Beyond Tariff Reduction: A Libertarian Approach to Reducing Non-Tariff Barriers

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One of the most important elements of a nation's foreign policy is its approach to international trade. Naturally, trade policy has important implications for the economic prosperity of the trade partners, but it also has important geo-strategic implications. Libertarian and liberal thinkers (I use the terms interchangeably), in particular, have traditionally subscribed to the view that free trade makes an important contribution to international peace. Frédéric Bastiat is often (inaccurately) credited with the classic statement of this position: If goods do not cross borders, troops will.[1]

Substantial portions of this chapter are derived from my entry to the Mont Pelerin Society's 2022 Hayek Essay Competition (Palmer, 2022).

[1] Outside of libertarian circles, Kant's version is better known: "The spirit of commerce, which is incompatible with war, sooner or later gains the upper hand in every state."

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B. Christensen (ed.), *Liberty and Security in an Anarchical World Volume I*, Palgrave Studies in Classical Liberalism, https://doi.org/10.1007/978-3-031-70525-0_10

The empirical validity of this proposition is unclear, but the practice of modern statecraft shows that today's policymakers still believe that trade can play an important role in foreign relations. President Biden, for instance, has hinged much of his 'Indo-Pacific' strategy on forming a weakened Trans-Pacific Partnership-style relationship between the United States and much of the Asia Pacific. Similarly, the default response by Western states to violations of international law or norms by authoritarian states is to withhold trade through economic sanctions. The threat of losing (or the prospect of gaining) access to trade appears to be seen as a persuasive lever in restraining aggressive government action towards other nation states.

However, trade's potential as a restraint on government action does not stop at a nation's frontier.

One of its most powerful consequences is the discipline it imposes on government regulation of the economy. Faced with free competition from abroad, state monopolies and other price-increasing interferences in the market are unlikely to survive.

Thus, improving trade access is an even more important libertarian objective that it might *prima facie* appear. Reducing tariff and non-tariff barriers to trades is not only *per se* good but also serves libertarian objectives in both foreign and domestic policy.

This helps to explain why most libertarians are—at least in principle—highly favourable towards arrangements for the lowering of trade barriers. F. A. Hayek, for instance, sang the praises of a European single market long before such an idea was plausible. His essay, *The Economic Conditions of Interstate Federalism* (1948), claimed that, "The material benefits that would spring from the creation of so large an economic area can hardly be overestimated."

However, arrangements ostensibly aimed at reducing these barriers are not always unambiguously liberty-enhancing. In the 21st century, such agreements often come with significant changes to domestic legislation (e.g., copyright terms) as a condition. Others create new supranational regulatory institutions in an attempt to increase regulatory coherence. Libertarians are essentially walking a tightrope, where the arrangement must be sufficiently prescriptive to bind nation-states and reduce coercion of individuals by them, but insufficiently prescriptive to replace national coercion of individuals with supranational coercion thereof. Leviathan must be strong enough to bind others (Hobbes, 2008), but weak enough to be bound itself.

This leads to debates about the libertarian credentials of particular arrangements. For instance, libertarians could be found on both sides of the debate about British membership of the European Union: Johan Norberg (2016) supported continued membership, while Daniel Hannan was one of the most strident advocates for withdrawal (Knight, 2016). Similarly, the Cato Institute, a libertarian think tank, published a report which found it necessary to conduct a chapter-by-chapter analysis of the Trans-Pacific Partnership before concluding whether it was "net positive" for liberty (Ikenson et al., 2016).

Understanding how the structural aspects of such trade arrangements can improve or degrade liberty will make it easier for libertarians to influence trade policy in their preferred direction. Moreover, it will offer a useful analytical framework even to those whose primary goal in politics is not the enhancement of liberty. Improving the understanding of the libertarian consequences of certain structural choices in the construction of trade arrangements is the contribution I hope to make in this chapter.

I begin by discussing the scope and nature of modern trade arrangements, providing context for their emergence. I then provide an analytical framework for such arrangements, based on the trilemma that exists between regulatory sovereignty, broad membership, and deep integration. I extend this by analysing three archetypal examples of trade arrangements, each of which choose a different two of the three characteristics—the Mexico-United States bilateral relationship, the Closer Economic Relations arrangements between Australia and New Zealand, and the European Union. Thereafter, I analyse which types of trade arrangements should be preferred by libertarians on a variety of metrics, concluding that a model similar to that of Closer Economic Relations is most compatible with libertarian objectives.

What Are Modern Trade Arrangements?

Arrangements to lower trade barriers have a long history. For instance, the World Trade Organization (2011, p. 49) points to the Cobden-Chavalier Treaty in 1860 between Britain and France as a key turning point, as it marked the beginning of a period of multilateral and bilateral trade liberalizations.

Nonetheless, the modern free-trade agreement ("FTA") is really a postwar phenomenon. The 1947 General Agreement on Tariffs and Trade ("GATT") created a uniform international legal framework for the conduct of trade policy for the first time, with significant consequences for the shape and character of subsequent trade arrangements.

Outside of Europe, this 'post-GATT' era has been characterized by the conclusion of relatively similar free (or preferential) trade agreements on a bilateral and multilateral basis between various countries. These conventional FTAs have often included other related provisions (e.g., on investment or intellectual property laws) but are typically primarily focused on the reduction of tariff and quota barriers to trade. Examples of this genre include the North American Free Trade Agreement and the New Zealand-Australia Free Trade Agreement that predated Closer Economic Relations.

However, inside and more sporadically outside Europe, more ambitious attempts have been made to reduce non-tariff barriers to trade. When such agreements reach beyond tariffs and quotas, they are often characterized as agreements for economic integration. They aim to create a "single market" comprising the economies of the signatories. They can include the harmonization of *external* tariffs (a customs union), arrangements for a common currency, the relaxation of immigration controls, and, most importantly for the purposes of this chapter, arrangements for the harmonization of regulations. Successful implementations of such a bold arrangement are rare—in the developed world perhaps only Australia and New Zealand, the European Union, and the Gulf Cooperation Council could be considered to be approaching such a status. By contrast, by 2010, roughly 100 preferential trade agreements were in place with at least one developed country as a member (World Trade Organization, 2011, p. 55).

Though it appears that economic integration arrangements are the anomaly today, one could argue that the 'conventional' tariff-focused free-trade agreement is the anomaly historically. Before the GATT, multilateral trade areas often occurred as part of wider political integrations. For instance, the largest free-trade area in history was the British Empire. Various incarnations of the policy of imperial preference ensured that trade within the Empire—and especially between the United Kingdom and the colonies—operated relatively freely. However, this occurred together with an effective currency union—as, after the collapse of the Gold Standard, most territories in the Empire were part of the sterling area, either using the British pound sterling directly or pegging their own local currencies to sterling—as well as significant regulatory convergence, as even the dominions, which had self-government over their internal affairs, continued to rely significantly on laws inherited from England and Wales. Judge-made law, in particular,—which comprised the majority of commercial and contract law, before the codification movement—remained highly coherent across the Empire as conservative local courts continued to hew closely to English precedent. Even today, a number of now-independent former British colonies retain a court in the United Kingdom as their final court of appeal. Of course, in the non-self-governing parts of the Empire, regulatory coherence was even more guaranteed.

Though they are currently small in number, economic integration arrangements are very important in scale and are likely to become increasingly so. This is because there is diminishing scope for trade liberalization solely through tariff reduction, so improvements must be found elsewhere: In 2017, the average tariff applied to global trade was only 2.59% (World Bank, 2022). That compares to Bown and Irwin's (2015) estimate of 22% immediately before the first round of GATT negotiations in 1947. Apart from special sectors (e.g., automobiles and agriculture), liberals have generally won the battle against blatant protectionism. Thus, in the future, the real potential for lowering trade barriers will come through abolishing non-tariff barriers through economic integration.

Those non-tariffs barriers abound. For instance, regulatory differences between states effectively tax firms for operating outside their home jurisdiction, by requiring them to comply with multiple sets of (often incompatible) rules. Moreover, due to the dynamics of regulatory capture, governments often write regulations to favour home firms (Watson and James, 2013), increasing these implicit taxes on imports. Similarly, the need to convert currencies across borders can impose significant transaction costs and create foreign exchange risks which must either be absorbed or hedged, both of which make trade more expensive, especially for smaller firms. Also, differing trade policies towards third parties can necessitate onerous border checks, undermine multinational supply chains, and require the imposition of bureaucratic rules of origin.

Deciding which barriers should be prioritized for lowering depends on several factors. Firstly, political considerations are likely to impose a significant constraint. For instance, British sentimental attachment to sterling (and bad memories of their brief foray into the Exchange Rate Mechanism) made any proposal of joining the Euro a non-starter. Secondly, the independent merits of the proposal should be considered: Will a customs union increase or decrease the pace of new trade agreements relative to the independent counterfactual? Will a common currency credibly maintain its purchasing power over time? However, even among the politically viable and meritorious options, some triage list is likely to be required: The limitations of political capital and bureaucratic time mean that politicians are unlikely to be able to achieve a customs union, common currency, and some form of regulatory accommodation at a single summit or in a single treaty.

This chapter focuses solely on the regulatory coherence component, with a brief discussion about the implications for trade with third countries. In particular, this chapter does not discuss the advisability of currency unions in detail. Such discussions are widespread and, again, libertarian-minded opinions diverge: Some thinkers (e.g., Issing, 2000) support common currencies with independent central banks as an important safeguard against the monetization of deficits and the politicization of money. Others (e.g., Ebeling, 2013) argue that increasing the concentration of the monetary monopoly is the exact opposite direction than that in which we should be headed. Moreover, whatever their advisability in the abstract, the Eurozone crisis has sufficiently tarnished the reputation of such unions that more unifications seem unlikely in the medium term. Finally, the trade barriers imposed by currencies are decreasingly relevant: The advancement of financial technology has reduced transaction costs significantly and increased the availability of hedging instruments.

Although it is difficult to rank the importance of different non-tariff barriers in a credible manner, there is little doubt that regulatory inconsistencies are a significant hindrance to trade, especially in services. For instance, Nordås and Kox (2009) estimate that if a sample of OECD countries made their regulations more coherent through harmonization or recognition, services trade could in crease between 13% and 30%, depending on the country considered. Similarly, Benz and Jaax (2022) found that, for their sample of 46 mostly-developed countries, the burdens imposed by regulatory incoherence were equivalent to a 16% *ad valorem* tariff on communication services at the lowest and up to 211% for financial services at the highest. Thus, finding ways to reduce these barriers in a liberty-enhancing fashion is an important step to realizing gains from trade.

How to Increase Regulatory Coherence

International arrangements for economic integration can be classified by how they approach this problem of regulatory coherence.

On one extreme is a model where state-members decide to give up their ability to make economic regulations to an international decision-maker (or, at least, to recognize the decisions made by that decision-maker as superior to those of their own sovereign decision-makers). In this chapter, I call this model an *economic union*—others refer to it as 'regulatory harmonization' (e.g., Law and Martin, 2009). This model is exemplified by the European Union, with its supreme EU law and significant European rule-making bureaucracy.

On the other extreme is a model where state-members continue to make economic regulations independently, but agree to recognize other state-members' regulations as equal to their own and accept their regulatory competence to tally. In this chapter, I call this model a *mutual* *recognition treaty*.[2] This model is exemplified by the relationship between Australia and New Zealand, where, with limited exceptions, each nation accepts the approval from the other nation's regulatory agency as evidence enough of a good's suitability for sale or a professional's suitability for service.

If one accepts (as one should) the argument from public choice economics that regulators act to some extent in self-interest, it seems unusual that economic unions form at all. After all, regulators should surely vigorously oppose attempts to render them unemployed or, at best, impotent by the imposition of superior international decision-makers above them. Given that regulators are often the very same agencies providing ministers with advice on international integration, it would seem that they should (in self-interest) use their power to advise to doom such projects.

There must, therefore, be some significant political advantage to the economic union model for it to have survived (albeit in a limited number of contexts). This advantage is simple: Trust.

With a mutual recognition treaty, politicians must be willing to accept the judgements of their counterparts in foreign states as suitable substitutes to their own. The political risks of making such a decision are clear: Voters in country X cannot hold ministers in country Y accountable for their regulatory decisions which, for instance, exposed the public in country X to harmful chemicals. Thus, they are likely to hold their own politicians responsible by proxy, despite those politicians having no ability to directly influence these regulations.

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[2] It is important to distinguish between what I am calling mutual recognition and the much narrower arrangement which is often known by the same name. These narrower agreements merely oblige member-states to accept the judgement of the certification bodies in other member-states that a certain product meets a certain agreed-upon standard. For instance, if Country X requires all toaster ovens to meet the international standard for toaster ovens (IEC 60335-1) and a company based in Country Y has had its ovens certified as meeting that standard by a Country Y certification body, Country X would be required to accept that certification as sufficient evidence of compliance. These narrower agreements have little to say about the content of the regulations themselves but simply reduce the compliance costs of obeying them. In this chapter, I use 'mutual recognition' to define an arrangement whereby member-states recognize each other's regulations themselves as equivalent, not just each other's certification bodies.

Given this risky proposition, the basic question which faces politicians in country X is whether ministers (and regulators) in country Y face compatible incentives while regulating to those that face them in country X. If we, for simplicity, assume that the only interest of politicians is gaining re-election, this proposition can be stated as follows: If voters in country Y are just as likely to punish politicians for bad regulation in a particular sector as those in country X, politicians in country X can likely rest assured that country Y's regulations will be sufficient (or at least, will attempt to be sufficient).

The easiest way to assess whether politicians in country X and Y face compatible or similar incentives is to compare the similarity of the political, economic, and institutional circumstances they face. Two countries which were effectively identical in these respects would probably have very similar sets of regulations—both now and into the future. However, if, for example, country X was dramatically poorer than country Y, its regulatory landscape might look very different. For instance, the environmental Kuznets Curve (Dasgupta et al., 2002) suggests that country X could be more willing to accept environmental degradation for economic gain than country Y. That might lead to the approval of products (for instance, defoliants) by regulators in country X for sale in the shared economic market that voters in country Y would prefer were not used. Similarly, if country X and Y have different political traditions, politicians in them might face different constraints when writing regulations, which might result in different regulatory results which may be unpalatable to bureaucrats in country Y, which may make the lives of politicians in country Y more difficult.

Given the large degree of political cost which politicians might face from a bad regulation imposed by their counter-party and the already-unfavourable political economy of trade liberalization,[3] politicians are likely to err on the side of caution. Thus, they are likely to conclude mutual recognition treaties only with very similar countries. For most

[3] Trade liberalization is a textbook example of the problem identified by Olson (1971) that some regulations (e.g., non-tariff regulatory barriers) have disperse costs and concentrated benefits, which (due to various political dynamics) might result in them being retained even if the costs do indeed exceed the benefits.

countries, the number of countries which are within the tolerance of politicians for similarity is likely to be small.

By contrast, in an economic union, politicians need only trust international decision-makers. These decision-makers could be directly elected by the people in their home country (e.g., Members of the European Parliament), providing an adequate scapegoat for domestic politicians to avoid accountability. Alternatively, they could be appointed by and (sometimes) subject to a veto override from domestic governments (e.g., European Commissioners). This would retain responsibility with the domestic government, but it would also provide them with power commensurate with that responsibility.

Given the economic union model doesn't require the trust of other countries' domestic politicians and bureaucrats, it is likely to be amenable to a much broader membership. Whereas mutual recognition treaties can only be concluded between countries which trust each other to regulate with extraterritorial effect in their own country, economic unions can be concluded between any set of countries which are willing to allow their industries to compete with (and, more importantly, their consumers to choose from) each other on a level playing field, with rules determined by a third party over which they have some control. Obviously, the latter precondition—while still a step too far for many protectionist politicians—requires far less trust.

There is a final, third option for economic integration outside of this dichotomy. It is a much weaker option. This is where the politicians' establish no new rule of regulatory recognition and no new regulatory authority, but simply—by treaty—agree to a set of regulations which will apply to their countries until they agree to vary them (hereafter *ad-hoc treaties*). The best examples of this type of regulatory freezing-in-amber come from free-trade agreements. For instance, many countries have agreed to shared patent law terms in FTAs, in an apparent attempt to reduce the regulatory barriers to trade in intellectual property.

Deep economic integration is unlikely to come from such an approach. Contrary to the wishes of Hayekian liberals, the modern regulatory state does not "confine itself to establishing rules applying to general types of situations" (Hayek, 2001, p. 79). Instead, it writes highly prescriptive regulations that must be often updated to account for technological progress and changes in economic conditions. International treaties are ill-suited for writing and maintaining such regulations. They require the involvement of elected politicians who lack expertise to make specific rules and are likely to take a longer-than acceptable time to conclude. Put simply, the coordination costs are high. In private markets, firms form when the coordination costs of conducting transactions on an ad-hoc basis are higher than the foregone efficiency benefits of market based coordination relative to command-and-control coordination within firms (Coase, 1937). By analogy, international regulatory agencies (or general rules of mutual recognition) could be expected to form when the expected transaction costs of organizing regulations in a particular sector across borders via ad-hoc treaty become higher than the political costs of ceding regulatory power to other decision-makers (either foreign governments or international decision-makers). Thus, absent a desirable but unlikely roll-back of the regulatory state, these ad hoc treaties can only result in the convergence of a limited subset of regulations and a limited reduction in the regulatory barriers to trade before morphing into one of the two aforementioned models.

Nonetheless, the ad-hoc treaty model does have the advantage (to negotiating politicians) of retaining substantial domestic regulatory sovereignty. Firstly, the limitations identified above imply that substantial aspects of the regulatory state must remain outside the scope of the treaty and thus, within the exclusive competence of domestic regulators. Secondly, even for those regulations covered by the treaty, state-parties can always refuse to assent to any amendments, giving them at least the ability to veto proposals from other state-parties.

Relative to the situation created by mutual recognition treaties, ad-hoc treaty-making requires a much lower level of mutual trust. State-parties must only trust each other to comply with their obligations under international law. If they are worried about future changes in policy in other members, they can rest assured that they can simply veto such policy before it is incorporated in the treaty. By contrast, mutual recognition treaties generally make such a unilateral move difficult, if not impossible, without invoking the nuclear option of withdrawing from the treaty altogether. Because the levels of trust required are lower, the universe of possible counter-parties is commensurately larger.

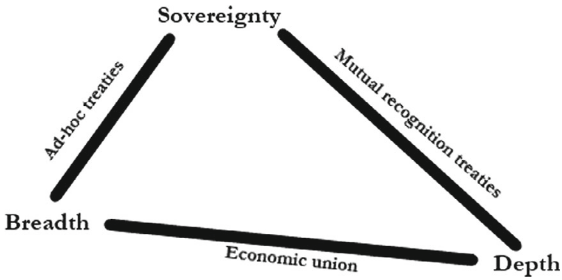

Fig. 1 Illustration of the regulatory coherence trilemma

This discussion implies that policymakers face a trilemma (see Fig. 1) when creating institutions for economic integration. If they wish to enable deep integration between the economies, they must make a trade-off between the breadth of membership available (maximized under an economic union model) and the level of regulatory sovereignty retained (maximized under a mutual recognition treaty model). Attempting to have all three will result in an untenable political situation, where firms operating with very different regulations created by very different countries will be able to operate on a level playing field with domestically-regulated firms. As much as we might wish such a situation were possible, it will likely not be, especially in the stricter of the two states. The consumers—or, perhaps more likely, the rent-seekers—who demanded the original regulation in the first place will not be willing to see it entirely undermined by what is essentially the extraterritorial application of foreign laws in their country.

Before advancing based on this trilemma, it is important to critically assess it. This regulatory coherence trilemma is less mechanical than the trilemma with which most economists will be most familiar, i.e., the Mundell-Flemming contention that a fixed exchange rate is compatible with only one of free capital flows and independent monetary policy. The existence of the Mundell-Flemming trilemma essentially only requires that the no-arbitrage assumption holds, while the existence of the regulatory coherence trilemma requires a number of bolder assumptions about the nature of political behaviour. These assumptions are, however, all in line with the standard assumptions of public choice economics (e.g., that political actors are primarily self-interested), which are considered by most to be a useful, if not infallible, predictive model of political behaviour.

Moreover, at least to date, the existence of the trilemma is supported by the empirical evidence. As far as I am aware, the only relatively comprehensive mutual recognition arrangements that exist are those between the constituent states of federal unions[4] and the Trans-Tasman Mutual Recognition Agreement between Australia and New Zealand. Both have very narrow memberships—satisfying the trilemma: Definitionally, the states in a federal union are very similar to each other, as are Australia and New Zealand.

Ironically, perhaps the only example of a mutual recognition arrangement with a broad membership comes from the European Union. EU members are required, subject to limited exceptions, to accept goods legal for sale in other EU members as legal for sale in their home market. However, this requirement applies only to goods and only to goods in non-harmonized sectors—i.e., those in which the European Union itself has not taken the responsibility of setting rules. This significantly reduces the risk of "bad regulation" which typically constrains the breadth of membership: The most "dangerous" sectors can be made the subject of highly-restrictive bloc-level rules, removing the risk that member-states will have to accept goods approved under their neighbours' "bad" rules. Thus, the European Union has created a mutual recognition arrangement that is compatible with the trilemma, by limiting the breadth of coverage rather than the breadth of membership.

The Models in Practice

The previous section has provided a significant theoretical explanation of how arrangements for lowering regulatory barriers begin and function. In this section, I will provide a more detailed outline about how such

[4] For instance, every Australian state is bound to accept that goods legal for sale and professionals legal for practice in another Australian state are legal on the same terms in their own jurisdiction, under the Mutual Recognition Act 1992.

arrangements work in three archetypal cases: For ad-hoc agreements, between Mexico and the United States; for mutual recognition, between Australia and New Zealand; and, for economic union, between the 27 member-states of the European Union.

Ad-hoc: Mexico and the United States

Cross-border trade between Mexico and the US has long been an important part of both economies, especially since the negotiation of the North American Free Trade Agreement ("NAFTA") in the 1990s. For both states, the other is their largest trading partner in goods.

Nonetheless, they have very different economies and political cultures. The US's GDP per capita is roughly three times that of Mexico. Moreover, though sharing a presidential form of government, the Mexican legal system is based on a continental-style civil system, inherited from Spain, whereas the United States (outside of Louisiana) uses a common law system inherited from the United Kingdom. They also speak different languages.

The political and economic divergence would appear to rule out the mutual recognition model as a viable model for reducing regulatory barriers to trade. The United States's jealous protection of its own sovereignty would also appear to rule out economic union. Thus, the only feasible model is ad-hoc treaty making.

Unsurprisingly, therefore, a variety of ad-hoc regulatory harmonization arrangements can be found in the primary trade agreement affecting the two countries (the *United States-Mexico-Canada Agreement* ("USMCA") that the Trump administration negotiated to replace NAFTA). These are primarily located in the Sectoral Annexes to the agreement and, in the area of cosmetics (as one example), include bans on requiring prior marketing authorizations and restrictions on labelling rules. Similarly, they include bans on either country unduly restricting the use of cryptographic technology.

As these examples suggest, the sectoral annexes of the USMCA cover only a very small subset of trade between the three parties. Moreover, many of the requirements that impose on parties are only consultative or procedural in nature. Thus, they naturally result in a much less substantive reduction in regulatory barriers to trade, relative to alternative arrangements like a general rule of regulatory recognition or common regulatory bodies.

Mutual Recognition: Australia and New Zealand

Given the regularity with which the two countries are confused by casual observers, it is unlikely to be surprising that the two English-speaking countries that share the Tasman Sea—Australia and New Zealand—have a very close economic relationship. No tariffs or quotas are levied on trade between them; citizens of one country have the automatic right to reside in the other; with limited exceptions, any good or service legal for sale in one trans-Tasman jurisdiction is legal for sale in the remainder of the trans-Tasman jurisdictions[5]; a similar arrangement applies to licensed professions.

Perhaps the only remaining hindrance in the way of a trans-Tasman single economic market is that the two countries still impose foreign investment controls on each other. Official government permission is required for investors of the other country to invest more than certain threshold amounts. Such controls are less stringent on trans-Tasman investment than on investment from third countries, but they still exist.

The core text of the trans-Tasman relationship is the *Australia-New Zealand Closer Economic Relations Trade Agreement*, which was signed in 1983. This agreement, which very quickly reduced all tariffs on bilateral trade to zero, has been called 'the world's most comprehensive, effective and mutually compatible free trade agreement' by the WTO (Joint Standing Committee on Foreign Affairs Defence and Trade,

[5] By trans-Tasman jurisdictions, I mean Australia's six states and two territories and New Zealand. This reflects the history of the mutual recognition arrangement, which was originally a purely Australian regime between the states. The Australian federal system is a relatively centralized one, with the federal government effectively controlling every tax base except payroll and property. Nonetheless, each Australian state retains its own separate regulatory regimes. By contrast, New Zealand is a unitary country with a highly-centralized state.

2006, p. 64). It is complemented by the Trans Tasman Travel Arrangement of 1973, which extends the unrestricted right to work in each nation to citizens of the other,[6] and the 1998 Trans-Tasman Mutual Recognition Arrangement, which is the focus of this paper. Loosely, the three components form a collective relationship known as 'Closer Economic Relations' (CER). In the 2000s–2010s diplomatic narrative, they were considered the precursors to a Single Economic Market. Though liberalization efforts continue, explicit official references to the goal of achieving a Single Economic Market have largely ceased except for pro-forma references in the names of inter-ministerial meetings—likely, in my view, due to the recognition that one already almost exists in all but name.

It is an interesting historical anomaly that this world-leading liberalization of trade relations occurred during the administration of one of New Zealand's most illiberal Prime Ministers. Confronted with the oil crisis and the aftermath of British membership of the EEC and the resulting loss of New Zealand's primary export market, Sir Robert Muldoon oversaw the imposition of economy wide price controls, engaged in a programme of public works (the 'Think Big' programme) which left the country with an unsustainable level of debt denominated in foreign currencies, and replaced the country's nascent contributory pension scheme with a inherently unaffordable pay-as-you-go system funded from general taxation (Bassett, 1998). The radical free market reforms of Sir Roger Douglas and Ruth Richardson in the 1980s and 1990s were required to wrest New Zealand from the malaise and near-bankruptcy which Sir Robert's policies compounded. Yet Ministers in his government also managed to conclude a world-leading trade agreement with Australia, despite the Prime Minister's deep personal loathing for his Australian counterpart (Templeton, 1995).

The result of this liberal arrangement has been to create highly-integrated labour, capital, goods, and services markets across the Tasman Sea. Australia is New Zealand's second largest export destination, while

[6] New Zealand additionally extends the right to work in New Zealand to non-citizen permanent residents of Australia, in a kind of unilateral recognition of Australian immigration law. An equivalent provision does not apply to non-citizen permanent residents of New Zealand in Australia.

New Zealand is Australia's eleventh largest destination (Simoes and Hidalgo, 2011). So fused are the two labour markets it is common to speak of a 'trans-Tasman labour market'. (e.g., Australian and New Zealand Productivity Commissions, 2012, p. 11). Approximately 650,000 New Zealand citizens live in Australia, while approximately 60,000 Australians live in New Zealand. The professional bodies in many regulated professions, like accountancy and surgery, are combined. Their financial markets are entirely intertwined: All four of New Zealand's largest banks are owned by Australian banks and many of New Zealand's largest firms (including multiple former state-owned enterprises) are listed on the Australian Stock Exchange.

Despite this tight integration, no supranational government exists. Only in very limited areas (chief among them food standards) do 'trans-Tasman' authorities have any independent regulatory authority. The creation of an ambitious trans-Tasman pharmaceutical regulator has twice been seriously proposed and twice died a quiet death on the order papers of the two countries' parliaments (Small, 2007; Dominion Post, 2014). Some private quasi-regulatory institutions do cross the Tasman Sea (e.g., the aforementioned professional bodies), but this is an independent decision of those bodies.

Other regulatory coordination occurs, but it is typically informal and ad-hoc, or narrowly tailored to areas where trans-Tasman cooperation is fundamental to the issue. For instance, the financial regulators in New Zealand and Australia have established a 'memorandum of cooperation' about the management of bank distress in a trans-Tasman bank (a term which includes all of both countries' major banks). This is an agreement to ensure that, in a crisis, the regulators act in the collective interest of the trans-Tasman economy, rather than engaging in beggar-thy-neighbour policies.[7] This obligation is reinforced by a specific provision in New Zealand's Banking (Prudential Supervision) Act 1989 obliging the Reserve Bank of New Zealand to, "to the extent reasonably practicable, avoid any action that is likely to have detrimental effect on financial system stability in Australia". A similar provision exists in

[7] For instance, New Zealand's banking regulator could worsen an Australian banking crisis by unnecessarily forcing a struggling Australian parent of an otherwise-sound New Zealand bank to inject more capital and weaken their Australian balance sheet.

the Australian legislation (Parliament of Australia, 1998). Nonetheless, despite this agreement to cooperate in crisis moments, both countries' regulators have retained their own abilities to set rules in normal times. Indeed, the Australian and New Zealand governments actively decided against a model of joint or Australian supervision in 2004.

Without a supranational legislature or bureaucracy, economic integration is based entirely on the operation of the rule of mutual recognition. This 'Trans Tasman mutual recognition principle' is stated in a set of equivalent laws passed in all six Australian states, both Australian territories, the Australian Commonwealth, and New Zealand. Each of these pieces of legislation is called the Trans-Tasman Mutual Recognition Act ("TTMR Act"). The New Zealand rule simply states:

> [S]ubject to this Act, goods produced in or imported into an Australian jurisdiction, that may be lawfully sold in the Australian jurisdiction ... may, by virtue of this Act, be sold in New Zealand ... without the necessity for compliance with any of the requirements relating to sale that are imposed by or under the law of New Zealand. (s. 10, TTMR Act 1997 [NZ])

A similar, though slightly more bureaucratic, provision applies for the practice of licensed professions. The Australian version (as it appears in the Commonwealth's TTMR Act) is reproduced below:

> [S]ubject to this Part, a person who is registered in New Zealand for an occupation is, by virtue of this Act, entitled after notifying the local registration authority of an Australian jurisdiction for the equivalent occupation:

(a) to be registered in the jurisdiction for the equivalent occupation; and
(b) pending such registration, to carry on the equivalent occupation in the jurisdiction.

> (s. 16(1), TTMR Act 1997 [Aus. C'th])

Much potential for mischief lies in the innocuous phrase "the equivalent occupation". Incumbent professionals have a strong incentive to prevent new entrants from outside of the jurisdiction from competing with them (Stigler, 1971). In this case, this incentive could lead to local incumbents 'capturing' their jurisdiction's regulatory body (many of which are primarily comprised of practitioner-members in view of their supposed expertise) and using it to declare the qualifications of the other country as insufficiently stringent to make the occupations "equivalent."

The potential for the abuse of this formulation was recognized by policy makers while formalizing the TTMR Arrangement. As such, independent regulatory tribunals exist on both sides of the Tasman, charged with hearing appeals against the decisions of local registration bodies on the equivalence of two professions for the purposes of the TTMR regime. To ensure a coherent approach is taken across the Tasman Sea, each independent tribunal can include a member of the other on its panels, under arrangements made by the Tribunal chairmen. Moreover, they are both required to take into account the decisions of the other. The legislation creates a presumption in favour of equivalence and requires the tribunals only to declare two occupations non-equivalent if the imposition of reasonable conditions (e.g., limiting the scope of a professional's practice) could not render them sufficiently equivalent. Moreover, in the Australian case, the independent tribunal is a Commonwealth body, protecting them from undue influence by the interests of the local profession. Finally, Ministers from New Zealand and an Australian jurisdiction are permitted to jointly declare, by Gazette, two occupations as equivalent, regardless of the decisions of the local registration body or the independent Tribunals. In a clear attempt to inject a bias towards liberalization into the regime, no power exists for Ministers to do the opposite and declare occupations non-equivalent without primary legislation.[8]

[8] For the Tribunal's powers and the limits on their ability to declare two occupations as non-equivalent, see s. 30(1) of the TTMR Act 1997 (NZ). For the Ministers' powers to make joint equivalence declarations, see s. 31 of the same Act. For the composition of the Tribunals, see s. 46(2). For the requirement to have regard to the other Tribunal's decisions, see s. 45. In all three cases, effectively equivalent provisions exist in the Commonwealth of Australia's Act. These are identified under the substantive provision in the New Zealand Act in the comparison notes.

These relatively broad principles are subject only to limited exceptions. The most prominent examples are road vehicles, therapeutic products (e.g., pharmaceuticals), and medical practitioners. In each of these cases, the initial regulatory schemes when the Arrangement was made diverged significantly and, a cynic might argue, local lobbying power of the affected groups is stronger than usual.[9]

Economic Union: European Union

Unlike the story of CER, this story is well-known. I will not belabour it. The EU evolved out of a post-war desire for European unity to maintain peace and prosperity. It grew from three distinct 'European Communities' into a single, semi-federal supranational union, complete with many of the trappings of a nation-state: A seat at the G7, a flag, an anthem, a capital (indeed, three), a currency, and a legislature, judiciary, executive, and bureaucracy.

The EU is an archetypal example of my institution-based model of international cooperation. Through the process of regulatory harmonization, gradually more and more of the European economy has been subject to regulation by European law as opposed to national law.

A striking example of this is the CE mark system. This system applies to a wide range of products, including toys, electrical equipment, medical devices, and machinery, all of which are subject to European-level regulation. Once a manufacturer certifies (often with the assistance of an accreditation body) that their product meets the requisite European directives, they are permitted to sell that product anywhere in the common market. These European directives are written by a supranational bureaucracy (the European Commission), interpreted by a supranational judiciary (the ECJ), and often based on standards composed by a supranational standards organization.

Given the existence of the regulatory integration trilemma, the EU's structural differences to CER are unsurprising. The European project is

[9] Medicine, in particular, meets all of Stigler's (1971) criteria for predicting an occupation to be able to secure especially harsh occupational licensure: A large size, a high per capita income, geographic concentration in metropolitan areas, and a high level of self-employment.

simply much more ambitious in its breadth. It attempts to integrate 27 states from vastly different legal and constitutional traditions with vastly different economic compositions and situations into not merely a free-trade and free-movement zone, but also a common currency and customs union. To take one data point: Whereas Australia's GDP per capita is 20% higher than New Zealand's, the richest EU member (Luxembourg)'s GDP per capita is 75% higher than that of the poorest (Croatia). The economic interests of those two countries are likely incredibly dissimilar. Thus, politicians are unlikely to be able to trust them to deliver relatively similar regulations.

Which Should Be Preferred?

Now we have established the options which are available to policymakers and analysed three archetypal examples thereof, it remains to assess those options against the metric of enhancing liberty.

Regulatory Quality

As Hayek accepts in *The Economic Conditions of Interstate Federalism* (1948), economic unions result in a regulatory monopoly for the international decision maker. Due to the operation of the internal market, "[c]ertain forms of economic policy will have to be conducted by the federation or by nobody at all" (Hayek, 1948, p. 266). Thus, we must evaluate whether monopoly international regulators will set more liberal economic policies than the individual un-federated states would have in the counterfactual.

Government failures are unavoidable. They can result from a mere mistake, simple bureaucratic incompetence, or industrial capture. If bad decisions are inescapable, it is preferable that fewer members of a given international order are subjected to them. If one assumes the propensity for government failure is as high for domestic governments as it is for international decision-makers, it makes sense to prefer national governments as rule-makers—because their mistakes affect a smaller population.

However, many government failures are not inescapable in a world of mutual recognition and total free trade. Firms and consumers can simply operate in another member-states' regime, without sacrificing market access. That increases static efficiency: From a given set of options, market participants can choose the set of rules which suits them best. This, naturally, is not possible where there is only a single set of rules (i.e., the international decision-maker's) to choose.

The natural result of such choice is, of course, increased dynamic efficiency. Competition acts as a discovery mechanism (Hayek, 2002) and as a disciplining mechanism. As Hayek (1990) argued later in his career in the case of currencies, when governments are forced to compete against each other for business, they are forced to adopt better practices. This inter-jurisdictional competition is not always unambiguously welfare-improving—see, for instance, Australian states competing with each other to maximize discretionary tax breaks given to favoured firms (Banks, 2002)—but, where politicians interests intersect at least partially with the general interest, they can do so—for instance, as Lemke (2016) revealed when he found inter-jurisdictional competition increased the speed of liberalization for the laws which governed married women's property rights in 19th century America.

However, this intuitive argument must be confronted with the possibility that national governments err more than international decision-makers and do so in a correlated way that makes inter-jurisdictional choice and competition less effective.[10] Here, we engage with Hayek's argument in *Interstate Federalism* that economic unions likely result in less protectionism and less planning.

Hayek argues that any given community's propensity for central planning varies roughly in line with its homogeneity (1948, p. 264). This proposed relationship arises from two distinct, but related, arguments: Firstly, that more homogenous societies have less conflicting objectives, making such plans easier to write. For instance, in a society

[10] That is, if every country is making the same mistake, choosing between them does not offer an effective remedy.

only comprised of farmers of a particular commodity, subsidies for that commodity are likely to be relatively easy to sell.[11] Secondly, that, where trade-offs do exist, they are easier to sell when the payers have some ties—however illusory—to the recipients. As Hayek puts it in the case of industrial subsidies, "the decisive consideration is that their sacrifice benefits compatriots whose position is familiar to them" (1948, p. 262). Given that international unions are *ipso facto* less homogenous than nation-states, these arguments lead to the conclusion that economies with international regulators will be less planned than those with national regulators.

The first of these two arguments assumes that, if agreement cannot be reached between the various constituent members of an economic union, the default result is inaction. That is, if France cannot agree with Germany what the correct subsidy for dairy farmers should be, it will default to nothing. Were this true, it would be a strong argument.

Rather, I would argue that the tendency is the inverse: When international organizations cannot agree, they regulate more, rather than less. The bureaucratic imperative to expand size and scope of government acts, despite any disagreements. Bureaucrats from France, Germany, and Italy may disagree, quite virulently, on the correct course of action, but, following the strong argument of Niskanen (1968), all three likely agree that it involves the expansion of the state. The result, therefore, is likely not that they agree to disagree and simply move on to the next thorny issue: Instead, they likely resolve their dispute by doing all three of their suggested solutions. Not only does that increase the sum-total of regulation, it also likely increases its complexity and the difficulty and dead-weight loss involved in adherence.

The second of these arguments assumes that nationalism is the primary consideration which persuades voters to abandon their self-interest and accept central planning (e.g., protectionism). This leads to the conclusion that, while nationalism can justify trade restrictions (or similar policies) within a single country's trade area, it will fail to inspire support for them in a broader union. Hayek asks: "Is it likely that the

[11] Naturally, they will also be pointless, because there will be no-one to fund the subsidy except the farmers themselves.

French peasant will be willing to pay more for his fertilizer to help the British chemical industry?" (1948, p. 262).

On the margins, it is likely true that nationalism increases the likelihood for bad policies aimed at industrial protection to be accepted. However, the conventional political-economic logic of 'disperse benefits and concentrated costs', which often dooms free trade (see Olson, 1971), still applies in an international context: Even if consumers do dislike these higher prices and no longer feel they are justified on nationalistic grounds, they simply do not care enough nor do they have enough political power to have the regulations removed, when compared to the significant and organized interest that the protected classes have in maintaining them. In addition, this argument ignores the relatively common case of shared industries: Belgian consumers might be unwilling to protect French dairy farmers from New Zealand competition by paying higher milk prices, but they are quite willing to protect their own dairy industry by paying said prices and therefore, indirectly, to protect the French farmers. Finally, it ignores the very real possibility of horse-trading. German consumers may dislike the protection that French farmers receive, however, French consumers also likely dislike the protection that German automakers receive: The quid-pro-quo is that each accepts higher prices for the goods they import, in exchange for those they export.

Thus, newer theoretical insights about the behaviour of bureaucracies suggest that, contra Hayek (1948), economic unions are likely to adopt protectionist and otherwise unwise economic policy. This is reinforced by the European example. Though it is certainly possible that many European states in a non federated counterfactual would have even more protectionism and planning than they do as EU members, the argument that interstate federation will result in a dramatic reduction in economic planning does not appear to hold water. Using government expenditure as an imperfect proxy for the scale of government intervention in the economy, we find that the gap between EU members and the rich world overall in government spending has not shrunk markedly since the Treaty of Maastricht as this theory might predict. Indeed, over 35%

of the EU's budget goes toward the Common Agricultural Policy (European Parliament, 2019)—the world's largest farm subsidy system and a clear example of protectionist economic planning.

These arguments taken together lead to the conclusion that a mutual recognition treaty will result in preferable regulatory outcomes to an economic union. Moreover, this argument applies even in the case where inter-jurisdictional competition and choice are neutralized by each state making common errors.

The Limits of Integration

In regulatory matters, economic unions and mutual recognition enable roughly the same depth of integration. Firms are allowed to trade in both their home state and a foreign state using the same regulations—the only difference is that in the former case, those regulations are set internationally and in the latter, they are set by the firm's home government.

However, outside of regulatory matters, economic unions can enable additional integration compared to mutual recognition treaties.

For instance, a common external tariff without an international decision making body to agree to it seems unworkable. The negotiations inherent in making trade deals require international decision-makers which are capable of making trade-offs between sets of intra-union stakeholders in deciding their priorities and what they are willing to concede. The only common trade policies which appear workable are unilateral free trade and a totally static tariff schedule. The former is a laudable goal but a pipe dream in the present political environment. The latter locks out the option of tariff reduction.

Nonetheless, the fact that economic unions can enable deeper integration does not decide the question. We must also consider whether such integrations are wise. Generally, they are not. All of the same problems of reducing inter-jurisdictional choice and competition which make unions inferior to mutual recognition for regulatory purposes apply in these areas too.

Consider trade policy. With independent trade policies but total market access, market forces will encourage governments to liberalize. Firms typically seek to maximize the available market for selling their products. *Ceteris paribus*, they will prefer, therefore, to produce their goods in the member nation with the most significant market access to external nations. The free trade area created by the mutual recognition treaty means shifting jurisdictions will not cost them access to their former domestic market, increasing the likelihood that they will shift. The natural result of this shift in firms is a shift in workers (possibly enabled by the free movement of people) and a reduction in corporate, income, and consumption tax revenue for the member states with less access, which budget-maximizing bureaucrats (see Niskanen, 1968) will naturally wish to rectify. The result, therefore, of this newly satisfiable demand for market access is likely to be that nations will seek to increase the number and value of free trade agreements they have, necessarily reducing their own tariffs to receive access to the foreign market. By contrast, where a single international decision maker has control over trade policy, this competitive pressure is much lower, because firms cannot access those external markets without exiting the customs union altogether and sacrificing access to their home market.

A Federal Combination?

Despite the general rule favouring decentralization, there may be some specific areas where it is desirable for a set of polities to share a single monopoly provider. Good examples include defence and foreign policy, both of which reward scale. Some libertarians (e.g., Christensen, 2021) have also argued that the presence of federal institutions can usefully restrain local governments, through the enforcement of a liberty-protecting constitution by a superior body. Such observations have tended to justify the formation (and expansion) of federal unions, like the United States and Australia.

Accepting this line of argument does not require one to abandon the mutual recognition concept. Australia (considered alone, not together with New Zealand) shows that a federal state can easily accommodate a mutual recognition rule between its members, while also providing 'federal' services. One could also imagine a situation in the United States where the Congress used its interstate commerce power to implement a nationwide mutual recognition rule. This would be in contrast to the current rule, where, via the so-called dormant commerce clause's 'antidiscrimination principle', the Supreme Court simply requires that states do not unduly burden out-of-state trade relative to in-state trade (Gorsuch, 2023). Very small steps in this direction have already been made, as the Obama, Trump, and Biden White Houses all recognized the significant growth penalty imposed by the incoherent occupational licensing requirements imposed by the various states (Tuccille, 2023).

The problem, as always, is how to ensure this new Leviathan does not use its federal power to layer 'harmonized' rules on top of the mutual recognition principle unnecessarily. A constitution featuring disproportionate state representation and enumerated legislative powers may provide some protection, but the glut of regulatory output produced by federal agencies of the United States shows that this protection is certainly not absolute. Nonetheless, the added benefits of federal union may be sufficient in certain circumstances to make this worthwhile. Mutual recognition provides an avenue through which such federal unions can achieve economic integration without adopting a damaging regulatory union.

The Breadth Trade-off

The preceding arguments lead to the conclusion that mutual recognition results in better policy-making than economic union. However, that benefit must be weighed against the naturally constrained scope of mutual recognition treaties to only similar countries.

A narrow membership appears to impose significant costs. For starters, it means that less trade is enabled, simply because there are fewer people included in the overall free trade area. More deeply, if the pre-existing similarity between the member-states is high, their regulations are likely to already be relatively coherent with each other. This means mutual recognition brings fewer static efficiency gains. Moreover, if the incentives on politicians in each country are very similar, they are less likely to reach different conclusions on future issues and thus engender inter-jurisdictional competition with each other. Finally, if the countries are relatively similar, the comparative advantage differences between them are likely to be relatively small, meaning additional trade will be less advantageous than between very different countries.

Nonetheless, there are three arguments which should be considered in mitigation.

Firstly, one of the legacies of European colonial domination in the nineteenth century is that the Earth is characterized by many networks of states which are similar to each other in important respects but are still economically diverse. They often share their colonizers' language and legal system, for instance. This means that, while the scope of mutual recognition treaties is certainly constrained, there are still non-trivial arrangements which could be made. Take the English-speaking settler colonies[12] and the United Kingdom, for instance. These five countries are culturally, legally, and politically similar, so much so that their signals intelligence agencies share almost all of their outputs with each other under the Five Eyes agreement. Thus, they are similar enough that mutual recognition would not be so risky that it would be politically impossible. However, they are also sufficiently distinct from each other economically that freer trade could be very worthwhile. For instance, New Zealand has a comparative advantage in agriculture relative to the other four states, whereas the United Kingdom has a comparative advantage in financial services. One imagines that similar plausible combinations exist among the Hispanophone and Francophone countries of the world.

Secondly, mutual recognition treaties need not be exclusive, unlike economic unions. Consider three countries (X, Y, and Z) where all three are not sufficiently similar to form a multilateral integration arrangement but where Y is similar enough to both X and Z to form such an arrangement with each separately. With bilateral mutual recognition, X would simply be able to accept all goods (or professionals) legal under

12 Canada, Australia, New Zealand, and the United States

Y's laws, without having to accept those which were legal in Y due only to being legal in Z. By contrast, Y could not simultaneously be bound by two economic unions which insist on monopoly control over economic regulations and thus would have to choose which of X and Z it prefers to integrate with. Thus, though mutual recognition treaties may be limited in their breadth when considered individually, their ability to be combined together can partially offset this disadvantage.

Finally, mutual recognition treaties can be combined with basic free-trade agreements to provide some additional breadth. Indeed, such agreements may be easier to conclude under mutual recognition than economic union. As discussed above, nations in mutual recognition arrangements are likely to retain an independent trade policy, unlike those in economic unions. These smaller negotiating units may find it easier to conclude deals than a union negotiating together. This is because they are less likely to contain industries which either threaten or are threatened by their trade partners' industries. For instance, while Germany has very little industrial overlap with New Zealand's primarily agricultural and tourism-based economy, small-scale French and Belgian farmers would face intense competition from New Zealand's highly-efficient dairy industry. Were Germany in control of its own trade policy, it would likely be very willing to conclude a free-trade agreement with New Zealand. However, the existence of Belgian and French resistance makes such a deal much less likely, although a limited free-trade deal was recently struck.

Sustainability

Economic integration is only useful for liberals as long as it lasts. Moreover, an integration arrangement should be stable in order to encourage firms to make investments which rely upon it. Thus, in addition to the quality of their regulation and the breadth of their membership and scope, we must measure international arrangements by their sustainability.

As Hayek laments in *Interstate Federalism* (1948, p. 262), nationalism is a powerful political force. From a merely symbolic standpoint, economic unions are much a more conscious rejection of the nation-state than mere treaties. The trappings of statehood—independent courts, a flag, an anthem, a capital city—come only with a union: As such, even if the union and the treaty imposed the exact same limits on sovereignty, the regular reminders to voters of the abrogation of their national'sovereignty' only come from the union. In any case, the limits on sovereignty are much more circumscribed in a mutual recognition model: Sure, you might have to accept the regulations of the other member states, but you still retain the ability to regulate your own firms, even if the extent of that power is limited by an exit-option for regulated firms. Given that concerns about national sovereignty are often very important to anti-integration campaigns, a model based on mutual recognition seems more likely to survive such campaigns.

Conclusion

Arrangements for international economic integration are as subject to the logic of public choice economics as any other act of government. That logic implies that advocates for trade liberalization must make trade-offs between three desirable objectives (i.e., breadth, depth, and sovereignty) if they are to successfully advocate for such arrangements. If one is interested in trade liberalization, successfully advocating for such arrangements is a battle worth fighting: The barriers imposed by different regulations in many cases dwarf those directly imposed through trade and quota policy.

The form of international economic integration that is most compatible with libertarian objectives is mutual recognition treaties. Such treaties achieve what appears impossible by reducing trade barriers while maintaining inter jurisdictional competition. Though they do come at the expense of broader integration (both in terms of membership and scope), that is mitigated by the availability of alternatives (e.g., free-trade agreements and a series of interlocking bilateral mutual recognition treaties) or the inadvisability of such integration. They can also be made part of wider integration programmes (e.g., federal unions), in lieu of granting the new integrated polity the power to regulate much economic activity.

By contrast, economic unions like the European Union undermine liberal objectives. They create inescapable monopoly regulators that resolve deadlocks by regulating more, rather than less. Even if they directly allow a reduction in trade barriers between more countries than mutual recognition treaties, they are not the only way to achieve such breadth. Simple free-trade agreements—which are likely easier to conclude outside of an economic union—could suffice, for instance. Thus, if they wish to maximize liberty, liberals should reject economic unions and proposals to give them more power. Instead, they should advocate for a return of power to the nation-state, together with a maintenance of mutual recognition and free trade.

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