Prospects for a New Zealand - China Closer Economic Partnership Agreement?

1. Background

1.1 On 18 April 2001, the Prime Minister announced that New Zealand and the Hong Kong Special Administrative Region would be commencing negotiations on a closer economic partnership (CEP) agreement. The Government believes that a CEP agreement with Hong Kong would increase bilateral trade flows and generate new employment opportunities through export led growth in the economy. New Zealand already has a CEP agreement in place with Singapore.

1.2 The Ministry of Foreign Affairs and Trade (MFAT) has released a discussion paper providing an analysis of the existing bilateral trade and economic relationship as a background to a possible CEP agreement. MFAT has asked for submissions on the paper by 25 May. Business New Zealand will be making a submission and we have asked 80 manufacturing companies that export to Hong Kong for their views on the desirability of negotiating a CEP agreement.

1.3 MFAT has suggested the following rationale for negotiating a CEP agreement with Hong Kong:

- Hong Kong is one of New Zealand's significant trading partners (it is our seventh largest export market).
- New Zealand would be taking an important step to reinforce linkages with North Asia and raise our profile in the region.
- A CEP agreement would be consistent with the APEC goals of free and open trade and investment in the Asia-Pacific region.
- Although Hong Kong currently maintains zero tariffs on all imports, a CEP agreement would provide us with a commitment that our exports would continue to face zero tariffs on a permanent basis.
- Trade gains can be made through the reduction of non-tariff barriers, and a CEP agreement would reduce compliance costs for businesses through the elimination or reduction of technical barriers to trade.
- A CEP agreement would offer more open and secure access for New Zealand services exporters.
- A CEP agreement would act as a stimulus to encourage Hong Kong and other Asian investors to increase flows of productive new investment into New Zealand.

1.4 There are also challenges that need to be addressed:

- On the import side, a CEP agreement would have implications for those remaining protected industries, notably textiles, clothing and footwear. Clearly, robust application of rules of origin would be required to ensure that non-Hong Kong goods (for example, goods largely made in China and shipped to Hong Kong for finishing and final export) could not claim tariff preferences on the basis of such a CEP agreement.
- The Government is concerned about labour and environment standards. It would appear though that Hong Kong's labour laws are not dissimilar to New Zealand's and its per capita income remains significantly higher. Hong Kong is also making an effort to improve environmental protection.

- Exceptions would be needed to maintain New Zealand's biosecurity, although these would be based on GATT Article 20 and would be similar to those in the Singapore CEP agreement. The Government is also likely to wish to be free to adopt measures deemed necessary to give Maori preferential treatment to meet its Treaty of Waitangi obligations.
- There would be implications of tariff elimination for protected sectors, so, in common with the CEP agreement with Singapore, provision for adjustment costs would need to be considered.

2. CEP Agreement with China?

2.1 As noted above, Hong Kong has no tariffs and there would appear to be few other barriers to New Zealand trade in either goods or services. Therefore, some members have suggested that there would be greater benefits (to exporters) from New Zealand also seeking to negotiate a CEP agreement with the People's Republic of China. The remainder of this paper considers this issue.

2.2 China is already our sixth largest market for basic manufactured exports ($327.8 million in 2000) with growth of 73.7% for the 2000 calendar year. Major export products include sawn timber and wood products; processed food; paper, paper products and printing; leather; and non-ferrous metals.

2.3 However, while China has great potential for further export growth, it imposes large tariffs on its imports, while a raft of non-tariff barriers and bureaucratic 'red tape' can make it a very difficult country in which to do business. A CEP agreement would eliminate tariffs and would also set in place a process to reduce compliance costs for businesses through the elimination or reduction of technical barriers to trade and other non-tariff barriers.

2.4 China is now our fourth largest country of origin for manufactured imports ($1879.4 million in 2000), with growth of 34.6% for the 2000 calendar year. Major import products include clothing and knitted products; textiles (excluding carpets and rugs); electronic equipment; footwear; and metal product manufacturing.

2.5 The advantages and challenges identified with respect to Hong Kong, would also apply with respect to China. Although the potential benefits would be enormous for our exporters in particular, the challenges are also likely to be on a considerably larger scale.

2.6 On balance though, the benefits of a CEP agreement with China are likely to outweigh the costs, particularly in the longer term. Whether we can get China interested in negotiating such an agreement with New Zealand is another matter altogether, but it would certainly be worth trying.

2.7 Further discussion of the implications and prospects for a CEP agreement with China follow in the rest of this paper.

3. New Zealand - China Bilateral Trade

3.1 The table below shows the value of basic manufactured exports to and imports from China for the 1999 and 2000 calendar years. It also shows the ratio of exports to imports for those years. The ratios indicate the degree to which New Zealand has a trade surplus (if the ratio is greater than 1) or a deficit (less than 1) for each type of product listed.

BMS Item	December 1999 Year			December 2000 Year		
	NZ Exports to China ($million)	NZ Imports from China ($million)	Ratio of Exports to Imports	NZ Exports to China ($million)	NZ Imports from China ($million)	Ratio of Exports to Imports
Food Processing	$36.2	$15.0	2.41	$49.2	$18.6	2.65
Beverages & Tobacco	$0.1	$0.7	0.10	$0.1	$1.1	0.11
Textiles (excluding carpets & rugs)	$0.5	$118.0	--	$0.3	$149.9	--
Carpets	$0.3	$1.5	0.21	$1.0	$0.9	1.05
Clothing & Knitted Products	$0.2	$421.9	--	$0.1	$550.3	--
Footwear	$0.0	$79.7	--	$0.0	$110.6	--
Tanned Leather & Dressed Fur	$6.6	$0.5	12.80	$21.9	$1.4	16.06
Sawn Timber & Wood Products	$28.9	$8.9	3.24	$49.3	$10.8	9.22
Paper, Paper Products & Printing	$22.5	$14.2	1.58	$26.9	$23.6	1.14
Industrial Chemicals & Petroleum Product	$52.5	$43.9	1.20	$13.0	$56.1	0.23
Synthetic Resins	$0.8	$0.4	2.14	$2.0	$1.3	1.46
Other Chemical Products	$3.5	$22.6	0.16	$2.1	$28.5	0.07
Rubber Products	$0.0	$11.3	--	$0.0	$18.5	--
Plastic Products	$0.7	$41.5	0.02	$1.0	$52.4	0.02
Non-metallic products	$0.0	$43.3	--	$0.1	$57.4	--
Iron & Steel	$6.4	$8.0	0.81	$7.3	$10.2	0.72
Non-ferrous metals	$9.3	$6.1	1.53	$21.4	$9.2	2.33
Metal Product Manufacturing	$0.6	$61.1	0.02	$0.9	$80.7	0.01
Transport Equipment	$0.0	$22.0	--	$0.02	$25.6	--
Electronic Equipment	$4.4	$188.8	0.02	$4.1	$279.7	0.02
Household Appliances	$0.1	$57.2	--	$0.0	$74.5	--
Electrical Equipment	$4.7	$47.3	0.10	$11.2	$66.3	0.17
Agricultural Machinery	$0.3	$2.0	0.17	$0.9	$2.4	0.38
Industrial Machinery & Equipment	$7.5	$34.3	0.22	$4.3	$50.8	0.09
Furniture	$0.1	$21.7	--	$0.0	$31.3	--
Other Manufacturing[1]	$2.4	$124.4	0.02	$110.8	$167.2	0.66
TOTAL, CHINA	**$188.7**	**1,396.2**	**0.14**	**$327.9**	**$1,879.4**	**0.17**

(Note: because of rounding, some of the totals may not add up)

[1] Includes confidential export items for the 2000 calendar year – mostly methanol and newsprint

3.2 Overall, the table highlights that Chinese manufactured imports into New Zealand are nearly six times higher than New Zealand manufactured exports into China. China is dominant in most manufactured product types, but this is particularly so with respect to clothing and knitted products; footwear; rubber products; non-metallic products; transport equipment; household appliances; furniture; and textiles (excluding carpets and rugs).

3.3 Conversely, New Zealand is particularly strong with respect to tanned leather and woolskins; sawn timber and wood products; food processing (excluding meat, dairy, and fish products); and non-ferrous metals.

3.4 There are few product types where values are similar for both exports and imports. Some examples in 2000 included: carpets; paper, paper products and printing; synthetic resins; and iron and steel.

3.5 It should be noted that the 2000 figures are still provisional. Statistics New Zealand waits 12 months before taking any commercially confidential items out of 'other manufacturing' and allocating the respective amounts to the appropriate BMS items. This explains why 'other manufacturing' jumped from $2.4 million in 1999 to $110.8 million in 2000. Although several of the BMS items will therefore be significantly undervalued in the table below, we understand that this would be particularly so for 'industrial chemicals and petroleum product', which showed a supposed decline of 75% between 1999 and 2000.

4. New Zealand and Chinese Tariffs Rates

4.1 Under the provisions of a CEP agreement, both countries would be required to remove their tariffs.

New Zealand Tariffs

4.2 Since the 1980s, New Zealand has progressively reduced and eliminated tariffs to the extent that a significant portion of the economy is no longer subject to any tariff protection. The previous Government had intended to eliminate all remaining tariffs by 2005, but the incoming Labour-Alliance Government reversed this decision, instead freezing tariffs at their existing levels until at least 2005.

4.3 For those products that are still subject to tariffs, some countries are exempt from tariffs altogether (such as Australia under CER and Singapore under the CEP agreement), while some countries enjoy preferential rates for some products (such as some Pacific Island countries, less developed countries, and least developed countries). China is classified as a 'Less Developed Country' (LDC). For the sensitive TCF sector, there are no LDC preferential rates - China is therefore subject to the 'normal tariff' (which is the highest rate applicable).

4.4 New Zealand still maintains tariffs on a number of manufactured items, although for the most part the rates are set at relatively low rates by world standards (between 5%-7.5%). Exceptions include the following product categories (the tariff rate listed is that for an LDC, such as China):

- New pneumatic tyres - up to 17.5%.
- Leather apparel - up to 14%.
- Woven fabrics - up to 10%.
- Carpets - up to 14%.
- Clothing - up to 19% as well as fixed $ amounts per item.
- Linen and curtains - up to 10%.
- Hats - up to 13.5%.
- Footwear - up to 19%.
- Mechanical parts for motor vehicles - up to 10%.
- Electrical machinery for motor vehicles - up to 17.5%.
- Reception apparatus for radio-telephony - up to 10%.

4.5 All of these product categories have significant levels of Chinese imports into New Zealand, which indicates that China is still very competitive even with relatively high tariffs imposed on its products. To take the TCF sector as an example, Chinese imports in the TCF sector rose by 30.8% during the 2000 calendar year to reach $813 million. This is despite facing up to a 19% tariff as well as fixed $ amounts per item for some clothing items. 39.4% of all TCF imports are now from China, with Australia now lagging a very distant (and declining) second.

4.6 When combining the import statistics with New Zealand manufacturing sales for the same period it can be seen that China is gaining a significant share of the total sales of the TCF sector (up from 14.4% to 17.4% during 2000):

Market	December 1999 Year		December 2000 Year		% Growth 1999-2000
	TCF Sales ($ million)	% of Total TCF Sales	TCF Sales ($ million)	% of Total TCF Sales	
Peoples Republic of China	$621.6	14.4%	$813.1	17.4%	+30.8%
Australia	$341.8	7.9%	$309.1	6.6%	-9.6%
All other countries	$858.7	19.9%	$940.4	20.1%	+9.5%
Total Imports	*$1822.1*	*42.3%*	*$2062.6*	*44.2%*	*+13.2%*
NZ Manufactured	$2486.8	57.7%	$2604.1	55.8%	+4.7%
TOTAL TCF SALES	**$4308.9**	**100.0%**	**$4666.7**	**100.0%**	**+8.3%**

(Note: because of rounding, some of the totals may not add up)

4.7 The statistics can also be broken down into market share by TCF sub-sector. For the clothing and footwear sub-sectors, Chinese products' market shares have grown particularly rapidly at the expense of both other imports and New Zealand made products. This has been especially true with footwear, where China has now overtaken New Zealand manufactures. However, for the leather and textiles sub-sectors, New Zealand manufacturing continues to be dominant over all imports and its market share appears to be holding steady. This is shown in the table below.

Industry	Sales ($million) December 1999 Year (market share % in brackets)				Sales ($million) December 2000 Year (market share % in brackets)			
	Chinese Imports	All Other Imports	NZ Made	Total	Chinese Imports	All Other Imports	NZ Made	Total
Clothing and Knitted Products	$421.9 (27.0%)	$366.1 (23.4%)	$774.2 (49.6%)	$1562.2	$550.3 (33.2%)	$361.0 (21.8%)	$746.0 (45.0%)	$1657.3
Footwear	$79.7 (26.9%)	$125.4 (42.4%)	$91.0 (30.7%)	$296.1	$110.6 (34.5%)	$128.6 (40.1%)	$81.4 (25.4%)	$320.6
Leather	$0.5 (0.0%)	$24.7 (8.3%)	$273.2 (91.7%)	$298.4	$1.4 (0.0%)	$23.8 (7.9%)	$275.6 (92.1%)	$300.8
Textiles and Carpets	$119.5 (5.6%)	$684.3 (31.8%)	$1348.6 (62.6%)	$2152.4	$150.8 (6.3%)	$736.1 (30.8%)	$1501.3 (62.9%)	$2388.2
TOTAL	**$621.6 (14.4%)**	**1200.5 (27.9%)**	**$2486.8 (57.7%)**	**$4308.9**	**$813.1 (17.4%)**	**$1249.5 (26.8%)**	**$2604.1 (55.8%)**	**$4666.7**

(Note: because of rounding, some of the totals may not add up)

4.8 On one hand it seems clear that even for the clothing and footwear sub-sectors, which have in place the highest tariff barriers faced by importers, tariffs at their current level are not posing a significant impediment to Chinese products entering the New Zealand market. Therefore it could be argued that the tariffs are failing to protect the New Zealand industry and because of this failure they should be removed as they only serve to increase costs to the consumer. Economic theory also suggests that the demise of inefficient industries frees up investment for sectors that have greater potential for growth and in which New Zealand would be more competitive.

4.9 While that argument is all very well in the long run, it would need to be balanced against the likely short-medium term impact of such a move on New Zealand manufacturing and the associated financial and human cost. Were tariffs to be removed entirely from Chinese imports then these imports would become even more price-competitive than they already are, with a likely negative impact on the New Zealand manufacturing sector and the loss of enterprises and jobs, at least in the short-medium term. This would be particularly pronounced in the TCF sector.

4.10 Clearly, this issue should be handled with sensitivity and care.

Chinese Tariffs

4.11 Unlike New Zealand, China has tariffs in place across all imports. According to the APEC Tariffs Database (www.apectariff.org/tdb.cgi), China has rates of tariffs that can be as high 100% even for those countries enjoying ‘Most Favoured Nation’ status (such as New Zealand).

4.12 Like most countries, China would appear to have tariff rates that are significantly higher for elaborately transformed manufactures and finished consumer goods compared with basic inputs to a manufacturing process. Also, there are certain sectors that China clearly wishes to protect through particularly high tariffs, such as motor vehicles.

4.13 Although there has not been time to examine every tariff chapter (China offers 96 chapters and 1242 tariff headings), an example of the range of tariffs for some key sectors is contained in the table below.

HS Number	Description	China MFN Tariff Rates
28	Inorganic chemicals	3-18%
30	Pharmaceuticals	9-15%
39	Plastics	14-20%
40	Rubber	3-40%
42	Articles of leather	15-30%
57	Carpets	25-31%
58	Special woven fabrics	22-31%
59	Coated/covered fabrics	8.4%-28%
60	Knitted Fabrics	21-33%
61	Knitted clothing/apparel	24-33%
62	Un-knitted clothing/apparel	26-33%
63	Other made up textiles	20-31%
64	Footwear	25%
65	Headwear	25%
70	Glass and glassware	2-30%
73	Articles of iron and steel	8-30%
82	Tools, Implements of metal	8-18%
85	Electrical machinery and parts	3-45%
87	Vehicles	9-100%

4.14 Particular attention has been paid to the sensitive TCF sector (HS numbers 57-65). Even though New Zealand has relatively high tariffs for carpets, clothing, and footwear (up to 19% plus $ amounts per item for some clothing items), the table shows that China's tariff rates are higher still (tariff rates of between 25-33% on average).

4.15 Considering how high Chinese tariff barriers are across the range of product types, it is clear that there would be significant benefits for those New Zealand manufacturers exporting to China in the reduction or elimination of tariff barriers. Considering how high China's tariffs currently are, it is surprising how well our manufacturing exporters have been doing in that market. Reducing or removing tariffs through a CEP with China would make New Zealand exports even more price-competitive, particularly against competing imports from other countries.

Comparison of New Zealand and China Tariff Rates

4.16 The table on the following page compares the respective tariff rates for those products where New Zealand has high tariffs in place.

4.17 It is clear from this table that China's tariff rates are still substantially higher than even the highest equivalent New Zealand tariff rates, although for clothing this is more difficult to quantify as New Zealand sets a fixed $ amount either as well as or instead of the % rate on some clothing. For particularly cheap items of clothing, the fixed $ amount per item on its own could be well in excess of China's 33% tariff rate.

Product	Highest NZ LDC Tariff Rate	Highest Chinese MFN Tariff Rate
New pneumatic tyres	17.5%	30%
Leather apparel	14%	25%
Woven fabrics	10%	31%
Carpets	14%	31%
Clothing	19% as well as fixed $ amounts per item	33%
Linen and curtains	10%	31%
Hats	13.5%	25%
Footwear	19%	25%
Mechanical parts for motor vehicles	10%	50%
Electrical machinery for motor vehicles	17.5%	20%
Reception apparatus for radio-telephony	10%	30%

Dumping Safeguards

4.18 Although eliminating tariffs would inevitably reduce the cost of goods entering the New Zealand domestic market, this is not to say that imports may be sold at prices below cost – this is called 'dumping'. The Ministry of Economic Development is responsible for investigating anti-dumping complaints. Anti-dumping duties have in the past been imposed upon Chinese footwear and business shirts.

4.19 Even within a CEP agreement, there would presumably be no reason why provision for anti-dumping duties could not be incorporated.

5. Non Tariff Barriers

5.1 China is a country that can be very difficult in which to do business due to bureaucratic impediments and other non-tariff barriers. There is no formal definition of what is a non-tariff barrier (NTB) or any exhaustive list of NTBs. However, they are generally described as any government actions that are discriminatory (i.e., would not be faced by Chinese businesses) and restrict trade flows. Examples of NTBs include import licensing, onerous documentation requirements or slow moving customs procedures, excessive inspections, discriminatory port charges, and requirements to use certain approved agents or freight forwarders, to name just a few. China's lack of a 'rule of law' could also be regarded as a NTB.

5.2 Trade gains can be made through the reduction of non-tariff barriers. A CEP with China would set in place a process to reduce compliance costs for business through the removal or reduction of technical or sanitary/phytosanitary barriers to trade (it would not, however, effect our ability to maintain in place a robust biosecurity regime). It would also promote greater bilateral consultation and transparency in areas such as business law and competition policy. Incorporating such concepts into a CEP would make it easier for New Zealanders to do business in China.

5.3 On the other side of the coin, with our open and competitive economy, Chinese importers and business people do not face the degree of barriers in doing business in New Zealand. Therefore, removing or reducing China's NTBs would be of great benefit to New Zealand.

6. Services

6.1 China's services sector is severely restricted, with major access impediments to foreign services providers and other bureaucratic obstacles that need to be overcome. A CEP agreement would offer more open and secure access to New Zealand services exporters, particularly if China's WTO commitments in this sector are restricted. It would also provide a framework for full bilateral liberalisation across all service sectors.

6.2 Meanwhile, Chinese businesses do not face barriers to enter our already open and largely deregulated services sector, so a CEP agreement would be of greater benefit to New Zealand in this regard.

7. Investment

7.1 China has not been a large investor in New Zealand (it does not currently rate among the top ten countries investing in New Zealand), but it has made some high profile investments in New Zealand in recent years, particularly in the forestry sector. A CEP agreement with China would be likely to act as a stimulus to encourage further Chinese investment in the New Zealand productive sector. This would be positive for business and employment.

7.2 An Investment Protection and Promotion Agreement (similar to the one we have in place with Hong Kong) would make also make it easier for investors from one country to invest in the other.

8. Trade and Labour and the Environment

8.1 The Government has stated that it sees labour and environmental standards as being important issues, and it would like see them better integrated with trade agreements. Although free trade agreements can actually improve labour and environmental conditions, in developing economies in particular, those who are opposed to globalisation have used concern about labour and environmental standards as a smokescreen to mask their protectionist and anti-business attitudes.

8.2 Although China is a member of the International Labour Organisation and is also a party to a number of environmental treaties, its practical implementation of such standards is not regarded as being particularly good to say the least and average incomes in China remain at very low levels (under US$1000 per annum), despite high rates of GDP growth. Its human rights record is also poor, particularly in relation to the suppression of religious and ethnic groups.

8.3 It is likely that because of its concerns about China's labour, environmental, and human rights record, the Government would be cautious about entering into a CEP agreement with China.

9. China's Trade Conservatism

9.1 However, probably the largest single impediment to a CEP agreement with China would be China's own conservative and protectionist attitudes. Although China is a huge country with potential to become the world's largest economy within the next twenty years if current growth rates are maintained, it still perceives itself as being a 'developing economy' and vulnerable to open slather competition.

9.2 An example of China's trade conservatism can be found in the area of air transport, which is regulated worldwide by bilateral air services agreements. Chinese air services negotiators recently told New Zealand transport officials that China "would not be ready for an open skies agreement for another fifty years". They have said that China would not be prepared to countenance an open skies agreement, even with a small country like New Zealand, as it would set a precedent for other countries (notably the United States). The same arguments would probably be used against us if we were to seek to negotiate a CEP agreement before they were ready.

9.3 We should also be cautious of the prospects of getting China, which is preoccupied with issues surrounding its accession to the WTO, to focus on a CEP agreement with New Zealand. MFAT therefore believes that a CEP agreement with China would not be a short-medium term prospect.

9.4 Because of China's far greater size and the fact that on balance New Zealand would probably have more to gain from a CEP agreement, it would be almost impossible to get China to enter into negotiations with New Zealand if were unwilling to do so. But that is not to say that we should not try.

10. APEC Dimension

10.1 However, a possible avenue of leverage with China might be to use APEC arguments. APEC is an informal gathering of 21 'economies' in the Asia-Pacific region whose goal is to achieve free and open trade and investment within the region by 2010 for developed economies (such as New Zealand) and 2020 for developing economies (such as China). According to our APEC obligations, we must remove all our remaining tariff barriers by 2010.

10.2 Each economy takes turn to Chair the APEC process for a year, and China is the APEC Chair for 2001. Chairing APEC gives economies a great deal of exposure and has a prestige factor. New Zealand was Chair in 1999 and was widely congratulated as having boxed above its weight.

10.3 China, which holds a lot of store on 'face', will be keen for its year to be seen as a success, and in order for this hope to realised, some 'deliverables' on liberalisation are likely to be needed. MFAT has been trying to develop ideas on how best to use China's year in the Chair as a way to increase and improve dialogue between New Zealand and China on trade issues. A CEP agreement could be put to the Chinese as a way for them to prove their APEC credentials.

11. World Trade Organisation (WTO) Accession

11.1 The WTO is an organisation for the discussion, negotiation, and resolution of trade issues covering goods, services, and intellectual property. As mentioned above, China is looking to accede to the WTO in 2001 and it is likely to be preoccupied with this work in the short to medium term.

11.2 While the WTO's fundamental obligation is that of 'most favoured nation' (which requires a member country to extend any favourable treatment it gives to one country to all other WTO members), one of the few exceptions to this equality of treatment concept is membership of a WTO-consistent free trade agreement. We could put to China that if it wishes to give preferential access to anyone, it could be through a CEP agreement and New Zealand (being small and relatively 'harmless') might be a good place for it to start.

12. Conclusion

12.1 A CEP agreement with China is likely to be greatly beneficial to New Zealand exporters and business people attempting to maintain and grow their positions in the Chinese market as well as for potential new-entrants that have otherwise been impeded from trading with China due to high tariffs and NTBs.

12.2 Depending on the sector, the likely direct impact on the New Zealand domestic industry would probably be neutral to strongly negative (especially TCF) in the short-medium term. However, it could be argued that because our existing tariffs are failing in their purpose of protecting our industry from cheap imports then there may not be much point in maintaining the pretence and keeping them in place. This issue has to be handled sensitively though.

13. Recommendation

13.1 On balance it would probably be worthwhile exploring this issue further with MFAT perhaps initially by mentioning the issue in our submission on the proposal for negotiations on a CEP with Hong Kong.