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Towards CANZCERTA?: The feasibility of Canada's entry into the Australia-New Zealand CER

Brent Cameron has kindly donated this essay to Commonwealth Exchange (CX) as a discussion piece on closer economic ties between Australia, Canada, and New Zealand.

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The following discussion paper reviews the trade relationship between Canada and the ANZCERTA nations – Australia and New Zealand – and examines the potential for a comprehensive trilateral trade agreement based on the already existing CER treaty. Brent Cameron is the author of "The Case for Commonwealth Free Trade: Options for a new globalization," published in Victoria, Canada by Trafford Publishing, 2005, (ISBN 1-4120-4277-1). He is a member of the Advisory Board of the Commonwealth Exchange. The opinions expressed in this document are solely those of the author.

Introduction

The global economy has undergone a dramatic transformation over the last two decades. The emergence of new economic powers such as China and India, combined with the consolidation of traditional powers – as witnessed in the evolution of the European Union (EU) have redefined how the world does business. At the same time, the developed world has continued to labour past the systemic shocks created in the economic crisis of 2008. Progress has been slow, and recovery has been, at best, anemic.

Against this backdrop, nations such as Canada are presented with the challenge of developing new strategies, not only to recover and preserve past economic gains, but also to build a foundation for future success. The demands of the evolving global economy, and a heavy reliance on exports to the United States, require Canada to explore trading relationships that are complimentary to its existing profile.

The current Conservative government under Prime Minister Stephen Harper has been actively pursuing trading opportunities beyond North America. Since taking office in 2006, the government has ratified, or is negotiating, a number of free trade agreements, including with Colombia, and the EU. Recently, Canada also joined the effort to conclude a far-reaching agreement among nations bordering the Pacific – the 'Trans-Pacific Partnership.'

An assertive trade promotion strategy is fundamental to future prosperity, but there is no guarantee that any bilateral, or multilateral, agreement will live up to its expectations. Critics of trade liberalisation point to the all-too-often realised fact that 'free trade' is not always 'fair trade'.

Research done on international trade flows indicates that successful trade agreements occur where the parties involved share similar attributes. Many factors include geographical proximity and limited exchange rate volatility (Frankel, 2000). Just as important to this are social, cultural, political, and linguistic attributes that have a measurable multiplier effect on trade flows. Research commissioned by the Commonwealth Heads of Government isolated and identified such a phenomenon – styled the "Commonwealth Effect" – that could lower the costs of bilateral trade by up to ten per cent, even in the absence of a free trade agreement.[1]

Based on the need for trade diversification beyond NAFTA, and in light of the factors that promote trade, it is the thesis of this paper that Canada should explore the possibility of negotiating a trade relationship with Australia and New Zealand, including a possible entry into the Australia-New Zealand Closer Economic Relations Agreement (ANZCERTA).

In reviewing the arguments in favour of a tripartite agreement, we will examine the following:

1. The impact of ANZCERTA on Australia – New Zealand trade;

2. The recent history of Canadian trade with Australia and New Zealand; and,

3. The application of trade flow modelling on existing trade levels.

Through the application of this modelling, it will be demonstrated that not only would some form of an expanded agreement be successful for Canada – particularly in value-added manufacturing and technology services - but that it would also benefit Australia and New Zealand, as well as provide a stable core for further scalability within the Commonwealth.[2]

The question that will remain to be discussed will be the actual form of Canadian participation in ANZCERTA, which could range from separate bilateral agreements with both parties, to full entry into the treaty, to a more limited agreement on specific sectors and services.

History of ANZCERTA

The first Australia-New Zealand FTA was concluded in 1963, and came into force in January of 1966. It was, in the view of the Australian government, somewhat problematic due to its limited scope, the lack of a timeframe for reducing many tariffs, and the 'consultative committee' process employed to resolve disputes.[3]

In order to resolve these perceived shortcomings, both nations concluded a new treaty – the Australia-New Zealand Closer Economic Relations Agreement, or ANZCERTA, in 1983. Unlike its predecessor, ANZCERTA specifically outlines a timetable for the reduction of tariffs and trade barriers, starting immediately and gradually completing by 1995. The success of the agreement by 1987 had encouraged the parties to move this final date forward to 1993.

It is important for us to recognize that ANZCERTA goes well beyond the usual territory of a Free Trade Agreement. In fact, it sets the objective of not only harmonizing tariffs and duties, but also a harmonizing of government regulations – from competition policy, to labour, health and safety standards. Though not as ambitious as the degree of political and economic integration being sought by the European Union (EU), the ANZCERTA treaty does require a level of policy integration that goes beyond what one would see, for example, in NAFTA.

Despite this, neither the governments of Australia or New Zealand appear overtly concerned about issues of sovereignty. No popular political movement in either jurisdiction seems to be advocating an end to ANZCERTA, or a rolling back of its provisions.

Three reasons for this lack of concern may be:

1. The relative success and prosperity enjoyed by both nations as a result of ANZCERTA;
2. A consensus that those areas of jurisdiction that have been harmonized do not fundamentally alter or affect the exercise of general sovereignty or popular democracy; and,
3. The fundamental character of both nations – political, legal, social, cultural, historical, and economic – are so close that harmonization does not equate with a dramatic shift in policy or stance.

The effect of ANZCERTA on Australia-New Zealand trade

Since the first FTA was brought into effect nearly four decades ago, trans-Tasman trade has become an important part of each nation's economic profile. According to the Australian government's Department of Foreign Affairs and Trade (DFAT), both nations are each other's primary market for exports as well as imports. Australia represents 15.3 percent of New Zealand's imports and 21.4 percent of its exports[4]. This makes Australia the largest customer for New Zealand exports, and the second largest source (behind China) for its imports.

For Australia, however, Japan, the United States, Korea and China are all larger export markets than New Zealand, although it remains significant. In terms of imports, despite the significance of that market to New Zealand, Australia imports more from five other nations (China, the US, Japan, Singapore and Germany).[5] It is, however, a very balanced partnership. Based on 2012 merchandise trade figures, Australia bought almost as much from New Zealand (A$7.27 billion) as it sold to that country (A$7.41 billion). This meant that on an overall volume of A$14.688 billion, New Zealand's trade deficit with Australia was only A$138 million, or 0.94 per cent of the total amount traded.[6] In effect, the Australia – New Zealand trade relationship approaches the balance point that all free trade agreements aspire to achieve, that of reciprocity.

Given the differences in population (Australia – 22.68 million; New Zealand – 4.46 million) and size of national nominal GDP (Australia- US$1.54 trillion; New Zealand – US$182.9 billion),[7] it is not surprising that the ANZCERTA relationship may represent more of a priority for decisionmakers in Wellington over their Canberra counterparts. In this respect, the political and diplomatic imperatives may be just as important as the trade component.

Trade challenges for Canada, Australia and New Zealand

Like Canada, the growth of the Australian and New Zealand economies has been the result first of initial colonization and exploitation by the British empire, then as independent and mature developed economies after the Second World War.

With some limited exceptions in the Pacific theatre, none of the three countries were physically attacked, or sustained damage to their industrial infrastructure. Moreover, as sources of raw materials and safe manufacturing sites for armaments, industrialization and productive capacity was higher after 1945.

All three nations were successful in their shift from Imperial Preferential to the new post-war multilateral economic framework, including Bretton Woods, the IMF, and the GATT. As part of the US-led western alliance posed against the Soviet sphere of influence, the relative power and influence of each of the three countries rose commensurately.

With the end of the Cold War, and the developing trends in globalization, each of the three nations have been faced with the challenge of preserving post-World War II gains in an environment where there is no greater client state to act as an economic guarantor (Britain, US). That is, rather than simply fitting neatly into a political, geographic, or ideological bloc, each of the three nations must navigate their own course and seek out opportunities on their own.

For Canada, this has meant deeper economic integration with the United States, while for Australia and New Zealand, it has meant closer ties between the two neighbours, as well as a focus on opportunities present in the Asia-Pacific region. These strategies are, however, not without their challenges. In both, there is the ever-present concern about vulnerability to larger, more powerful partners that might result in pressure to compromise positions in the national interest. Such has been the historical concern of Canadian leaders vis-à-vis their American counterparts, where both the difference in population and in GDP provides the United States with a 10:1 advantage ratio. The issue is even greater with Australia and New Zealand. They operate in a region dominated with nations such as Japan and China, where the shared history and attributes are not as broad and are relatively recent, As well, when combined, the two countries equal Canada on both counts.

Nevertheless, all three nations, at present, are performing well economically, with their respective governments running current account surpluses. In terms of exchange rates, the Canadian dollar, while maintaining a sustained level of near-parity with the US dollar, has remained somewhat stable against the Australian[8] and New Zealand[9] currencies, considering the impact of resource prices on all three, as well as the volume of Australian and New Zealand dollars in play relative to Canadian currency.

Canada-ANZCERTA Trade

Using 2009 data, merchandise trade between Canada and ANZCERTA[10] was as follows:

Canadian imports from ANZCERTA	C$2.1 billion
Canadian exports to ANZCERTA	C$2.1 billion
Total trade	C$4.2 billion
Trade balance – Canada (surplus / deficit)	C$0.00 (0.0 %)

In 2007, services trade between Canada and ANZCERTA[11] was as follows:

Canadian imports from ANZCERTA	C$709 million
Canadian exports to ANZCERTA	C$857 million
Total trade	C$1.566 billion
Trade balance – Canada (surplus / deficit)	C$148 million (9.45 %)

Taking both goods (2009) and services (2007) together, the aggregate would be:

Canadian imports from ANZCERTA	C$2.809 billion
Canadian exports to ANZCERTA	C$2.957 billion
Total trade	C$5.766 billion
Trade balance – Canada (surplus / deficit)	C$148 million (2.56 %)

Main Australian exports to Canada in 2009 included inorganic chemicals ($388.5), mineral ores ($264.9), beverages ($252.3), machinery ($158.2), and meat ($95.0), while Canadian exports to Australia included machinery (C$447.4 million), aircraft & spacecraft (C$207.9 million), meat (C$139.5 million), electrical and electronic equipment (C$102.7 million), and scientific and precision instruments (C$68.3 million).[12]

New Zealand's exports to Canada in 2009 included meat (C$186.9 million), beverages (C$55.2 million), albumins, modified starch, glue (C$39 million), dairy products (C$31.5 million), and fruits and nuts (C$23.7 million). Canadian exports to New Zealand during this period included fertilizers (C$47.2 million), aerospace products (C$39.6 million), machinery (C$32.4 million), meat (C$27.1 million), as well as electrical and electronic equipment (C$16.2 million).[13]

Application of trade flow gravity model

Research done by Jeffrey Frankel of Harvard University assessed the various factors that contributed to trade facilitation. In his study, Frankel quantified the following factors that inhibit trade[14]:

Trade Inhibiting Factor	Impact on trade (reduction)
Presence of border	33%
Not adjacent geographically	50%
Separate currency	33%
Exchange rate volatility	87%
Different language	50%

No FTA	33%

Table 1: Trade Flows Gravity Model

This research seems to suggest that the combination of a common language and a FTA can have an impact on trade flows great enough to compensate for currency differences and geographical separation – an impact comparable to sharing a contiguous border with a trade partner (e.g.: Canada and the United States, France and Germany).

An appropriate application of the Efficiency Gains Model developed by Frankel would involve studying existing trade flows between the principals (ANZCERTA, Canada), and applying those factors that would be impacted by the creation of a Canada – ANZCERTA agreement of any degree.

Given that geography, fixed borders, separate currencies, and language are fixed, and that we accept that exchange rate volatility between the three national currencies remains in a constant pattern, the only variable in the Frankel model that would apply to the proposed configuration would be the impact of a FTA. If we are to accept that the lack of such an agreement presents a 33% degrading of trade flows, then the existence of a FTA would have the opposite effect.

Therefore, for this particular model, we will work from the premise that Canada's full inclusion into the existing ANZCERTA will increase volumes of imports and exports by one-third.

Using the above data included, we can extrapolate the following:

Jurisdiction	Merchandise (2009), Services (2007) - actual (C$ million)	CANZCERTA model (C$ million)	Change
Canada to ANZCERTA	2.957	3.941	984.68
ANZCERTA to Canada	2.089	2.784	695.63

Table 2: Trade flows between Canada and ANZCERTA

This, however, is a simple arithmetic model that may not fully take into account several factors, including:

1. The impact of product substitution within the tripartite agreement, which may cause demand for certain goods and services to shift from one source to another;
2. Increases in per capita GDP in one or more member states, which may lead to increased consumption for specific imported products;

3. The impact of capital mobility, which may see one or more member states experience increased investment in infrastructure (transportation, telecommunications, etc.); and,
4. Enhanced access to vital natural resources, and variances in global commodity prices (e.g: Australian precious metals, Canadian oil and natural gas);
5. The increasing role of electronic commercial activity, primarily in the financial services sector, where geographical constraints to trade are nullified.

Any variance in these factors could adjust trade balances within a proposed CANZCERTA. Indeed, as evidenced by the impact of higher energy prices on trade between Canada and the United States, volumes in this commodity alone could represent enough of a shift in the balance of Canada –Australia trade, or Canada – New Zealand trade.

Challenges and options for Canada-ANZCERTA trade

With reference to trade with the ANZCERTA, there are three distinct approaches that Canada may consider – bilateral trade agreements with Australia and New Zealand, full entry into ANZCERTA, or a Canada-ANZCERTA agreement relating only to specific goods and services, with the option of expansion to other areas on a mutually agreed upon schedule.

The first option is attractive in the sense that agreement with one ANZCERTA party is not contingent on agreement with both. Also, as we have seen with NAFTA (which is not one, but three, intersecting agreements), there is the opportunity to adjust the specific terms of the respective agreements to suit particular objectives – namely access to a particular sector in one jurisdiction.[15]

While this may yield some marginal benefits, it is the least optimal of the three approaches. It assumes that such accommodations are necessary to achieving a tangible benefit for specific Canadian interests. One could counter that the greater benefit for Canada and her partners lies in a more comprehensive agreement – one that reduces internal zone impediments to a minimum.

Let us assume, for example, that Canada negotiates separately and successfully with Australia and New Zealand. We can also assume that the "rules of origin" clauses are unique to each agreement. Australian manufacturers and marketers who are sourcing with Canadian materials may find that while there are no limitations selling within the Australian market, that Canadian content may be subject to a minimum tariff when shipped to New Zealand. They would compare this to the fact that no such problem exists with either Australian or New Zealand inputs, and they would decide accordingly.

Separate bilateral treaties may help in fostering Canada-Australia trade, or Canada-New Zealand trade, but inclusion in ANZCERTA would have the additional benefit of Canadian business being able to serve the Australia-New Zealand trade flow.

In this respect, there are fewer more suitable partners than Australia and New Zealand. As both of these nations already possess a successful free trade relationship, the best long-term option would be for Canada to lobby both for inclusion in the CER. In the short- to medium-term, however, it may be more feasible to conclude a Canada-ANZCERTA where agreement is limited to specific sectors, with the possibility of further expansion upon mutual consent.

Such a strategy would avoid potential problems arising from ANZCERTA objections to Canadian agricultural marketing boards, or Canadian interest in clauses relating to the automotive sector – an area not specifically covered by ANZCERTA.[16] Moreover, it would avoid a broader debate on the issue of harmonizing business and competition law, either due to Canadian reluctance on issues of sovereignty, or the accommodations that Canadian entry into ANZCERTA would require of Australia and New Zealand regulations. Given that the population and GDP of Canada exceeds that of Australia and New Zealand combined, political pressure to garner concessions is always a temptation for negotiators.

The Political Environment

Trade agreements should, at their core, be about liberalising commercial flows between jurisdictions for mutual benefit. In reality, free trade treaties are as much about politics as they are about economics. This is why the record of free trade agreements around the world is inconsistent. Gains are often unequal, or at the very least, fall below expectations. Canada needs to pursue other promising markets if it is to ensure opportunity for its citizens. Just as important, Canada needs to establish such relationships with partners who are compatible on a wide range of economic and structural measures, if these partnerships are to be effective.

Modern free trade agreements often are akin to marriages of convenience, where compatibility takes a back seat to other considerations. Such agreements always look better on paper than they do in practice. ANZCERTA, on the other hand, represents a stable and successful partnership precisely because there is compatibility between the signatories. Those attributes are also shared by Canada, and its entry into the agreements should derive sustainable benefit to all involved.

For the first time in decades, the political leadership of all three nations is philosophically predisposed to such a proposal. Australian PM Tony Abbott has recently received a mandate that will carry to 2017, while New Zealand PM John Key and Canadian PM Stephen Harper have mandates that extend to 2015.

While it is unlikely that a change of government in Ottawa or Wellington would result in the cancellation of existing trade negotiations, it is equally unlikely that opposition leaders in either Parliament would be prepared to initiate talks. Regardless of the economic conditions, it is the political environment that will determine whether Canada would, or could, join ANZCERTA. That environment could become more difficult in

2015. Only those negotiations already begun would be rooted enough to withstand that change.

Conclusion

Given the opportunities present in the ANZCERTA market, the trade enhancing attributes shared by Canada, Australia, and New Zealand, as well as the already established trend toward increased trade, the establishment of an enhanced trading relationship between Canada and ANZCERTA is a logical and beneficial strategy to pursue. In particular, Canadian business involved in leading-edge manufacturing and technology services, who already comprise the bulk of Canadian exports to Australia and New Zealand, should derive great benefit from even more enhanced access.

It should also be pointed out that a successful trade agreement between the three developed Commonwealth economies, each among the most robust in the G20, could represent the 'critical mass' needed for a 'Commonwealth Free Trade Agreement (CFTA). An orderly and phased expansion could, in its initial stages, include Singapore and India, with further growth toward member states who could meet the economic and political criteria for entry.

What remains for Canadian decisionmakers would be to determine the scope and extent to which a final agreement would apply. Over time, depending upon the successful functioning of such an agreement, it is possible that Canada may wish to pursue a deeper relationship with her Commonwealth trading partners in ANZCERTA – just as both Australia and New Zealand concluded seventeen years after their first free trade agreement came into effect.

While trade with ANZCERTA will not supplant that of the United States, it represents both a means to diversify Canada's export mix, as well as the core of a possible new global trade strategy that will enhance Canadian economic prospects in the coming years.

The economic and political conditions have never been better for Canada to act, and for Australia and New Zealand to respond positively.

Endnotes:

[1] Lundan, Sarianna M. and Jones, Geoffrey, "The 'Commonwealth Effect' and the Process of Internationalisation," in *The World Economy* 24 (1), (London: Blackwell Publishing, January, 2001), 99-118.

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[3] Government of Australia, "*Australia-New Zealand- Competition Law and Administration-*

What next across the Tasman?"
http://tpareview.treasury.gov.au/content/subs/133_AttachmentC_SpierConsulting.rtf, downloaded March 1, 2006.

[4] Department of Foreign Affairs and Trade, Government of Australia, "*New Zealand: Fact Sheet*," http://www.dfat.gov.au/geo/fs/nz.pdf, downloaded September 23, 2013.

[5] Department of Foreign Affairs and Trade, Government of Australia, "*Australia: Fact Sheet*," http://www.dfat.gov.au/geo/fs/aust.pdf, downloaded September 23rd , 2013.

[6] Department of Foreign Affairs and Trade, Government of Australia, "*New Zealand: Fact Sheet*," http://www.dfat.gov.au/geo/fs/nz.pdf, downloaded September 23rd , 2013.

[7] Population and GDP figures based on 2012 data.

[8] Tracked from May 1st, 2013 to September 23rd, 2013, the Australian dollar traded at a high of C$1.01 to A$1.00, with an average of C$0.966 per Australian dollar, http://www.x-rates.com/d/AUD/CAD/data30.html, downloaded September 23rd , 2013.

[9] Tracked from May 1st, 2013 to September 23rd, 2013, the New Zealand dollar traded at a high of NZ$ 1.16 to C$1.00, which has also been its effective average over the same time period, http://www.x-rates.com/d/NZD/CAD/data120.html, downloaded September 23rd , 2013.

[10] Foreign Affairs, Trade and Development Canada, "Canada's Priority Markets – Australia and New Zealand," http://www.international.gc.ca/strategy-strategie/r4.aspx , downloaded September 23, 2013.

[11] Ibid.," http://www.international.gc.ca/strategy-strategie/r4.aspx , downloaded September 23, 2013.

[12] Ibid," http://www.international.gc.ca/strategy-strategie/r4.aspx , downloaded September 23, 2013.

[13] Ibid.," http://www.international.gc.ca/strategy-strategie/r4.aspx , downloaded September 23, 2013.

[14] Frankel, Jeffrey A., "*Assessing the Efficiency Gains from Further Liberalization*," John F. Kennedy School of Government, Harvard University, Faculty Research Working Papers Series, RWP01-030, December, 2000.

[15] This is reflected in NAFTA, where the United States negotiated the creation of a unified energy market with Canada, but do not have the equivalent agreement with Mexico.

[16] Government of Australia, Department of Foreign Affairs and Trade, "*An Australia-United States Free Trade Agreement - Issues and Implications*," http://www.dfat.gov.au/publications/aus_us_fta_mon/Annex7.pdf, downloaded March 1, 2006.