

Tim Groser

The CER Negotiations the real backstory

Abstract

This article is an ‘insider’s account’ of the background to the negotiation of New Zealand’s first comprehensive bilateral trade agreement, the Australia–New Zealand Closer Economic Relations Trade Agreement, or CER. It argues that this agreement marked the first step in the process of a systematic reform of the New Zealand economy along orthodox liberal economic principles, and, in that sense, anticipated the comprehensive internal economic reforms initiated some two years later by the Labour government headed by David Lange. It analyses key ‘drivers’ of CER: the growing realisation that New Zealand was falling further and further behind Australia in its living standards, and the shock of the entry of the UK into the EEC, which forced a diversification of New Zealand trade and foreign policy away from the United Kingdom towards the Asia-Pacific region. It includes a critical re-evaluation of the role of Prime Minister Robert Muldoon in the negotiations during a period of New Zealand political history in which he was dominant.

Keywords CER, trade policy, economic reform, EEC, Muldoon

Tim Groser began his career in the New Zealand Treasury and spent several decades in the Ministry of Foreign Affairs, specialising in international trade and economic relations. He has chaired numerous international trade negotiations; has been executive director of the Asia New Zealand Foundation; and served as New Zealand ambassador to Indonesia, the WTO and the United States. During his parliamentary career (2008–15) he held ministerial portfolios for trade, conservation and climate change issues. He is currently a visiting fellow at Victoria University of Wellington, teaching a course on global political economy.

Background

These personal reflections on the CER negotiation are an unapologetic ‘insider’s account’ of what I consider to be the most important trade negotiation in New Zealand’s economic history – most important because it was much more than a trade negotiation per se; we were, in effect, using a so-called ‘trade’ negotiation to initiate a process of changing dramatically New Zealand’s economic policy settings, which, by 1979 – the formal commencement of negotiations – were long past their use-by date.

One way or another, any reform at that time of the New Zealand economy would have to include reform of New Zealand’s highly unusual and deeply protectionist trade policy regime, because of the huge resource misallocation it implied. Given the scale of the adjustment problem and the ferocious opposition to any unilateral liberalisation programme on an MFN (most favoured nation) basis, a systematic phasing out of trade barriers on a bilateral basis with Australia seemed a more realistic starting point. This was the real CER agenda for the officials at the centre of the negotiations.

The key targets were New Zealand's then extreme system of import licensing/high industrial tariffs combined with performance-based export subsidies, which were designed to offset the worst effects of such policies on our non-agriculture exports. This is not a 'wise after the event' observation: the key New Zealand officials with responsibility for the CER negotiations were consciously strategising in exactly these terms.

That said, one must observe that had the prime minister in either country decided not to proceed, that would literally have been it, whatever the view of Australian and New Zealand senior officials – or any minister in either Cabinet – may have been. That is exactly what happened with the CER precursor negotiation ('All The Way With Schedule A'), when officials working to that implied free trade agenda found themselves stranded on a political atoll with no visible means of support when the political tide went out. It happened again in the course of the ultimately successful CER negotiations when the Australian prime minister, Malcolm Fraser, pulled the plug (thankfully, only temporarily).

More generally, it was CER, in my view at least, that represented the real political 'starting point' of the long and controversial process of reforming the New Zealand economy along market-oriented lines. It was not a matter of 'which was more important, internal or external reform?' We had to do both. In that sense, the systematic reforms of the internal New Zealand economy, put in place by the Labour government elected on 14 July 1984, were not, I believe, the initiation of the economic reform process, but a logical and essential counterpart to the reforms of frontier protection initiated by CER. I have no doubt that without these two interlocking sets of economic reform – or some theoretical comparable reform process aimed at the same objectives – New Zealand would have carried on looking – to use David Lange's memorable phrase – like a (Soviet-era) 'Polish shipyard on a bad day'.

Those who continue to decry those reforms using the usual pejorative ideological labels ('neo-liberalism') are guilty of the political sins of the Bourbons – imagining the past and remembering the future. Back

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in the mid-1970s, with persistent double-digit distortions throughout the New Zealand economy, ten years of anaemic growth in per capita incomes, a creaking fixed exchange rate system that had failed to recognise the implications of US president Richard Nixon closing the gold window some years previously, and the almost existential challenge to New Zealand's trade structures posed by the entry of the United Kingdom into the EEC, we New Zealanders were looking over the edge of an economic precipice. For better or worse, something had to give.

The CER agreement would, in time, wash away a lot of political and economic detritus that had accumulated in New Zealand. Naturally, there were many tributary streams that fed into the process and gave it political momentum. I would instance three main background influences, which were closely related.

- Driver A: the slow realisation that our standard of living was declining relative to Australia and to the world. Comparative data assembled by the great economic historian and statistician Angus Maddison shows that New Zealand's per capita income in 1900 was an estimated 107% of Australia's; in 1950 it was 117%; in 2000, 74% (Maddison, 2003). Suffice it to say that midway between the latter two data points – 1975 – we in the Treasury and other economic agencies were well aware that we were slipping dramatically off the pace.
- Driver B: the shock of the UK's entry into the European Economic Community

(now the EU), which was more than an economic shock. However, in terms of trade narrowly defined, it cut our economic umbilical cord to the 'Mother Country', in spite of the negotiation of the key transitional trading arrangement ('Protocol 18') that gave us some temporary breathing space to make our very different way in the world.

- Driver C: the refocusing of our external relationships away from the UK and Europe towards the Asia-Pacific, which would inevitably require us to redefine our relationship with Australia. On the other side of the Tasman, meanwhile, Australian decision makers, notably the then Australian deputy prime minister, Doug Anthony, but also leading officials, had, by the mid-1970s, become immensely frustrated both with New Zealand's idiosyncratic economic policies and with the existing formal framework for trans-Tasman trade (NAFTA) that accommodated those highly unusual policy settings.

Driver A: declining New Zealand per capita income – a period of reckoning

New Zealand operated the developed world's last comprehensive system of import licensing on industrial goods, and, to compound its negative impact on efficient resource allocation, we married that with extremely high tariffs in the 'protected area' (combined with zero tariffs in the 'unprotected' area, thereby raising the average effective rate of protection well above even the high nominal tariff average). This was accompanied by many deeply interventionist 'industrial policies', including foreign exchange controls.

Australia had started to move away from these policy settings long before. Australia abolished comprehensive import licensing in 1960, although that left much adjustment yet to be undertaken in the area of high industrial tariffs. I distinctly recall comparative OECD measurements of the average effective rate of protection (ERP) in our two economies: Australia had the second-highest average ERP in the developed world, yet this was no match for New Zealand – we were 'number one' and our average ERP was about twice that of Australia.

Many considered that this extreme system of protectionism was justified by

the double standards of the rest of the developed world in maintaining similarly prohibitive barriers to our extraordinarily efficient agriculture exports. And that was certainly the case until the late 1980s and early 1990s, when the Uruguay Round of GATT negotiations began to integrate agriculture into the framework of global rules that governed trade in what were called 'industrial' goods. Yet in the late 1960s and back in New Zealand, the deep and understandable resentment about developed countries' double standards on protectionism astonished – it should not have – an eminent group of World Bank economists who arrived in 1968 to produce a landmark report on the New Zealand economy. They concluded:

There is one particular argument for protectionism which seems to carry great respectability in New Zealand, even with several outstanding economists and officials. The argument is that as long as other countries, including some of the richest, pursue for their domestic agricultural products protectionist policies harmful to New Zealand, she should in turn protect her own domestic industries against their exports. (World Bank, 1968, p.44)

The second reason for the persistence of policies of high protection in New Zealand was basically that we could afford the inefficiency it implied (until reality imposed itself) – *pace* Ragnar Nurkse, one of the outstanding development economists of the mid-20th century, who once famously said, 'no country is rich enough to ignore inefficiency'. Like many comments or predictions, it was right, provided you kept repeating it for a long enough period. And our policies of extremely high protection, introduced largely in the 1930s, lasted half a century.

Driver B: the UK enters the EEC – an existential challenge

It would be a mistake to see the shock of Britain's entry into the EEC simply in trade terms. Even a cursory familiarity with New Zealand history would show our economic, political and cultural dependency on the UK. When I arrived in New Zealand from the UK in 1958 as an eight-year-old, my parents were deeply puzzled by New

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Zealanders' references to Britain as 'home'. I can recall distinctly my mother saying to New Zealanders: why do you call the UK home; isn't New Zealand your home?

But economically, New Zealand was described by the British prime minister, Harold MacMillan – with perfect metaphorical accuracy – to President de Gaulle of France as 'an English farm in the Pacific'. And for many years being Britain's 'offshore farm' was a political formula that worked, giving New Zealanders a very high standard of living by the international standards of the day. This period of our economic history was dubbed 'living off the sheep's back', our vastly efficient farming sector providing the platform for a confusing series of cross-subsidies and exceptionally high effective rates of protection for other sectors of the economy. Our exports to the UK were overwhelmingly meat and dairy products and we were an integral part of the British food security system.

The UK entered the EEC prior to the initiation of any serious reform of its common agricultural policy. Its two key policy instruments were the 'variable levy' and 'export restitutions'. The variable levy was an adjustable tariff on designated tariff lines which attempted to neutralise the difference between competitive world prices for the designated commodities and the uncompetitive internal European price. When this management system overachieved and produced surpluses that could not be absorbed or stored indefinitely until the internal market came back into

balance, European officials discovered what they called 'la vocation exportatrice', an absurd rationalisation which implied that Europe had a 'moral destiny' to export subsidised food, irrespective of its competitive position.

It should be noted that the creation of this system owed everything to the United States and its overwhelming dominance of the architecture of the post-war international trading system. Without the massive mistake by the US in 1947 in taking agriculture outside the normal global framework for liberal trade (to protect the US Department of Agriculture's sugar and dairy regimes), the common agricultural policy (in its unreformed state) would never have been legally possible.

Among developed country suppliers of agriculture products to the UK, only New Zealand received a special transitional device when the UK entered the EEC: the protocol 18 referred to above. However, because of what was called 'degressivity' (i.e., trade 'liberalisation' in reverse), the noose was always going to tighten around New Zealand's neck each time the protocol was reviewed (every three years). New Zealand officials, ministers and farming leaders understood this only too well, and so it provided a massive impetus to all of New Zealand's efforts to diversify. I recall two outstanding deputy prime ministers (who were also trade ministers), Jack Marshall and Brian Talboys, repeating ad nauseam 'diversify, diversify, diversify'. It was a slow-moving national crisis.

The need to diversify our exports was a powerful influence on the decision to upgrade our trading relationship with Australia. We talked about creating a 'single area market' that would, or so we hoped, reorient the vision of our companies towards thinking of producing for our combined 18 million consumers (in 1975), not just the 3.5 million New Zealand consumers (the comparable figure today would be 27 million, of whom 5 million are New Zealanders). To do this we needed a single economic area with none of the direct frontier measures that had been designed to do exactly the opposite – impede imports into each other's market – complemented by a sophisticated 'behind the frontier' agenda of regulatory reform.

The bigger political message of Britain's decision to go into the EEC (and thus reverse its decision over a hundred years previously to repeal the Corn Laws) can be described simply: it was a massive wake-up call to New Zealand to diversify away from distant Britain towards markets in our region, starting with Australia; and part of that process involved rationalising the strange bilateral agreement we had negotiated in 1965 called NAFTA, the New Zealand Australia Free Trade Agreement.

Driver C: reassessing our relationship with Australia

In the mid-1970s, and with the very important exception of our military and security officials, we and the Australians were, I would say, cousins, but distant cousins who came together only on major family (read British Commonwealth) occasions. We would indeed 'look at each other closely', but, metaphorically speaking, via a giant reflecting mirror located somewhere near Westminster Abbey around 15,000 kilometres away. That is to say, we looked at each other via our shared and deep historical and cultural relationship with Britain, not as parties in a true 'bilateral' relationship.

There were some brilliant, albeit sometimes eccentric, intellectuals in the Ministry of Foreign Affairs, including the secretary of foreign affairs, Frank Corner, who by the early 1970s wanted a profound realignment in our foreign policy relationships. I recall Corner saying in meetings: 'For God's sake, people still think we are located in the middle of the English Channel.' By the mid-1970s there was an appetite to think 'outside the box' (to use a popular cliché of the time). We had started to prioritise our relationship with Japan (then the only 'rich' country in Asia) in the 1960s. In 1973 we had established diplomatic relations with Beijing (admittedly only after Henry Kissinger's historic visit opened the political door), which would lead to a revolution in our trading future: in the 12 months ending February 2019, we exported on average more to China every hour of every day than we exported in a year in 1975.

We were also slowly developing our networks in South East Asia beyond the British Commonwealth countries of

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Singapore and Malaysia by formalising our relationship with the newly founded ASEAN. This started as a political/strategic play; it would mature into a trade/economic strategy – the AANZCERTA agreement involving Australia, ASEAN and New Zealand, then the P2 or Singapore/New Zealand free trade agreement, which begat P4, which begat the Trans-Pacific Partnership (TPP), which begat the Comprehensive and Progressive Agreement for Trans-Tasman Partnership (CPTPP). Time alone will tell whether further policy progeny, and yet another name change, lie ahead of us.

Yet in the mid-1970s, the moment had arrived to think about Australia in a different way. Although I was, at the time, at the official front line of our relationship, I cannot recall today who might reasonably claim paternity, or at least shared paternity, of the idea that culminated in the 1978 Nareen Declaration; though it must have included our trade minister and deputy prime minister, Brian Talboys, who signed the declaration. The Nareen Declaration was the political culmination of the first systematic visit to each of the Australian states by a senior New Zealand minister, at least since the war and probably ever.

I agree with the assessment that the Nareen Declaration was a signpost on the way to the CER treaty. But it was only a

signpost on a political map; there was no negotiating highway that connects the declaration signed on Malcolm Fraser's farm directly with the negotiating process. Further, as an official who attended (as far as I recall) every important negotiating meeting – and countless associated discussions in both countries – of CER, I would say that the Australian states were functionally irrelevant to the negotiations. It was entirely a central government to central government negotiation.

Rather, the Nareen Declaration should, in my view, be seen for what it was, an acknowledgement by New Zealand that Australia needed to be treated directly, not through the political lens of our shared 'British' past, and that it was time to treat Australia, not the UK or the United States, as the 'most important country in the world' to New Zealand (this formulation was used many times in speeches written for Brian Talboys – often by me – in the late 1970s).

This intersected with increasingly strong views held by key thinkers in the New Zealand Treasury and the Reserve Bank (people such as Roderick Deane and Graham Scott). There were also some prominent New Zealand academic economists, such as Frank Holmes and Peter Lloyd, who were advocating for a radical shift in the direction of New Zealand policy; I was one of a small group of New Zealand officials working on the bilateral economic relationship who were deeply influenced by their academic writings and views.

On the other side of the Tasman, among senior Australian officials and political personalities there were unmistakable signs of intense frustration with New Zealand's policies and our attachment to the hopelessly outmoded treaty that governed our bilateral trade relationship, the 1965 NAFTA. As noted above, by the 1970s Australian policymakers were ready to join the rest of the OECD in liberalising (non-agriculture) trade, and we were not. At least in some collective political sense, since neither National nor Labour governments had shown any interest in doing more than tinkering with import licensing/high tariffs, Australia caught the wind and we stalled, becalmed in protectionist waters.

The Australian frustration with the 'Shaky Isles' came to a head over two related

matters. First was the deep disappointment of Australia with the results of the GATT Tokyo Round and the complete failure of contracting parties to start a process of integrating world trade in agriculture with the general rules-based framework for non-industrial trade. Doug Anthony, leader of the then Country Party and deputy prime minister, with the assistance of Jim Scully, permanent head of the old Department of Trade and Resources (who impressed me the most among a very impressive group of senior Australian officials), arrived at a simple conclusion: put aside GATT and its failings and promote multilateral trade liberalisation, at least for the time being – let's sort out Australia's trade relationships with our neighbours, starting with New Zealand.

The second broad shift in Australian perspectives that caught us off guard was the depth of Australia's commitment to redirecting Australia's focus away from the UK and Europe and towards Asia. We were late to the party – to repeat Frank Corner, New Zealand still felt we were an offshore island somewhere in the English Channel.

These two strands in the direction of Australian strategic thinking about economic policy and foreign policy are reflected in the formal preamble to the CER treaty (of which I wrote the first draft, via a draft heads of agreement). It states:

BELIEVING that a closer economic relationship will lead to a more effective use of resources and an increased capacity to contribute to the development of the region through closer economic and trading links with other countries, particularly those of the South Pacific and South East Asia ...

The actual negotiation

I was asked to write an essay on the background to CER, not the negotiating process itself; that would require me to have access to all the files. But to round this account out, I will make a few large observations about the negotiation, which took place at three levels.

- At the mid-senior official level was the CER joint working party, chaired by the ebullient Frank Anderson, assistant secretary of the Department of Trade and Resources, on the Australian side, and Graham Scott, at that stage in the

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New Zealand Prime Minister's Department, for New Zealand. The department technically responsible for trade policy, the Department of Trade and Industry, was largely and deliberately sidelined because of its deep ambivalence towards any trade liberalisation and thus the CER negotiation, a legacy of the intellectual influence of its most famous head, W.B. Sutch.

- The meetings of permanent heads (of the key Australian and New Zealand departments) had the responsibility of assessing (and approving) the recommendations of the joint working party. On both the Australian and New Zealand sides, the mid-level officials in the working party were constantly checking informally with their more senior colleagues on their 'political comfort levels' before confirming their advice to them.
- At the top were the New Zealand prime minister, Robert Muldoon, and the Australian deputy prime minister, Doug Anthony. I have deliberately described the top political level in this way because, in spite of some determined creative rewriting – even invention – of history, I have yet to be convinced that any other ministers (not even the New Zealand trade minister, Brian Talboys, once the Nareen Declaration had served its pre-negotiation purpose) had any real role in the actual negotiation. I will not develop this here.

The key negotiations were all undertaken at the first – joint working party – level. Only rarely did the 'sifting' process of the second level (the meetings of permanent heads) make much material difference to the results; less still were the

issues 'negotiated' by Prime Minister Muldoon and Deputy Prime Minister Anthony. But the Australian and New Zealand officials who negotiated, let us say 99% of, CER succeeded only because the key political leaders established what we would today call the 'permission space' to move in this direction. Of those political leaders, only two – Muldoon and Anthony – are, in my opinion, truly relevant to the actual CER.

The two sets of negotiators at the joint working party level were not so much 'negotiating' with each other, as attempting to find a solution set that would pass political muster with their respective key stakeholders – the key lobbies and, most importantly, those two key political personalities. With a few exceptions – there were one or two destructive officials who set out to wreck the negotiations – the personal relationships between the key Australian and New Zealand officials who carried out the negotiation were exceptionally good.

I would also highlight the significance of the key document launching CER: not the joint communiqué of prime ministers Fraser and Muldoon of 30 March 1979, which launched the CER negotiation itself (that was well drafted, but with boilerplate communiqué language), but the technical annex accompanying it. That annex essentially 'pre-negotiated' some of the key political decisions on import licensing and performance-based export subsidies, the two key Australian concerns. Both had to go; the negotiation was only about how.

Almost all the provisions involved gradualism and progressive liberalisation. The most important by far related to the import licensing liberalisation formula, initially agreed to be strung out to 1995. But, of course, once the process of progressive liberalisation was under way, the commercial and political adjustment to the new reality began. Within only five years, the New Zealand manufacturing community and New Zealand political leaders had realised that the sky had not fallen in.

Officials were careful not to bite off more than they could chew at the outset. For example, we did not deal comprehensively in the first iteration with services or investment, but we provided for a comprehensive review of what were called

‘second generation’ issues, and this proved wise and successful. On the more traditional problem of trade in goods, there were also the ‘hardest nuts’ which we did not try to crack initially. But agreement was reached on a negotiating process: roughly, ‘industry plans’ that would develop a pathway to achieving the objectives of CER within (as I recall) five years. But there was a kicker in the tail: in the event of failure to agree on a plan, the standard default option of CER would then apply. This helped with some very tricky issues, such as dairy and, although less important, wine. The New Zealand wine industry fought CER tooth and nail – extraordinary in the light of its huge success in the Australian market once the industry was forced to compete.

The role of Prime Minister Muldoon

Finally, a personal comment on the role of Robert Muldoon; and here my views are remarkably similar to those of the one academic study I have read which I think puts aside Muldoon’s divisive personality and extraordinarily abusive style of politics to look dispassionately at the actual political record and his role in the CER negotiation (Mein Smith, 2007).

I later became his foreign policy adviser (a non-political job, and I carried on in that capacity with his Labour Party successor, David Lange). In literally hundreds of private conversations I had with Muldoon, I never once saw any evidence that he thought in terms that are customarily described as ‘strategic’ – i.e., a systematic series of steps targeted at a predetermined long-term endgame. On the contrary, he was the consummate tactician, adjusting his position to the daily flux of his interpretation of daily events. Every encounter I had with him was consistent with his notorious reply to the question as to his ‘vision’ for New Zealand: ‘to leave New Zealand no worse off’.

So in no sense do I believe that Muldoon saw CER as an opportunity to remould

New Zealand economic settings. Given his extraordinary predilection for crude interventionism and deep contempt for market-oriented policies that I and my more senior colleagues were fighting for, it would be an astonishing claim that he supported CER as a mechanism for re-engineering fundamental New Zealand policy settings in a more market-oriented direction (which is my strong view about the real purpose of those so-called ‘trade’ negotiations).

But what is certain is the following:

- Muldoon approved the initiation of the CER negotiations and signed off on the operationally effective joint communiqué and annex that scoped the negotiations and set its terms. Muldoon read everything – he had an exceptional intellect, was the most voracious and efficient consumer of written material I have ever met, and had an elephantine memory.
- Second, he monitored the negotiation extremely carefully. There were frequent meetings of the key Cabinet committee – the Cabinet Economic Committee (CEC) – involving reports back from New Zealand officials on progress in the CER negotiations. Muldoon, intriguingly, did not chair the CEC, allowing the deputy prime minister, Talboys, to do so. Yet in all that committee’s CER discussions he never once tried to torpedo the negotiation, and that is crucial. I think he was testing the waters and was genuinely neither committed nor opposed to the radical shift in direction CER implied.
- Third, and on the surface at least paradoxically, it was immensely helpful to New Zealand officials working on the negotiations that Muldoon did not proactively advocate for CER. All the forces in New Zealand that opposed CER assumed it was a bureaucrats’ parlour game run by the very people Muldoon would himself call ‘ivory tower academics’ (such as Graham Scott and

myself). I remember walking into the room of a senior Trade and Industry official (not involved in trade policy but responsible for import licensing), who said to me essentially (and in mocking terms), ‘we know this is BS. Muldoon is never going to allow it to happen’ – a view shared by many senior Ministry of Foreign Affairs officials, with the very important exception of the secretary of foreign affairs, Mervyn Norrish.

When Muldoon finally signalled the shift in favour of CER, the effect was electric. If I had written this not from memory but from the archives I could find the transcript of a Morning Report interview that I recall vividly, even though it is now nearly 40 years ago. When asked about the chances of CER being successful, the prime minister said on radio: ‘I think it is about 60–40 in favour of success’. I recall the panic that statement created in certain quarters among those who had wrongly assumed (see above) that the entire CER negotiation was simply never going to happen.

Following the prime minister’s first overtly positive assessment of the CER negotiations, I recall two or three days later a meeting between Muldoon, Laurie Stevens, president of the New Zealand Manufacturers’ Federation, and three of his senior lieutenants from the regions in the prime minister’s suite. I was the only official present. The Manufacturers’ Federation had passed a series of coordinated resolutions up and down the country demanding that the prime minister not proceed.

Muldoon was never going to back down. He dissected the joint resolution of the business leaders analytically and brutally, sentence by sentence. Within a short period of time, the knights of industry melted politically. And that was it: with the end of opposition to ‘fortress New Zealand’, we then embarked on a new chapter of our economic history.

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