MANUFACTURED EXPORTS TO AUSTRALIA

One of the factors which has contributed to the recent upturn of the New Zealand economy has been the rapid expansion of manufactured exports. In value terms these grew by 28.8 per cent in the year to March 1984. While part of this growth can be attributed to a substantial increase in aluminium exports (chiefly to Japan), it would also appear that there was a significant contribution from a wide range of products which were exported to Australia which is New Zealand's major market for manufacturing goods.

This article examines New Zealand's manufacturing trade with Australia. First it briefly describes the structure of that trade and then it looks at the basis for the recent growth and prospects for further expansion. In doing so it examines the impact of the Closer Economic Relations (CER) agreement on trans-Tasman trade.

THE IMPORTANCE OF THE AUSTRALIAN MARKET TO THE NEW ZEALAND ECONOMY

In the year to March 1984 Australia was New Zealand's second largest export market purchasing 14.1 per cent of New Zealand's total exports. Only Japan (15.4 per cent) took a greater share of our exports although the USA (14 per cent) purchased nearly the same proportion as Australia. However, Australia is of considerably greater relative importance as a market for manufacturing exports, accounting for 38 per cent of manufactured exports in the March year 1984 (or about 50 per cent if aluminium ingots are excluded) compared to 21 per cent for Japan and 8 per cent for the US. In fact for some individual manufacturing subsectors, Australia purchases in excess of 50 per cent of the sector's exports. In particular this applies to textiles, electrical machinery and appliances, and road vehicles and furniture. Nevertheless, manufactured exports to Australia are small in relation to New Zealand's total exports and as a proportion of total manufacturing output. In the year to March 1984 they accounted for only 8.6 per cent of total exports and although manufacturing sales and trade statistics are not fully comparable the data suggests that about 15 per cent of manufacturing output was exported in the year to March 1984 and that the share of total output that went to Australia was about 6 per cent.

THE STRUCTURE OF TRANS-TASMAN TRADE

Trade Ratios

Trade ratios measure the balance of merchandise trade between two countries. At the time the New Zealand Australia Free Trade Agreement (NAFTA) was signed in August 1965, the balance of trade was in Australia's favour to the extent of almost four to one. Since then New Zealand has steadily increased its share of trans-Tasman trade so that the trade ratio in the year to March 1984 was about three to two, though still in Australia's favour (see diagram I).

The varying shares that each country has in specific trade categories are illustrated in diagram II which shows New Zealand exports to Australia by trade sectors as a percentage of trans-Tasman trade in that category for both the 1977 and 1984 years. The most notable feature revealed by this data is the slight advantage held by New Zealand exporters in the manufactured goods category — the most important category in trans-Tasman trade. Even when this category is combined with the machinery and transport equipment category to give a wider manufacturing classification, trade is still very nearly balanced with the New Zealand exporters share being 47 per cent of the total trade in the March 1984 year.

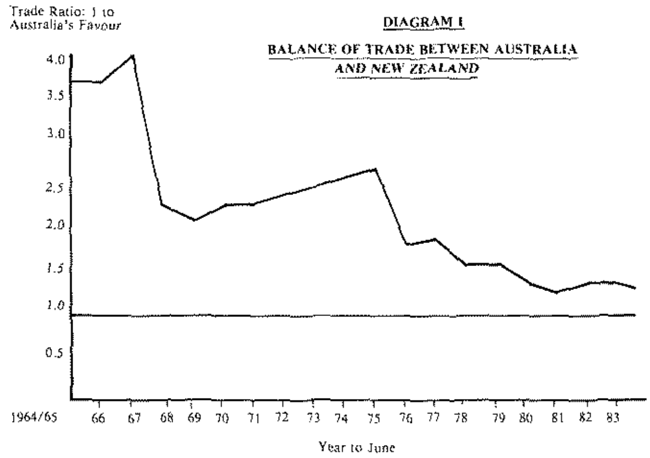
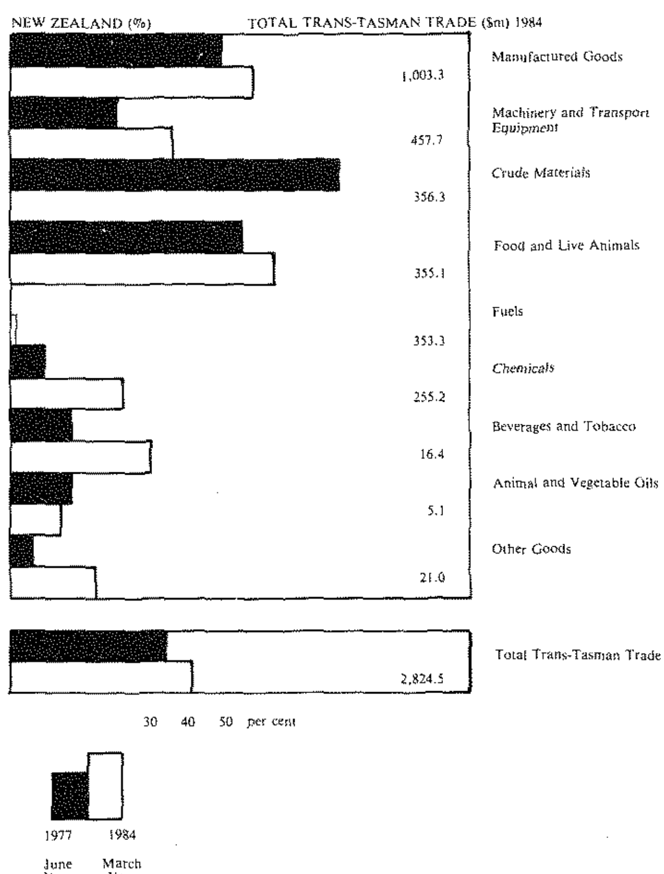


DIAGRAM II

Trade Ratios by Individual Trade Sections between New Zealand and Australia



Another feature of Diagram II is the change in the pattern of trans-Tasman trade since 1977. New Zealand exporters now account for a higher proportion of the trade in most categories. The only significant increase in Australia's share is in their export of crude material to New Zealand, which includes bauxite imported for New Zealand's aluminium smelter.

On the Australian market, New Zealand exporters held a 5.1 per cent share of total Australian imports in the year ended December 1983, ranking as Australia's fifth most important supplier. However, New Zealand manufacturers held a slightly lower market share (4 per cent) of Australian manufactured imports in 1983 which represented a slight increase on their 3.6 per cent market share of the previous year.

Growth of Manufactured Exports to Australia

Starting from a low base, the value of manufacturing exports to Australia increased more than four-fold between the March years 1971 and 1977 while in the following six years this growth slowed to a two-and-a-half-fold increase. The slower rate of increase in the latter period (see Diagram III) was partly due to the 1982/83 recession in Australia during which manufactured exports fell by 5 per cent. In the following year the value of manufactured exports again grew strongly (+21 per cent).

As there is no official volume index for manufactured exports to Australia it is not possible to give a precise picture of the quantity changes. It is only possible to get some indication of the magnitude and direction of volume changes by deflating the value figures by the price index for total manufactured exports. However, the resulting data should be treated with some caution as the overall price index is only a proxy for actual price movements of manufactured exports to Australia. On this basis it would appear that manufactured export volumes to Australia increased by an average of about 12 per cent during 1980–1982, followed by a sharp contraction (of between 10 and 20 per cent) in 1983. While there was a recovery in 1984, export volumes in that year would probably at best have only regained the level reached in 1982.

DIAGRAM III

Annual Per Cent Change in Manufactured Export Receipts from New Zealand Exports to Australia

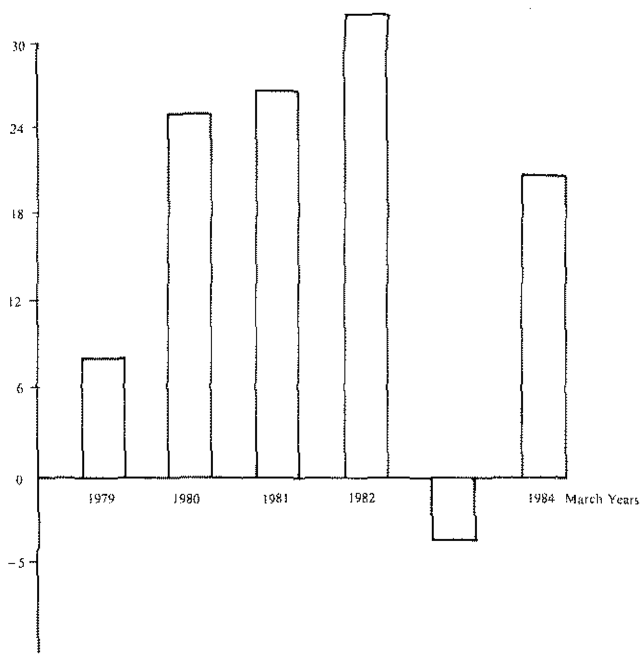
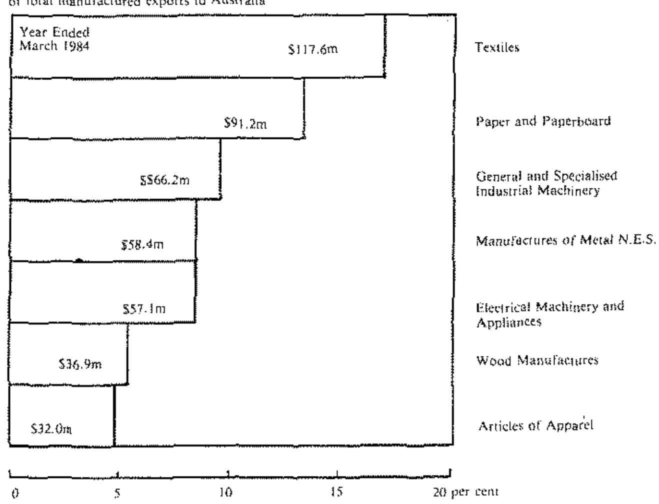


DIAGRAM IV

Major manufacturing trade groups exports to Australia expressed as a percentage of total manufactured exports to Australia



Source: See Table 3, Appendix.

REASONS FOR GROWTH

Three main factors help explain the recent growth in manufactured exports to Australia; the buoyant Australian economy, the implementation of CER, and factors affecting relative competitiveness (exchange rate movements, labour cost differentials and input price differentials). A fourth factor, an increasing awareness of the need to compete internationally using more professional marketing techniques may also be relevant.

Australian Recovery

The Australian economy experienced a period of recession during 1982 and the first half of 1983, brought about by the international recession, high domestic interest rates and a widespread drought. In response to these developments Australian manufacturing stocks were reduced, private consumption weakened and, as a consequence, total manufacturing imports fell. However, the economy turned around very quickly after mid – 1983 assisted by an expansionary fiscal policy, the flow-on effects of an international recovery and the end of the drought. In the nine months to March 1984, housing starts increased at an annual rate of 41.2 per cent, a record wheat crop was harvested and economic growth was provisionally estimated at 9.2 per cent (at an annual rate). With the economy also in the midst of a restocking phase, manufacturing imports increased very strongly, and undoubtedly this would have been reflected in the growth of New Zealand manufacturing exports to Australia in 1983/84.

CER

The CER agreement, which was signed on 28 March 1983, provides for the elimination of barriers to trade between New Zealand and Australia. It allows for a gradual and progressive movement towards a free trade area so that business concerns can plan investment and marketing decisions with a greater degree of certainty. In the context of manufacturing exports to Australia, the most important provisions of CER are the phasing out of Australian tariffs; the certainty that no further quantitative restrictions will be imposed and the planned reduction in New Zealand's export incentives.

Several commentators have cited the certainty that the CER agreement provides (in that no further barriers to trade will be legislated) as being one of the most important aspects of the agreement. Compared with other markets, where the smaller New Zealand manufacturers might be reluctant to accept the risk of a legislated protective barrier damaging a newly developed export market, the large Australian market now affords an expanded 'domestic' market where market development risks are perceived to be similar to those in New Zealand.

The CER agreement provides that Australian tariffs on goods that were previously dutied at 30 per cent or less will be reduced by 5 percentage points each year, while tariffs on goods which were dutiable at rates of over 30 per cent will be reduced by one-sixth of the initial amount each year. To date tariffs have been reduced by a minimum of 10 percentage points and will be phased out by 1988 at the latest. The agreement also provides for a halving of New Zealand export incentives on exports to Australia from 1 April 1985 followed by reductions of 25 per cent of the initial level in the following two years. This means that New Zealand manufacturing exporters have thus far benefited from some reduction in Australian tariffs without as yet suffering from a reduction in export incentives. However, it is uncertain as to what extent manufacturers have taken advantage of this short-term benefit rather than waiting to assess what impact the phasing out of export incentives will have on their future profitability.

Relative Competitiveness

While it is difficult to measure movements in relative competitiveness with precision, a number of indicators would suggest that the position of the New Zealand manufacturer has improved significantly since the imposition of the wage and price freeze in July 1982.

In the year to March 1984 the annual rate of increase in the Australian CPI was 7.6 per cent (after adjusting for the impact of Medicare), compared with the New Zealand rate of 3.5 per cent. Over the same period the New Zealand dollar depreciated by 6.6 per cent against the Australian dollar implying a change in the real New Zealand-Australian exchange rate of about 10 per cent. A better indicator of competitiveness is the manufacturing input cost differential. The latest available data, for the year ended December 1983, shows a 6.6 per cent rise in Australian manufacturers' costs compared with a 3.1 per cent rise in New Zealand manufacturers' costs. Adjusting for exchange rate movements this implies that Australian manufacturers' costs increased by 6.7 per cent more than New Zealand manufacturers' costs in that year.

Similarly data on manufacturing wage rates for the year to December 1983 suggest that Australian manufacturers' wage costs increased by about 10 per cent more than their New Zealand counterparts. While it is possible that part of these input cost differentials could be offset by Australian productivity gains this appears to be unlikely. One measure of manufacturing productivity (gross output per person employed) showed that New Zealand experienced a small relative improvement vis-a-vis Australia, of 0.2 per cent per year for the period 1979–82. While more up-to-date data is not available there is no evidence to suggest any significant reversal in this performance.

Manufacturers' Awareness

Finally there are those factors which have increased manufacturers' awareness of the need to sell their products on overseas markets. Both the promotion of the opportunities CER affords and the realisation by previously protected industries that there will be a movement toward freer trade will in themselves have helped to promote a more outward looking marketing perspective. Another 'awareness' factor is the 'Focus New Zealand' campaign, initiated in September 1983, which is aimed at 'a well-maintained sustained attack on the Australian market'. The venture is backed by the Export Institute and the Department of Trade and Industry and offers: trade advertising, market research, trade fair organisation, and guidance from those experienced in the Australian market. This export drive will probably impact more heavily in the current March year as trade groupings develop their marketing plans.

PROSPECTS FOR NEW ZEALAND MANUFACTURING EXPORTS TO AUSTRALIA

Over the next year or so the continued expansion of the Australian economy and the lagged effects of improvements in New Zealand manufacturer's export competitiveness should ensure continued strong growth in export volumes. The recent 20 per cent devaluation of the New Zealand dollar will have led to a further marked improvement in exporter's profitability as product prices which are set in Australia should have increased by about 25 per cent in New Zealand dollar terms. As a result a rapid rate of export growth should be maintained during the next twelve months. In the longer term the effect of the devaluation will depend critically on its impact on manufacturers' costs. Firm domestic macroeconomic policies will clearly be critical in this respect.

The implementation of CER will have both negative and positive effects. While the removal of Australian tariffs will help profitability for most exporters this will probably be outweighed by the removal of export performance incentives which on average are equivalent to around 16–18 per cent of FOB values on a post-tax basis.

However, an informal survey of large exporters has established that their Australian export programmes will not be materially affected by these prospective changes. No doubt established exporters will be concerned to maintain their market share even at lower rates of profitability, but new and prospective exporters might be more sensitive to lower margins. In the longer term there could be more pronounced effects on exports (and also imports from Australia) as manufacturers relocate their production to take advantage of the more closely integrated trans-Tasman market. If the New Zealand real exchange rate can be maintained at or near its current level by an appropriate mix of incomes, monetary and exchange rate policies then clearly a New Zealand location would have a considerable labour cost advantage. Australian locations would tend to have transport cost advantages as they are nearer the major population centres. It is difficult to draw firm conclusions about the magnitude of these effects particularly as other factors could also become important such as Australian trade liberalisation vis-a-vis third countries and changing transport costs resulting from a more competitive transport industry.

CONCLUSION

The growth of manufacturing exports to Australia has been identified as one of the factors assisting the current economic upturn although some of the data presented in this report would perhaps caution against placing too much emphasis on this as an explanatory factor. These exports constitute only a small part of total exports and a still smaller part of total manufacturing output.

The immediate prospects for a significant expansion in export volumes are favourable given the broadly based recovery of the Australian economy, the improvement in the relative competitiveness of the New Zealand manufacturers in the past two years which has been enhanced by the July devaluation, and the likely positive impact from CER.