

# **NEW ZEALAND – HONG KONG CEP DISCUSSION PAPER**

## **SUBMISSION BY BUSINESS NEW ZEALAND**

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### **1. Introduction**

1.1 With 76,000 members, Business New Zealand is the leading national organisation representing the interests of New Zealand's business and employing sectors. Business New Zealand champions policies leading to business growth and national prosperity; efficient government with minimal intervention and compliance costs; reduced taxation; balanced employment, economic and environmental legislation; and excellence in knowledge and learning.

1.2 Overall, Business New Zealand supports the proposal that New Zealand and Hong Kong should enter into negotiations for a closer economic partnership (CEP) agreement. We agree that a CEP with Hong Kong would increase trade flows and generate greater employment through export led growth. It would also complement similar existing agreements with Australia and Singapore and would be consistent with the ambition to engage other significant trading partners, such as the United States.

1.3 Business New Zealand represents many manufacturers that have struggled to compete against a large influx of Chinese imports, particularly in the textiles, clothing and footwear sectors. While supporting a CEP agreement with Hong Kong, Business New Zealand is concerned to ensure that non-Hong Kong goods (such as those from the People's Republic of China) are not able to claim tariff preferences on the basis of the CEP with Hong Kong. It is important, therefore, that New Zealand strongly advocates for a robust rules-of-origin regime to be designed and applied.

1.4 Hong Kong maintains zero tariffs on all imports, so some members of Business New Zealand have suggested that the advantages to New Zealand goods exporters would be rather limited under a CEP agreement with Hong Kong. Therefore Business New Zealand suggests that the Government should also explore negotiating a CEP agreement with the People's Republic of China. Attached to this submission is a paper that we have prepared on the prospects for such a CEP agreement with China.

1.5 Comments on the issues raised in the discussion paper follow, in the order they appear within the paper.

## **2. Why New Zealand is Interested in a CEP with Hong Kong (Chapter One)**

2.1 Business New Zealand endorses and supports the arguments set out in this chapter, that is, a CEP with Hong Kong would:

- Provide New Zealand with an opportunity to strengthen and deepen its relationship with an important trading partner.
- Help position New Zealand businesses to take advantage of new and emerging opportunities in North Asia.
- Provide an opportunity to promote quality trade rules at a time when progress on trade liberalisation in the WTO is uncertain.

2.2 The New Zealand economy is small, geographically isolated, and heavily dependent on international trade for the maintenance of its standard of living. Business New Zealand recognises that greater international trade will be crucial to our goal of seeing New Zealand advance up the rankings of OECD economies. We therefore support the broad objective of trade liberalisation, as it makes our exports more competitive in international markets and, domestically, it reduces the cost of imports to the consumer and for intermediate inputs.

2.3 We believe that despite the well-publicised problems of recent years (such as the failure of Seattle), progress within the WTO should eventually pay dividends in the longer term. The WTO should therefore remain New Zealand's key long-term trade policy objective, although all commentators agree that this may take some time. Therefore, Business New Zealand also believes that pursuing WTO-consistent bilateral and regional trading initiatives, particularly those that accelerate trade liberalisation among our important trading partners, is a sensible intermediate strategy.

2.4 A CEP agreement with Hong Kong would be complementary to our existing CER agreement with Australia and CEP agreement with Singapore. A CEP agreement with Hong Kong would also be consistent with the Government's efforts to engage other trading partners, most notably the United States, in entering into a bilateral or regional free trade agreement.

2.5 We also agree that a CEP with Hong Kong would have strategic benefits in increasing New Zealand's profile in what is a key market. This argument has been supported by recent statistics that have shown a large increase in two-way trade (27% for exports and 11% for imports for the March quarter) between New Zealand and Singapore since the inception of the CEP. This compares with overall March quarter growth estimated at 18% for exports and 12% for imports. Therefore, it is debatable whether the increase in trade with Singapore is as spectacular as first appears when it is compared to strong growth across all markets over that period. While encouraging, we believe that more time is needed before we can come to firm conclusions about the true impact of the CEP with Singapore.

### **3. Overview of the New Zealand and Hong Kong Economies and Trade Profile (Chapter Two)**

3.1 We have no comment on the factual material that is contained within this chapter, but have an observation to make on New Zealand's standard of living compared to other economies.

3.2 Table 1 is interesting though in that it shows that while Hong Kong's GDP per capita increased by 74% from 1991-99, New Zealand's only increased by 27% over the same period. It shows that New Zealand has a lot of work to do to arrest its relative decline in standards of living compared with other developed and even developing economies.

3.3 The paper is correct in stating that one of the main reasons for New Zealand's relative decline has been the tariffs and other barriers our primary products face in most of our markets. However, while that analysis may be true, it ignores the fact that international commodity prices for primary products have been falling consistently in real terms for many years (despite the occasional upwards blip, such as the one we are currently experiencing). This has had an adverse impact on our terms of trade.

3.4 Few developed economies are as reliant on natural resource products as New Zealand is. While removing tariff barriers and quotas on our primary product exports would certainly help increase trade and economic growth, and thereby our relative standard of living, success in improving New Zealand's GDP per capita will also be reliant on utilising a highly educated and skilled labour force and exporting products with a higher value added component.

### **4. The Hong Kong – New Zealand Trading Relationship (Chapter Three)**

4.1 We have no comment on the factual information that is contained within this chapter, although we note that when comparing tables 7 (major exports from New Zealand to Hong Kong) and 8 (major imports from Hong Kong into New Zealand) it would appear that New Zealand and Hong Kong tend to each concentrate on certain types of exports, with only electrical machinery appearing in both tables. It would not appear therefore that New Zealand and Hong Kong exporters currently compete significantly in each other's home markets.

4.2 We note that 45% of Hong Kong's exports to the world are clothing and textiles, yet apparel and knitted goods are relatively insignificant exports from Hong Kong into New Zealand (5.5% and 3.8% of total imports respectively in 2000). This could be because Chinese imports have increased so significantly in recent years, making Hong Kong imports of clothing and textiles less competitive in New Zealand and 'crowding' them out of the market. And it could be that New Zealand's high tariffs on clothing and textiles have been successful in protecting our domestic industry from Hong Kong

imports (but not so successful with respect to cheaper Chinese imports). A CEP with Hong Kong, which would eliminate tariffs on clothing and textiles from Hong Kong, might therefore enable it to significantly increase its imports of clothing and textiles into New Zealand. This is unlike the situation with respect to Singapore, which is not a significant exporter of textiles and clothing in the first place.

## **5. Issues with Goods Trade (Chapter Four)**

### *Tariff Barriers*

5.1 Business New Zealand recognises that New Zealand must be committed to a dynamic and internationally competitive economy. Although tariffs were initially an important component of Government revenue, since the 1930s they have mainly been used as a tool to protect local industries (and therefore jobs) from cheaper imports. However, while having social benefits, tariffs are an imposed cost on the economy and result in resource misallocation. Business New Zealand therefore supports a phased approach to tariff reduction, which would allow affected industries time to adjust to greater import competition.

5.2 We note that although Hong Kong does not currently maintain any import tariffs, there is no legal obligation on it to maintain completely open access for those industrial tariff items that are 'unbound' through its WTO obligations. We agree that this constitutes a risk (albeit a small risk) for our exporters and that a CEP would provide security of access for our exporters.

5.3 While New Zealand exporters would not gain a great material benefit from tariff elimination (as they already face zero tariffs), Hong Kong would certainly benefit from a CEP that eliminates tariffs. Hong Kong is currently subject to the 'normal tariff' rate, and although 95% of imports currently enter New Zealand duty free, certain sectors still receive tariff protection. These include the textiles, clothing and footwear sector as well as some automotive parts and machinery. Eliminating tariffs on Hong Kong imports would have implications for profitability and employment in these sectors.

### *Rules of Origin*

5.3 Of greater concern though is the issue of goods making their way to New Zealand from China via Hong Kong. The People's Republic of China is already New Zealand's fourth largest import source and growth in imports has been very rapid (for example, manufactured imports from China increased by 34.6% in 2000). China has become the single largest source of imports of both clothing and footwear and it is taking a significant and growing share of the New Zealand domestic market for both types of product.

5.4 The paper is quite correct in emphasizing Hong Kong's status as a regional entrepot and transport hub. Re-exports sourced from or destined to China are a significant feature of Hong Kong's trade. Most of the goods transhipped from China

through Hong Kong to New Zealand are clothing, telecommunications equipment, and toys.

5.5 A key issue for domestic manufacturers when assessing the impact of a CEP with Hong Kong will having an assurance that a robust rules-of-origin regime is designed and applied so that Chinese imports cannot circumvent New Zealand tariffs by taking advantage of the tariff concessions that would apply to products originating in Hong Kong.

5.6 Business New Zealand members are concerned about the integrity of the border between Hong Kong and China, and whether it is adequately policed. There is anecdotal evidence from some members, which highlight the porous nature of the border between China and Hong Kong. Some members are therefore sceptical that rules-of-origin can be adequately applied to New Zealand's satisfaction.

5.7 Another key issue would be the percentage of local content required for products to comply with rules-of-origin requirements and the type of costs that may be included in calculations. For example, CER/CEP agreements with Australia and Singapore have 50% and 40% local content requirements respectively. There are also some differences in definitions of the costs that can be included in these calculations (for example, marketing expenses and profits are often explicitly excluded). A robust rules-of-origin enforcement regime will also be required with severe penalties for those attempting to abuse the tariff preferences.

5.8 These important 'detail' issues will need to be carefully worked through, and the existing close relationship between the New Zealand and Hong Kong customs authorities further enhanced, to ensure that products that are essentially Chinese goods are not able to slip through the cracks and enter New Zealand tariff free. At the same time, we agree that the rules-of-origin regime will need to be transparent and easy to use so as not to unduly increase business compliance costs.

5.9 Although the clothing and footwear sub-sectors have in place the highest tariff barriers faced by imports into New Zealand, tariffs at their current level do not appear to be posing a significant impediment to Chinese products entering the New Zealand market. However, while this could be an argument for those who would argue that the rules-of-origin might not matter so much in practice (and therefore why bother with tariffs at all), it is important to recall that China imposes high tariffs across its entire economy, which impose real impediments to New Zealand exporters.

5.10 It is these concerns that have lead some members of Business New Zealand to advocate a 'free and fair' trade agreement with China that might provide greater reciprocal benefits, particularly to our exporters that face high tariffs exporting into China. Attached is a paper that discusses the prospects for a CEP agreement with China.

5.11 A key issue in any free trade agreement is whether there are any constraints on the level of government financial assistance that is provided to business. For example, a free trade agreement will be significantly undermined if production subsidies or other forms of financial assistance are provided to business in one country. While the WTO has significantly limited the ability of WTO members to provide export incentives or subsidies, there are fewer constraints on more general financial incentives that nevertheless provide an unfair competitive advantage to recipient businesses.

5.12 To be effective, the CEP agreement would require additional constraints on the ability of the Hong Kong Government to undermine the intent of the CEP. To this extent, the CEP would require a limit on the level of financial assistance or tax credits the Hong Kong Government can provide to businesses in Hong Kong.

### *Non Tariff Barriers*

5.13 Business New Zealand supports efforts to reduce non-tariff barriers. Non-tariff barriers impose significant compliance costs on our exporters and can be more of an impediment to free and fair trade than tariffs (which are at least relatively transparent). New Zealand should therefore actively pursue means to reduce and eliminate such barriers to doing business, both multilaterally (for example through the WTO, OECD and APEC) and bilaterally. We agree that a CEP agreement that seeks to address or eliminate non-tariff barriers would be beneficial to New Zealand businesses.

5.14 Recent events such as the foot and mouth outbreak in the United Kingdom and our recent own scares over exotic insect pests have increased the awareness of how important it is to maintain a secure border. We would be wary about a CEP agreement that would compromise our ability to maintain in place a robust biosecurity regime.

## **6. Services Trade (Chapter Five)**

6.1 Business New Zealand recognises that services are a significant and growing component within our total export and import trade. However, despite the service sector's global and national importance, traditionally in many countries it has been a restricted sector with many institutional and regulatory barriers to access. Only in recent years, has attention turned to opening and deregulating services markets. However, some countries continue to take a conservative position on services and even Hong Kong (the world's 10<sup>th</sup> largest services exporter) has declined to not make many services sector commitments in the WTO. As the paper points out, Hong Kong is a significant global player in the services sector, so there is potential for New Zealand to benefit from a CEP agreement that comprehensively liberalises services.

6.2 We also note that New Zealand's own services market is already open and largely deregulated and our WTO commitments on services are more extensive than Hong Kong's. Therefore, a CEP agreement would go some way to level the services playing field between the two parties and provide equal opportunities to each side's businesses.

## **7. Investment Issues (Chapter Six)**

7.1 Hong Kong is an important source of international direct investment into New Zealand. We would support a CEP agreement that would help stimulate greater two-way flows of productive new investment. We note as an encouraging sign the early experience with the Singapore CEP, where the agreement has encouraged Singapore's Economic Development Board to send an investment mission to New Zealand.

## **8. Other Issues Within a CEP (Chapter Seven)**

8.1 We are uncomfortable with a Treaty of Waitangi clause being written into a CEP agreement with Hong Kong. We would not support any measures that would allow the Government to give any special interest group preferential treatment. This could be construed to be protectionism by another name - how would New Zealand feel about agreeing to a trade agreement with France that would let the French accord favourable treatment to their farmers on 'cultural grounds'? Business New Zealand would not be surprised were such a clause to be viewed by Hong Kong with suspicion and there is therefore a risk that our negotiators could find themselves having to make important concessions in other areas.

8.2 Also, the discussion paper does not elaborate on what sort of 'favourable treatment' to Maori might be considered. If such measures were to take the form of non-tariff barriers or subsidies, then they could potentially add significant costs to the economy and/or result in the misallocation of resources.

## **9. Labour Standards and Environmental Standards (Chapter Eight)**

9.1 Business New Zealand recognises that the Government places a high importance on labour and environmental standards, but would be concerned if such considerations became the overriding factor in whether to negotiate a CEP with any economy.

9.2 Notwithstanding the fact that free trade has been proven to be beneficial to developing countries in raising living standards, opponents of free trade have used labour and environmental standards as a smokescreen to mask their inherent protectionism. While on one hand complaining about gap between rich and poor, the anti-globalisation lobby has sought to keep the developing world 'in its place' by effectively seeking to restrict its ability to trade by insisting on adherence to strict labour and environmental standards.

9.3 With respect to Hong Kong, we do not believe that the Government should be concerned about labour and environmental standards being applied in that territory. With regard to labour standards, Hong Kong and New Zealand apply many of the same ILO conventions and although there is no minimum wage, its average wages are higher, even in the manufacturing sector, than those in New Zealand.

9.4 Hong Kong also applies many of the key international environmental conventions and, as the discussion document states, has made efforts to improve the quality of its environment.

## **10. Conclusion**

10.1 Overall, Business New Zealand is broadly supportive of the intention of New Zealand and Hong Kong to negotiate a CEP. However, this support is predicated on assurances that:

- (a) A robust rules-of-origin regime can be designed and implemented that would prevent circumvention of tariff preferences by goods that are in reality Chinese; and
- (b) Constraints on the level of financial assistance available for businesses in each country are put in place.

10.2 Business New Zealand also encourages the Government to consider pursuing a CEP with the People's Republic of China. This proposal is discussed further in the attached paper.