it is perceived to be looking for a free ride to prosperity by hitching its wagon to a leading economy.