Free trade vs economic development

15 October 2000 Bill Rosenberg

Bill Rosenberg of CAFCA and Gatt Watchdog was invited by the Alliance to run this workshop at its National Conference. It attracted a large audience. This background paper was prepared for it.

The Alliance is now in government. It is confronting the conflicting pressures that power brings. It is one of the most crucial of those conflicts that I want to address this morning: that between economic development and free trade. Though we call it free trade, it actually means much more than that: the agreements in the WTO or with Singapore mean deregulation of not just trade but foreign investment, services, government procurement, and much more. I'll refer to it as the "open economy". The alternative is not a "closed economy", but a managed relationship with the rest of the world.

Two policies are more than anything associated with the Alliance. You have an explicit, active and interventionist policy on economic development, and a critical view of the "open economy". They are entirely consistent with each other. What most distinguishes you from your coalition partner, Labour, is the open economy. You campaigned strongly against the MAI. In stark contrast, the Singapore free trade agreement signals that Labour will pursue its open economy policies aggressively.

Michael Cullen told the IMF/World Bank meeting in Prague just a couple of weeks ago (27 September), surrounded by angry protestors,

> "As an exporting nation, we are committed to lowering trade barriers around the world because they inhibit our ability to compete. Trade liberalisation is important to New Zealand, but it is also a critical part of any genuine effort to alleviate global poverty."

Those views are not what we read in Alliance election policies. How important is it that you stick to your views on these issues?

The theme of what I will say is quite simply this: New Zealand must make a choice. We cannot have both economic development and an open economy.

I'll first review some of the tools that might be needed to foster economic development, then look at how free trade and investment, and the agreements that enforce this, conflict with those tools. I'll use as an example the Singapore free trade agreement. Then I'll suggest some things that need to be done.

Economic development

I won't try to rigorously define what economic development is. That is a debate in itself. But it certainly is *more* than simply pursuing economic growth. It may well include economic growth, but also includes growth in per capita incomes, reducing income, gender and racial inequalities, and improving people's social state, including health, education, social and physical environment.

How do we achieve these ends? I don't need to convince you that the free market will not do it, left to its own devices. New Zealand has been the victim of an experiment that is as good a proof as any of that truth.

Tools that Alliance election policy suggested for economic development include

- Tariffs, both to reduce the current account deficit and to nurture new industry.
- Stricter criteria for foreign investment, with the intention of being more selective as to what we accept
- "Investment capital funding for Small and Medium Sized Enterprises, not only to establish new businesses but also sustainably expand existing ones through its regional agencies."
- "Funding for industry joint ventures between government and private industry in research and development."
- "Establish Regional Development Agencies to work through local communities to utilise the human and physical resources peculiar to each region to build new industries and create sustainable job opportunities."
- Monetary policy that balances price stability with the need for balance of payments and exchange rate stability, full employment and low interest rates.

There is much more detail than that of course, but those are some of the main features of your policy.

In international terms, none of these are exceptional policies. Most other countries follow them to one degree or another, and indeed the approach is frequently to the left of these. The Alliance would presumably have included other policies if they had been allowed. Higher tariffs, regulation of strategic services, favouring local suppliers of goods and services, capital and exchange controls, and import controls are just some possibilities.

Why are such policies necessary?

If you want to see the long term effects of free trade and free movement of capital, then an analogy I find useful is to look at the regions of our country. There is of course free trade and free movement of capital between, for example, the West Coast of the South Island, Auckland, and the rest of New Zealand.

Has this led to uniform enrichment of all regions? No – Auckland has prospered, with a steadily increasing proportion of the country's population. Much of the country's services, industries – and employment – are concentrated here. At the other extreme, the West Coast has to contend with a constant loss of population – particularly the young and the skilled. It has to fight constantly to maintain its essential public services such as hospitals, rail, and ports. Though rich in natural resources, very little processing of those resources is done locally: most are "exported", either to the rest of the country or overseas. Most of the wealth created by those exports goes to owners outside the Coast; most of the social and environmental costs remain[1]. And I'm not talking about

[1] For example, Buller's mayor, Pat O'Dea, says that over 45% of his district's adult population are on benefits, and the district has one of the lowest per capita incomes in the country. Tranzrail, which earns over $30 million per year transporting Buller

the presence or absence of the native forest logging in the recent controversy! This is a much longer standing situation.

New Zealand is not unique in this. All countries have their prosperous and their depressed regions: their Londons and their Liverpools, their Massachusetts and their South Dakotas. What saves the depressed regions from absolute poverty is central government intervention to transfer resources – usually by use of taxation – from wealthy to poor.

So we see that unfettered free trade leads to growing inequalities between regions. If we go back to the international setting, and apply what we have learned from the national setting, we see that it is likely to lead to increasing inequalities between nations. In the countries that are falling behind, that will show up in increasing unemployment, falling incomes, the destruction of industry, and loss of population. And there is no international taxation, international welfare payments nor international regional development assistance!

But hang on, will say the free-trade economists, you've forgotten some very important barriers to this happening.

First of all, countries have currencies, and regions don't. If the exchange rate is flexible, it will fall if the country isn't exporting enough, or is importing too much. Then exports will become competitive and imports uncompetitive, and things will right themselves.

Come on. You *know* that in practice, currencies don't work like that, except perhaps in the long run. The main short term effects on the currency are speculation and the huge, volatile, capital movements of investors. Capital movements overwhelm the effects of trade on currency values. Just two days of New Zealand's *daily* foreign exchange turnover is worth about our *annual* exports of goods and services[2].

A Treasury Working Paper on abandoning our currency, stated:

> "there is a growing consensus among economists that exchange rates are excessively volatile, and that there is little short term relationship between exchange rates and economic fundamentals even if exchange rates eventually reflect fundamental factors in the longer term."?[3]

Indeed, as you know, there is growing talk in Treasury, a variety of business groups, and recently even Helen Clark, about abandoning our currency.

The MAI, APEC, and as we will see, the Singapore agreement, undermine the currency by forcing the abandonment on any controls on capital movements. Some South Ameri-

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coal, employs only 12 full time staff there, and pays rates of only $12,600. "Buller seeks share of Lyttelton port profits", *Press*, 24 March 1999, p.4.

2 New Zealand's daily foreign exchange turnover averaged around $13.5 billion in a sample taken by the Reserve Bank in April 1998. Reserve Bank of New Zealand News Release, 30 September 1998, US$ converted to NZ$ at US$0.5531=NZ$1 (the mid-rate for April 1998).

3 Treasury Working Paper 99/6, "Economic Integration and Monetary Union", by Andrew Coleman, p. 24.

can nations, under pressure from their creditors in the U.S. and the IMF, have also abandoned their currencies in favour of the U.S. dollar. Argentina recently began to regret that when it had a deeper and longer recession than its neighbours because its currency is fixed against the U.S. dollar. New Zealand had a fixed exchange rate until the 1930s – parity with the British pound – and the first Labour government abandoned it to avoid defaulting on its foreign debt. A flexible currency remains an essential tool in managing our international economic relationships – especially as most others have been given away.

Well anyway, will say the economists, even if some industries go bankrupt as a result, that's what being internationally competitive is all about. New industries will start up to replace the failed ones.

But why will that happen when open foreign investment policies allow investors to withdraw at will? When an industry fails – or if the country looks shaky – capital will flow out, leaving thousands unemployed. An increasing proportion of the foreign investment in New Zealand is in short term investments. 50% of New Zealand's foreign debt is due in less than a year, up from 43% in 1999. Many foreign investors have left or are preparing to move at short notice.

At best the employment left will be in unskilled, low paying jobs. A 1999 study by Professor Ralph Lattimore from Lincoln University showed that New Zealand's export industries are relatively intensive employers of lowly qualified rather than highly qualified people[4].

No, say the economists – people can emigrate. That will cause a shortage of labour and push up wages here.

Or as the Treasury economist who wrote the paper I quoted earlier about abandoning our currency put it – showing the importance he attached to it by burying it in a footnote in the middle of the document,

> "28 The distinction between residents and citizens is important. Even if people remaining in New Zealand were worse off after closer integration, it would not necessarily be a disadvantage to all New Zealanders, as some will migrate to take advantage of the higher wages in the benefiting regions."[5]

Don't we know it! Is that *really* New Zealand's future? As an exporter of skilled labour? Where the preservation of community, common values and culture is of no importance?

The current controversy over loss of our people by immigration has very little to do with a new government coming to power, and a lot to do with the depletion of New Zealand as a nation over an extended period.

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4 "Trade and Factor-Market Effects of New Zealand's Reforms", by Alan Deardorff and Ralph Lattimore, June 1999 (accepted for *New Zealand Economic Papers*).

5 Treasury Working Paper 99/6, "Economic Integration and Monetary Union", by Andrew Coleman, p. 15.

That is the picture of "economic development" – or rather, lack of it – in a small open economy.

Free trade and investment

This is not to say that all trade is bad. Far from it. But free trade makes economic development of new industries difficult. If industries are successful and foreign investment is uncontrolled, even those may be taken over and their highest value functions – such as research, development, design and marketing – moved to head office or elsewhere. We have seen plenty of examples of that in New Zealand.

Further, international trade and investment do not in practice lead to a balance in our current account – the record of payments and receipts to and from overseas. Chronic current account deficits are paid by constantly increasing foreign debt. High reliance on foreign investment leads to political influence on our social and economic policies, and increasing resources being used to pay investors dividends and interest. At present 24% – almost a quarter – of our exports don't buy us imports we need, but pay for foreign investors' income.

For all those reasons, countries want to manage their trade, and even more, their investment, in order to pursue economic development.

New Zealand is now party to a number of agreements that enforce the opening of our economy and thereby severely constrain our policies: the WTO, CER, and now the Singapore agreement.

The extension of these agreements has less to do with mutual benefits of trade than the interests of the transnational corporations which control two-thirds of world trade and most foreign investment.

The WTO's influence is steadily expanding into almost every area that affects our economic lives – the control of our industries, our environment and health. There is not time here to go into this in detail, but let me give you some examples.

- Agreements on Tariffs. These have the aim of progressively reducing tariffs to zero, Not only are tariffs targeted but so are "non tariff measures" such as import controls, and regulations – including inspections for diseases and pests – that get in the way of trade.
- The General Agreement on Trade in Services (GATS) is about investment in our service industries. New Zealand has committed to increasingly open them to commercialisation and overseas ownership – in education, broadcasting, transport, banking, telecommunications, and so on. It means that we cannot legislate for local content in broadcasting, and allows transnational educational institutions to gradually work their way into tertiary education. It prevents us from favouring local suppliers, or from imposing a number of other conditions such as joint venture arrangements, employment levels, or local ownership. Commercialisation of services constantly undermines regional development initiatives, as we have seen with telecommunications, rail and electricity among others.
- The Agreement on Trade-Related Investment Measures (TRIMs) is a predecessor to the MAI. It restricts our ability to increase the local content of goods manufactured

here, or to make an overseas investor export a proportion of its production. Such measures were used extensively for economic development by East Asian countries and were some of the reasons for their rapid growth rates.

And then there are new areas in the pipeline. An investment agreement like the MAI is under discussion. The U.S.A. has put a high priority on dismantling State Trading Enterprises, such as the Dairy Board. The obvious motivation is that it wants to expand the dominance of its corporations, some of which hold de facto export monopolies – such as Del Monte, which controls 95% of Costa Rica's pineapple exports[6]. Both the U.S.A. and the E.U. are pushing for competition agreements which would open exporting to competition. That would be another means to break up the Dairy Board.

Yet, even the *theoretical* benefits from all this are vanishingly small – let alone any real benefits. That is what prominent U.S. economist, Paul Krugman, calls "economics' dirty little secret".

Even the Ministry of Foreign Affairs and Trade's upbeat analysis immediately following the Uruguay Round in 1994, forecast it would produce a barely noticeable annual increase in GDP growth – only 0.2% to 0.3% a year[7]. That is so tiny as to be probably not even measurable in reality.

Similar gains are being predicted for the CER-ASEAN (CER/AFTA) free trade area that is planned as the sequel to the Singapore agreement: for New Zealand they "rise" to 0.3% of GDP by 2010[8]. The gains for the Singapore agreement are so small that even MFAT has not bothered to predict them.

The Singapore Agreement

The Singapore free trade agreement (officially called a "Closer Economic Partnership" because the words "free trade" have had such a bad press) is a crucial milestone in the process of opening the economy. Tim Groser, head of the Asia 2000 Foundation and former negotiator for New Zealand in the GATT Uruguay Round and Singapore agreement, described the agreement[9] as "a Trojan Horse for the real negotiating end-game: a possible new trade bloc encompassing all of South East Asia and Australia and New Zealand". Add to that Chile and possibly the U.S.A. Though of comparatively small significance in its own right, the Singapore agreement is seen by both New Zealand and Singapore as a model and a catalyst for other such agreements. It is seen as a boost for a stagnating APEC, and a way to revive the WTO.

But it does have significance in its own right. I don't have time to go through all its points in detail, but will give you a taste. I can go into more detail if you wish during the discussion after this.

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[6] "World Hunger: 12 Myths", by Frances Moore Lappé, Joseph Collins and Peter Rosset, Food First, Grove Press, New York, Second Edition, 1998, p.117.

[7] "Trading Ahead: The GATT Uruguay Round: Results for New Zealand", Ministry of Foreign Affairs and Trade, April 1994, p.18.

[8] "Economic benefits from an AFTA-CER free trade area, Year 2000 study", Prepared for the Australian Department of Foreign Affairs and Trade, Centre for International Economics, Canberra and Sydney, June 2000.

[9] "Beyond CER: new trade options for NZ", address by Tim Groser to the New Zealand Institute for Policy Studies, 15/3/00.

Unions and manufacturers in the textile, clothing and footwear industry are greatly concerned at the removal of **tariffs** on textiles, clothing, footwear, furniture and carpets from Singapore, and the low (40%) content requirement (Rules of Origin) for goods to be eligible for the zero tariff. It raises concerns that products produced in appalling conditions from neighbouring low-wage free trade zones, such as Batam, will find entry to New Zealand through this Agreement. It negates the tariff freeze on which this government was elected.

More than that, it makes it even more difficult to reinstate tariffs and other support to rebuild New Zealand's productive base in this and other sectors, and to restore our balance of payments. It also weakens **anti-dumping** rules, and completely removes **safeguards**, both of which are standard parts of trade agreements designed that allow us to prevent harm to local industry.

In **services**, the GATS agreement is extended into new areas. New Zealand has offered a whole new list of areas that will be open to Singapore-based investors on an equal basis. They include for example environmental services such as rubbish collection and sewerage, and ambulance services. Education remains as exposed as it was under the GATS agreement.

The effect of its **Government procurement** provisions is that central government and local government, will not be able to use their considerable spending power to simultaneously achieve social aims. Those aims typically include supporting non-profit groups, creating employment, and regional economic development. Commercialisation will be encouraged, as we have already discussed in relation to GATS. The government procurement provisions prevent government purchasing being used to favour local suppliers for contracts greater than $125,000, and have specific clauses *preventing* "measures used to encourage local development or improve the balance of payments accounts by requiring domestic content".

In **investment**, we are prevented from imposing controls on capital movements or favouring local investors. There are unprecedented MAI-like provisions for investor enforcement of the agreement, under which they can force compensation, or even law changes.

It has wider significance in that its provisions could form a back door entry to New Zealand for overseas investors wanting to take advantage of these provisions.

For example, the financial crisis in Asia in 1997 was triggered by investors with "hot money" panicking at the indebtedness and current account deficits in several countries. Huge capital flight caused severe financial, economic and social problems. Millions were thrown into unemployment and poverty. Governments fell. Whole industrial sectors have been sold to U.S. and European transnational corporations.

Malaysia reacted by imposing capital controls to prevent further runs. China and India came through the crisis relatively unscathed because they already had controls in place, as had Chile. Consequently, many economists are favourably reconsidering such policies.

A New Zealand government could well decide it needs capital controls to prevent a similar crisis in New Zealand, or to reduce the dollar's volatility.

If the Singapore agreement is ratified, we won't be able control capital from any investor with a *legal presence* in Singapore. That could be almost any major company in the world. Singapore is a major commercial hub and most corporations with any international ambitions have a presence there.

Suppose, say, Bankers Trust (now part of Deutsche Bank) decided it wanted to protect its ability to pull money in and out at will. A Bankers Trust dealer speculated several hundred million dollars against the New Zealand dollar in 1987, crashing it by 10 percent[10], so it's not an implausible scenario. All it needs to do is to make all its investments and do all its dealing through a Singapore subsidiary.

So the Singapore agreement effectively rules out using capital controls at all: we lose a crucial tool for managing our economy and protecting our currency.

To take another example, until November 1999, all overseas investment proposals worth more than $10 million required the approval of the Overseas Investment Commission. Only weeks before the election, the National government made buying our assets easier by increasing that threshold to $50 million, except for buying land or fishing quota.

Until the Singapore agreement is ratified, the government can return the threshold to $10 million. The right to tighten scrutiny further was given away in commitments to the GATS. Now the $50 million threshold will be formally sealed into the Singapore agreement.

Suppose after the Singapore agreement has been ratified, a New Zealand government decides it wants more control of overseas investment and pulls back the threshold to $10 million. It could do that for all but investors based in Singapore. But the agreement makes Singapore a back door for undesirable investors. All they have to do is make the New Zealand investment through its Singapore branch.

This is no level playing field. Singapore's investment rules are more stringent than New Zealand's. Its investment in New Zealand, which, at $1.023 billion is over five times New Zealand investment in Singapore, is largely in the service industries, where New Zealand has made many new commitments.

And the agreement provides for binding arbitration if there are disputes under the agreement. That could force changes in our laws.

Furthermore, there is a commitment to progressively lessen even the limited controls that remain.

If you want to read more, you can get a copy of our submission or Jane Kelsey's devastating analysis from our Web site
http://canterbury.cyberplace.org.nz/community/CAFCA.

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[10] "The Money Bazaar - inside the Trillion-dollar world of Currency Trading", Andrew J. Krieger with Edward Claflin, Times Books N.Y., 1992, p.93ff.

The CAFCA submission includes details of all Singapore investment in New Zealand since 1990 of which we have a record through the Overseas Investment Commission.

Despite these far-reaching implications, the public submission process and parliamentary debate were cut short to merely 15 sitting days of Parliament, and only one week for the public to notify submissions.

What is to be done?

There are a number of actions we can take.

- On the Singapore agreement, we cannot let it pass without a fight. Even if it appears a done deal, it is important we make it as difficult as possible politically for other deals in the wings to be considered, let alone ratified:
  - there is the CER/AFTA deal (in which New Zealand is represented by Bill Birch) which proposes the expansion of the Singapore agreement to all of ASEAN and Australia
  - there are investment agreements with Chile and Argentina that were signed by Lockwood Smith in 1999 which require only Cabinet approval to go into effect. We have seen the Chile one, and it is highly dangerous. It has expropriation provisions very like the MAI and NAFTA, and a 15 year term – extended by an additional 15 years for investments in existence while it is in force. Mixed with the Singapore agreement, it could be doubly dangerous. These must be rejected.
  - There is a review under CER that could lead to further deregulation.
  - There is a declared intent to pursue full free trade agreements with Chile and the U.S.
  - Other countries may ask to sign on to the Singapore agreement, or negotiate one based on it.
  - The WTO negotiations continue and the full round will revive at some time.
  - APEC is still in the background, and was quoted in several places as an underpinning of the Singapore agreement
  - There is still the threat of abandoning our currency.
- We – both the extra-Parliamentary movement and the political parties – need to campaign, raising people's awareness of the conflict between the open economy and development. It can have an immediate objective of forestalling a wider agreement between CER and AFTA or other APEC countries; to prevent any extension of New Zealand's commitments in the WTO and other arrangements; and to start to roll back those that have been made.
- We need to democratise the process used to approve such arrangements. The process used for the Singapore agreement was an improvement on what happened previously, but was still a farce, as was admitted by Labour members of the Select Committee hearing submissions. In this area we should have more support than on the substantive issue – ACT, parts of Labour, and the Greens for example. Essential ingredients include
  - Prior to negotiations beginning, an independent National Interest Analysis of the proposal, accompanied by real consultation with anyone interested
  - During negotiations, real consultation (not just one-way assurances to invited parties) informed by periodic releases of negotiating drafts of agreements. Without drafts we have to take the word of officials and politicians

with strong vested interests in a successful outcome. That was shown to be completely unreliable in this case.
- Another independent National Interest Analysis after completion of negotiations, release of the final text, and normally several months for public debate, submissions to a Select Committee, and binding vote by Parliament.
- The process should apply to amendments, extensions and changes in commitments to arrangements as well as to new ones. Including education and health under the Singapore agreement's services provisions or GATS would be of huge significance, and involves simply a change to schedules to those agreements.

We can work for these through the bill currently before Parliament under Keith Locke's name, and through the review of Parliamentary Standing Orders, for which submissions close at the end of November.

- We need a moratorium on further agreements, including that with Singapore, until a proper independent review has been made of the effects of previous agreements and the public have had an opportunity to debate these issues and have their say. The world's political climate has changed radically with the 1997 Asian financial crisis, the Seattle debacle and the demonstrations and numerous critical reports and studies that have followed. We need to look at how we can start to build an environment that focuses on development as an end, using trade and investment as *means* to that end. Fair trade cannot survive in the present environment.
- As part of that, New Zealand must start to look for new groupings internationally, with countries that are of similar mind, and begin to take part in the international movement rebuild a development agenda.
- As a survival task, we need to examine the commitments that have been made and ensure we do no more than is necessary legally to fulfil them. We must look for loopholes, favourable interpretations, and the possibility of withdrawing from either individual sector commitments or whole agreements.
- We must start to reconstruct some of the tools we have had in place in the past: strengthen the Overseas Investment regulations – at the least, put back the $10 million threshold; make use of the tariffs we still have the right to impose, and extend them; prepare capital and exchange controls, and so on.
- We should look at the opportunities a pension fund will bring to use locally sourced investment for economic development.
- An economic crisis is highly likely given our current account deficit, debt and international liabilities. That can be treated as an opportunity as well as a threat. Contingencies should be carefully planned, beginning now.

Economic development in the interests of New Zealanders demands that we take control of our own economy and society. Like other countries, we must make use of all the economic tools available. The Singapore agreement, its predecessors and planned successors prevent us from doing that. We cannot have *both* economic development *and* the deregulated open economy that these agreements impose.