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New Zealand: Political/Economic Developments and Relations with the United States

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Summary

Since 1984, New Zealand has restructured its economy, long agrarian and highly dependent on guaranteed access to the British market, into a more industrialized and balanced market economy. The reforms have been comprehensive; New Zealand now is rated as one of the most open and unregulated economies in the world. The reforms, however, also have entailed painful adjustment costs as expected increases in production have taken about a decade to materialize. In the process, popular dissatisfaction with both major political parties has emerged contributing to a more complex domestic political situation. U.S. relations with New Zealand are quite strong, despite differences over nuclear weapons and lamb imports, and ties will be reconfirmed during President Clinton's visit when New Zealand hosts the APEC economic summit in September 1999. This report will be updated periodically.

Political Developments¹

New Zealand is a constitutional monarchy with a parliamentary democracy modeled after Great Britain. Its single 120-seat legislative body is called the House of Representatives, but is more commonly referred to as Parliament. Legislators are elected for a maximum term of three years, and a government may call for an election before the full term is over. The Prime Minister and all members of the Cabinet must be selected from the House of Representatives. Under the unwritten constitution, power is

¹ Sources for this section include Australia, New Zealand and the Pacific Islands, CRS Report 95-794 S, July 1995; Economist Intelligence Unit, Country Reports: New Zealand 2nd Quarter 1999; and consultations with New Zealand officials and U.S. experts on New Zealand.

concentrated in the central government. Queen Elizabeth II is the Head of State and is represented by a Governor-general.

The two major parties are the Labour Party and the National Party. The National Party, conservative and moderately right-wing, took office in October 1990 and was narrowly re-elected in 1993 and 1996. National is led by Prime Minister Jenny Shipley and has traditionally been sympathetic to agricultural and business interests.

Labour, which governed from 1984 to 1990, is an unlikely coalition of pragmatic, left-wing politicians and radical activists, most notably represented by trade union members. Helen Clark, Labour's leader since 1993, has transformed the party into a cohesive opposition that currently is favored to win Parliamentary elections scheduled for November 1999.²

Popular dissatisfaction with both major parties in the early 1990s resulted in the formation of several splinter parties. The most important splinter parties are the New Zealand First Party (NZF), formed in 1993, and the Alliance Party, forged in 1991 from a coalition of five small parties including the environmentalist Greens. Another party, ACT New Zealand, emerged from the Association of Concerned Taxpayers. They espouse a radical center-right agenda of tax and spending cuts and are currently a junior partner in the National government.

These splinter parties have appeared attractive to those who have suffered from the economic policies of the Labor and National party governments over the past decade. Both parties have advocated economic nationalist themes such as restrictions on foreign investment and imports. New Zealand First also supports immigration restrictions as well.³ New Zealand's wage rates today are much more differentiated by skill level than they were in the mid-1980s, and there is a growing gap between the wealthy and the poor. A decade of restructuring and downsizing, both in the government and private sector, has increased the insecurity of many workers. The perception that reforms have benefitted the wealthy has created resentment against immigrants, particularly Asians that make up the new business and financial elite.

A 1993 referendum changed New Zealand's electoral system to a mixed-member proportional system (MMP). This method provides more opportunities for smaller parties to win seats in Parliament. Noting current public and business dissatisfaction with MMP as a source of government instability, the National Party has pledged referendums on alternative suffrage systems or a return to the previous "first-past-the-post" system.

The October 1996 general election, the first to be held under the new electoral system, failed to produce a clear winner.⁴ As a result of this electoral deadlock, National and NZF

² "MP's Chipper in the Face of History," *Sunday Star Times* (Auckland), July 18, 1999.

³ The National Party government eased the entry requirements for wealthy and skilled immigrants in the early 1990s. It has since tightened up English language to deflect political attacks from NZF.

⁴ The current makeup of the House of Representatives is National (44 seats), Labour (37 seats), New Zealand First (8 seats), Alliance Party (12 seats), ACT New Zealand (8 seats), Maori Pacific (continued...)

formed a coalition government in December 1996. The coalition collapsed in August 1998 as National became disenchanted with the contentiousness and inexperience of NZF ministers and alarmed by NZF's sagging popularity. Discontent with the coalition also led to a party coup, orchestrated by then Transport minister Jenny Shipley, which ousted Jim Bolger as Prime Minister in December 1997.⁵ National has governed alone since that time by forming alliances with ACT New Zealand, Maori Pacific (itself a splinter of NZF), and independents.

Economic Developments⁶

With a small population of just 3.7 million and located 2,000 miles away from Australia, its nearest neighbor, New Zealand's economy historically has been predominantly agrarian. Blessed with a fertile land mass approximately the size of the British Isles and a temperate climate, the country has been a major producer of livestock, dairy, and forestry products, as well as grains.

In the early 1950s, New Zealand enjoyed one of the highest living standards in the world. During this period, between 60-70% of its exports of primary products (mostly lamb, mutton, wool, and dairy products) were sold to the United Kingdom on a preferential basis. Generous and comprehensive government programs at the time covered social security, education, and health services.

In the 1970s, the New Zealand economy was confronted with several shocks: the loss of its preferential access to the United Kingdom when London joined the European Community and the oil price shocks of 1974 and 1979. These events convinced government policymakers of the necessity to encourage the development of a more diversified economy, both in terms of the range of its products and its export markets.

In support of that objective, the government pursued very interventionist economic policies that included state-funded investment programs, agricultural subsidies, rigid trade and investment protection, and wage and price controls. However, by the early 1980s, the results of these policies — high inflation, rising budget deficits, declining productivity, and a stagnating economy — created political support for moving New Zealand from a protected, interventionist, low-growth economy to an open, unregulated, and more productive one.

Labour Party Economic Reforms and Results, 1984-1990. A Labour Party government, elected in 1984 and re-elected in 1987, commenced New Zealand's liberalization program. The main reforms pushed through Parliament by the Labour government entailed a unilateral reduction in tariffs, removal of controls on foreign direct

⁴ (...continued)

(5 seats), United New Zealand (1 seat), with independents holding the remaining 5 seats.

⁵ Peter Wilson, "MMP and the Year of the Coup," *The Press* (Christchurch), December 27, 1997.

⁶ Unless otherwise noted, the information presented in this section is drawn from the following sources: Bolard, Alan. *New Zealand: Economic Reforms, 1984-1991*, International Center for Economic Growth, 1992; Economic Intelligence Unit, *Country Reports: New Zealand*, 2nd Quarter 1996; and U.S. Department of State, *New Zealand 1996 Commercial Guide*.

investment, deregulation of key sectors such as finance and transportation, lifting of price controls, the privatization of state-owned enterprises, and the establishment of price stability as the number one macroeconomic objective.

The reform program was accompanied by fairly high adjustment costs during the 1984-1990 period. During this period, GDP growth averaged from 1% to 1.5% and overall unemployment increased to over 7% by 1990, up from 4.5% in 1984. Given that the population was increasing at a 1% annual rate during this period, New Zealanders experienced a near-zero growth in per capita income for eight years. This economic record, combined with continuing internal divisions within the Labour Party concerning the reform program, contributed to the election of a National Party government in 1990.

National Party Economic Reforms and Results, 1990-1996. With its election in October 1990, the more conservative National Party not only maintained the reforms introduced by the Labour government, but moved to extend them into the area of labor markets and social services. In 1991, the new government acted to curb the power of trade unions to act as sole bargaining agent for workers and to reduce expenditures on social services.

The economy did not begin to respond positively to the reforms implemented until almost a decade after the reform program was initiated. From 1993-1997, New Zealand experienced a sustained economic recovery with annual growth rates averaging 3.5%. Unemployment dropped to a low of 6.2% in March 1996, and inflation subsided to an annual rate of 1% by 1998.

New Zealand's economy experienced a brief recession in early 1998 due to the Asian financial crisis. Its GDP growth contracted 0.2% in 1998 and unemployment reached 7.7% in the last quarter of 1998. The economy began to recover in 1999 and unemployment fell back to 7.2% in the first quarter. However, unemployment is a particular acute problem for the native Maori population. Recent figures indicate that Maoris were over three times more likely to be jobless than a person of European or Asian descent.

As a result of its comprehensive reforms and long-term economic turnaround, New Zealand has received widespread international praise. In addition, the Heritage Foundation in 1999 ranked New Zealand as the 4th most open and unregulated economy in the world.⁷ Ironically, world praise for New Zealand's reform efforts has coincided with increased internal criticism and rising political opposition to some elements of the reform program.

The Labour Party has pledged in its election manifesto to reverse cuts in pension rates, health care, and higher education funding. Labour has also vowed to restore income based sliding-scale rents for state owned housing. Labour is expected to increase income taxes on wealthy residents to pay for these reforms.

In order to broaden National's appeal in the upcoming elections, Prime Minister Shipley has outlined an industrial development strategy that actively seeks to create a knowledge based economy through government promotion of innovation and enterprise.

⁷ Heritage Foundation, 1999 Index of Economic Freedom, Washington, D.C. Web site address is [<http://www.heritage.org:80/index/countries/maps&charts/lists/gif>]. July 20, 1999.

Her program does continue the privatization process with the sale of Contact Energy, the state owned electricity generator, further reforms of business regulation, and an overhaul of the university education system.⁸

Relations with the United States

Domestic opinion and New Zealand's close identity with the South Pacific region were major factors in the country's decisions in the 1980s to reorient its security policy in a decidedly anti-nuclear direction. Up to that point, New Zealand had been a close partner with Australia in the ANZUS alliance with the United States. It benefitted from close intelligence sharing arrangements, access to advanced U.S. military equipment, and access to high-level U.S. officials. In return, New Zealand cooperated closely with the United States on regional and global security issues and sent forces to fight along side the Americans in major conflicts including the Korean and Vietnam wars.

Taking a stand strongly opposed to U.S. and other states' nuclear weapons in the South Pacific, the Labour Party government in 1987 pushed through legislation banning nuclear weapons and nuclear-powered warships from New Zealand. In response, the United States suspended military alliance relations and reduced other government contacts to a low level. President Bush's decision in late 1991 to remove nuclear weapons from U.S. ships except ballistic missile submarines may have helped to ease U.S.-New Zealand differences. New Zealand is willing to welcome U.S. warships that are not nuclear powered and do not carry nuclear weapons, but over 40 % of U.S. naval combatant ships are nuclear powered. The Clinton Administration in February 1994 resumed high-level contacts with New Zealand, but security and intelligence ties remain on hold.

New Zealand has also taken a leading position in the South Pacific Forum, a regional organization instrumental in advocating the treaty that resulted in the South Pacific nuclear free zone. This treaty precludes the stationing or permanent emplacement of nuclear weapons in New Zealand, Australia, and Pacific island states south of the equator. Protocols of the agreement also strongly criticized nuclear testing in French Polynesia. The treaty was signed by South Pacific Forum members in 1985 and by China and the then Soviet Union in 1986 and 1987, respectively. After refusing to sign the document for strategic reasons in the 1980s, the United States and Great Britain initialed the treaty in 1996. France also signed the agreement after abandoning nuclear tests in the south Pacific in 1994.

New Zealand, which has been critical of the U.S. arrearages to the United Nations, is a strong supporter of the UN and its peacekeeping efforts. It also supports international efforts to protect the environment. In this area, New Zealand has also worked with the United States to prohibit driftnet fishing in the South Pacific, and has cooperated with the United States on protecting the environment in Antarctica.

Both Australia and the United States have been concerned in recent years about the level of New Zealand's defense spending. These fears have been assuaged by the government's commitment to an army equipment modernization program and its decision to upgrade its troop sealift capacity. New Zealand has also concluded a lease-to-buy

⁸ "Policies Aim to Boost Economy," *The Press* (Christchurch), July 12, 1999.

arrangement with the U.S. for 28 F-16 fighters originally destined for Pakistan, but withheld due to nuclear proliferation sanctions. The Royal New Zealand Air Force will lease the planes for ten years at a cost of \$105 million; it can purchase them thereafter for \$140 million. Delivery of the planes is expected in 2001.

Trade Issues

The United States is the second largest exporter to New Zealand and the United States is the third largest recipient of New Zealand exports. Trade in 1998 reached \$3.5 billion, with a \$220 million surplus for the United States. U.S. investment in New Zealand totaled \$6.1 billion by 1999. The United States and New Zealand have cooperated in the Asian Pacific Economic Cooperation (APEC) forum: New Zealand will host the forum's annual summit in Auckland this September.

New Zealand has moved to solidify its trade relationship with Australia, its largest trading partner, through the Closer Economic Relations (CER) treaty. Since its inception in 1983, CER has eliminated tariff and non-tariff barriers to most goods and services trade. Extending CER to tax policy, product standardization and monetary union has also been proposed. CER has created, in effect, a single market for the 21 million residents of Australia and New Zealand.

New Zealand is committed to agricultural sector free trade and, as a member of the Cairns group, it has worked with the United States at the WTO to break down agricultural trade barriers. For this reason, both New Zealand and Australia have been highly critical of the recent U.S. decision to impose Section 201 restrictions on the importation of antipodean lamb. New Zealand has filed a request for consultations regarding the quotas at the WTO.⁹

New Zealand is concerned over subsidized U.S. farm exports, especially dairy exports under the U.S. Dairy Export Incentives Program (DEIP). As a non-subsidizing exporter, New Zealand believes that subsidized U.S. sales have a negative impact on its prices and market share. It also criticizes the recent changes in the implementation of the DEIP, which broadened the objectives of this and other subsidy programs to include market development.

Conversely, the U.S. dairy industry is concerned about the pricing and marketing power of the New Zealand Dairy Board, which has a statutory monopoly on exports of New Zealand dairy products, and the upcoming merger of the Dairy Board and New Zealand's ten national dairy cooperatives to create the world's 12th largest dairy company.

⁹ "Australia, New Zealand to fight U.S. Lamb Safeguard at WTO," *Inside U.S. Trade*, July 9, 1999.

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