

## 19. NEW ZEALAND AND HONG KONG CLOSER ECONOMIC PARTNERSHIP AGREEMENT

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The purpose of this report is to outline the implications for local government and for Christchurch of the proposed New Zealand and Hong Kong Closer Economic Partnership (CEP). The report seeks endorsement by the Council of a full submission on the proposed negotiations. A copy of the submission is attached.

The Council has previously made submissions on the Closer Economic Partnership with Singapore, the World Trade Agreement and the Multi-lateral Agreement on Investment.

### INTRODUCTION

On 18 April 2001 the Prime Minister, the Rt Hon Helen Clark, announced that the New Zealand Government planned to negotiate a free trade and investment agreement with Hong Kong: Closer Economic Partnership Agreement (CEP). She identified that a particular focus of the negotiations would be to promote two-way trade in goods and services and to increase bilateral investment flows.

The Minister of Trade Negotiations, the Hon Jim Sutton, subsequently released a discussion paper on the issues to be covered in the negotiations with Hong Kong and the current state of the Hong Kong/New Zealand trade and economic relationship. The Minister also released the text of the Understanding Agreed between New Zealand and Hong Kong on Parameters for a CEP Negotiation, setting out the principles and parameters on which the negotiations would be based.

The Government is seeking input on the proposal by 25 May 2001. This input will form the basis of the report to the Government and therefore New Zealand's positions in the negotiations with Hong Kong.

The New Zealand and Hong Kong Closer Economic Partnership will be modelled on a similar agreement with Singapore which was initiated by the National Government and signed by the Labour/Alliance Government November 2000. The Council made a submission on that agreement in September 2000.

There appear to be few benefits from the proposed agreement with Hong Kong. Both New Zealand and Hong Kong have very open economies. Any concessions by Hong Kong in service areas may require further concessions by New Zealand (we already have one of the most wide-ranging commitments of any WTO member) which could cost highly in terms of further commercialisation of our social and environmental services. The agreement is also likely to result in further tariff cuts in our textile, clothing and footwear industries, which are extremely vulnerable.

The agreement would open New Zealand to the risk of threats of litigation by corporations regarding environmental, economic and social policies that adversely affect them. It may restrict local government's social and economic development policies and environmental protection policies.

Agreements on recognition of qualifications, for example education and engineering qualifications, could be negotiated separately from a CEP.

### BACKGROUND

Hong Kong is New Zealand's seventh largest export destination with exports worth \$772 million in 2000, equivalent to 2.76 per cent of our total exports. Imports from Hong Kong were \$171 million in 2000, equivalent to 0.56 per cent of total imports.

The discussion document identifies that a CEP with Hong Kong would have a key objective of increasing bilateral trade flows and generating new employment opportunities in New Zealand through export-led growth and increased flows of investment from Hong Kong to New Zealand industries.

The discussion paper identifies that a closer economic partnership with Hong Kong provides an opportunity to set benchmarks on trade rules and to promote trade liberalisation within the APEC region. It states that:

"There are continuing uncertainties about the framework and scope of the next round of multilateral negotiations. The failure of Seattle has seen an increasing focus on bilateral and regional trading initiatives as a means of encouraging accelerated trade liberalisation including in the APEC region. While progress in the WTO will remain New Zealand's key trade policy objective, it is important that every effort is made to advance and secure our trade and economic interests in key markets" (Ministry of Foreign Affairs and Trade 2001).

## **ISSUES**

### **Globalisation and Social, Economic and Environment Objectives**

New Zealand has lowered its national barriers much further than most countries. The Government could justifiably impose a moratorium on further commitment to lowering the barriers on trade in goods, agriculture, services and other areas. It could shift its attention to securing a balance between international trade rules and domestic economic, social, environmental and cultural objectives. Many countries maintain barriers against a wide range of New Zealand goods to protect their local producers.

There is growing support of the view that New Zealand's self-regulated free markets and free trade and investment approach is unsustainable. New Zealand economy faces a sustained external current account deficit and trade imbalance, rising foreign debt, and a net outflow of investment funds. New Zealand's market share of trade has decreased despite its extreme free trade commitments. Trade has expanded faster in countries with greater protection. New Zealand's social infrastructure continues to deteriorate and poverty and inequality has increased. Comparative growth figures show that countries that followed a more benign or pragmatic policy regimes have fared much better (Dalziel 1999). In the past year the balance of payments has start to improve but there is still a large account deficit. Similarly, there have been some improvements in employment and the income levels of the low paid, but the poverty gap remains a matter of concern.

A review of the Government's commitment to universal free markets would be appropriate. We would like to propose the Government evaluate the impact of free trade policies on economic development, environmental standards and democracy. Even the noted international financier, George Soros, has suggested some check on globalisation (Press 7/5/01). Such a review may identify that a focus on rebuilding the domestic economy would better achieve our social, environmental and economic objectives and supporting small local enterprises and innovation (as per Minister of Economic Development's regional development strategies) would generate better employment opportunities (Kelsey 1999, Halzedine 1998). This would not involve retreating to isolationism but ensuring that trade policies are aimed at developing a productive economy.

The Council has previously sought a deferral of trade agreements while there is a review of the implications for local government and local economies (April 1998). The Council has also previously argued that it is inappropriate that local authorities are constrained by an agreement to which local government is not a party (April 1998).

### **Removal of Tariffs**

The Understanding Agreed between New Zealand and Hong Kong on Parameters for the CEP Negotiation states that Hong Kong and New Zealand will "seek to agree on the modalities for early elimination of tariffs on all goods of Hong Kong and New Zealand origin by an agreed date". This proposal contradicts the policy position behind the Government's policy<sup>1</sup>

As Hong Kong currently maintains zero tariffs on all imports there are no immediate commercial gains from tariff elimination for New Zealand. However, a CEP with Hong Kong would have implications for New Zealand's protected industries, including the textiles, clothing, and footwear (TCF) sectors. Free trade with Hong Kong would result in the elimination of tariffs on goods of Hong Kong origin, including textiles, clothing and footwear (TCF). This could result in significant increase in imports from Hong Kong/China.

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<sup>1</sup> Labour Policy states it will "freeze remaining tariffs at year 2000 levels for at least five years, or until key trading partners match those levels while promoting transitional measures to allow industries to prepare for the tariff reduced environment". Alliance Policy states "We believe in the right of all countries, including our own, to protect their environment, resources, development, and the health and safety of their people as they see fit ... Trade agreements on a bilateral or multilateral basis will be encouraged where they meet environmental, labour and social standards."

Currently, 95 per cent of New Zealand's global imports enter duty free, either because the goods are not made in New Zealand or because of preferential tariff arrangements. "Normal" tariff rates on protected sectors in New Zealand are typically in the region of 5-7 per cent. However, certain sectors receive higher protection. For example, clothing and certain footwear items are protected by a 19 per cent tariff (or more when "alternative specific" tariffs, expressed in dollars per garment, are applied to low cost clothing). Re-exports are 92 per cent of the total exports from Hong Kong to New Zealand. Almost all of the clothing is recorded by Hong Kong as coming from China originally (where labour costs are extremely low).

The Christchurch City Council has previously opposed the move to zero tariffs on the grounds that it would impact severely our region which still depends on the fragile textiles, clothing and footwear (TCF) industries. Other industries susceptible to cheap imports may also be affected (September 2000).

### **Rules of Origin**

Unless there are robust Country of Origin clauses there is the possibility that non-Hong Kong origin goods may claim tariff preferences on the basis of a CEP with Hong Kong. It will be exceptionally difficult to define rules of origin that are enforceable and distinguish domestic products from those made elsewhere (Rosenberg 2001). Hong Kong's geographical situation and the extent of re-exports of traded items via Hong Kong means that rules of origin should be a central issue in a CEP negotiations. However, it is difficult to see that given the circumstances that any rules of origin clauses will sufficiently protect New Zealand's textile, clothing and footwear sector.

The Christchurch City Council has previously sought assurance that there will be rigorous ongoing monitoring arrangements that would ensure that rules of origin provisions in such agreements are observed (September 2000).

The Council has argued that other rules of origin provisions have been circumvented and that the resources available in the past to the New Zealand authorities for monitoring and enforcing obligations of this nature have not been sufficient. As a result the damage to a local business can be done before remedial action is taken.<sup>2</sup>

The Council may wish to again seek assurances that if the negotiations proceed the Government ensure there are adequate rules of origin provisions. It may also wish to seek assurances that sufficient resources will be made available to the New Zealand Customs to enable it to establish and maintain a sufficiently rigorous monitoring and enforcement process.

### **Non-Tariff Barriers**

The discussion paper identified that trade gains can be made not only through the removal of tariffs, but by the reduction of non-tariff barriers. It is proposed that the CEP would set in place a process to reduce compliance costs for business through the elimination or reduction of technical or sanitary/phytosanitary barriers to trade. It would also promote greater bilateral consultation and transparency in areas such as business law and competition policy (Ministry of Foreign Affairs and Trade 2001).

The Council may wish to seek assurances that any removal of non-tariff barriers does not affect our ability to maintain a robust biosecurity regime. Hon Marian Hobbs identified "the level of [biosecurity] protection is lagging behind the growth in trade" (28/11/00).

### **Services**

Services will be a focus of negotiations. The wide gap between what Hong Kong and New Zealand have already committed to the WTO's General Agreement on Trade in Services (GATS) will put New Zealand in a weak position in the negotiations. New Zealand already has one of the most wide-ranging commitments of any WTO member. Hong Kong's commitment are substantially lower. It has not made commitments in the WTO on a number of services sectors in which New Zealand has a significant trade interest (architecture, engineering, legal, postal, education, environment and air transport services). In others areas, such as construction services, Hong Kong's commitments have limited scope (in construction they cover only building completion and project management).

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<sup>2</sup> We note the recent report by the Deputy Prime Minister stating that "the rules of origin under the agreement were being rigorously enforced" (Anderton 7/5/01).

Education and professions including architecture and engineering were New Zealand's targets in Singapore and are likely to be in Hong Kong. Hong Kong can be expected to demand concessions in return. These additional concessions may have major implications. In the Singapore agreement, concessions in services included environmental and ambulance services among many others. If Hong Kong asks for similar concessions, New Zealand's public education and health systems, both of which have become commercialised and open to private sector competition, are at risk of being locked opened to commercial competition from companies based in Hong Kong. That would undermine the Government's proclaimed intention to restore the public dimension to these systems and increase pressure to further commercialise our social services (Rosenberg 2001).

The existing WTO commitments have already imposed constraints on policy options for the tertiary sector, such as not allowing the New Zealand Government to limit the total number of universities in the country. The Government would be better advised to withdraw from these commitments rather than further cementing them and making withdrawal more difficult.

At the same time, it is difficult to see New Zealand benefiting from opening Hong Kong's education system to New Zealand educational institutions. Hong Kong has a well-developed tertiary education system, with considerably better student : teacher ratios than New Zealand, particularly in tertiary education. Though Hong Kong has a shortage of facilities costs of providing services will be high, and require significant capital investment when most New Zealand institutions are critically short of funding (Rosenberg 2001).

The New Zealand institutions are already attracting Hong Kong students to New Zealand without the need of a full Free Trade and Investment Agreement (FTIA). Specialised agreements on mutual recognition of qualifications could be made without the wide-scale concessions an FTIA will entail. Mutual recognition of qualifications, such as engineering and related services could also be negotiated outside the context of a full free trade and investment agreement.

Jobs created in service industries are of very mixed quality. Those created in the sectors favoured by Hong Kong-based investors are likely to be largely in hotels and distribution, such as supermarkets – jobs which are notoriously low paid, insecure, casualised and deunionised. Its investment in property and business services is unlikely to provide many jobs.

### **Government Procurement**

In the Singapore Agreement, all Government procurement of goods and services over the equivalent of \$125,000 were opened to Singapore on an equal basis to local companies. This area is particularly contentious because it indirectly affects local government. While the Singapore Agreement did not bind local government directly it requires Central Government to use its "best endeavours" to secure compliance from local government. Therefore local government may come under pressure to comply.

Local providers, for example, environmental services (rubbish collection, sewerage, and perhaps services in relation to water supply), may find themselves competing with companies from around the world using a Hong Kong base for tendering (unless they are run by the local government's own department or are less than \$125,000 in value).

There are restrictions on the Singapore agreement on achieving social ends in procurement (Article 53). Limits are put on central and local governments imposing conditions on suppliers to encourage local development, create employment, gain technology, support not-for-profit groups or earn foreign exchange.

The Council's policies on preference for local suppliers are as follows:

"That the Council adopt a policy of active preference within a small financial cost for local firms for the supply of goods and services, and actively seek out quotes from local firms for all possible supplies" (25/6/90) and "That all future tender documents be worded in such a way as to enable a comparison between New Zealand and overseas produced goods, where relevant." (19/11/90).

In practice most tenders are from local firms so the issue of giving them preference does not arise. The Council has adopted a balanced, pragmatic approach, sometimes awarding a contract to a local supplier, sometimes preferring an offer from an overseas company, and sometimes choosing a combination.

The Christchurch City Council has also previously sought assurance that that any government procurement clauses would preserve the freedom of the Council to continue to exercise this sort of choice in order for decisions to be made in the best overall interests of its community. This has included a request for assurances that there will be no restrictions on local governments rights regarding achieving social ends in procurement and no restrictions regarding conditions on suppliers that would “encourage local development or improve the balance of payments accounts by requiring domestic content, licensing of technology, investment, counter-trade or similar requirements” (September 2000).

The Council also notes that the requirement to award a tender on the basis of “value for money” alone does not even make good commercial sense. Increasing attention is being given in the theory and practice of purchase and supply to building relationship, and formation of partnerships, in business and between businesses and public agencies. There is a growing body of experience in the commercial world showing that relationship contracting between buyers and sellers produce significant economic and strategic benefits in the form of lower costs of doing business and greater ability to meet strategic goals, and to do both on a sustainable basis. The shift in business practice is from managing contracts to managing relationships.

### **Investment**

Investors are unlikely to produce a high quantity of jobs and those jobs that are created are likely to be low-paid and insecure. Hong Kong based investors have been active in New Zealand for some time, but rarely have these investors put money into areas that would be most benefit to New Zealand.

There is evidence that much of the investment is for tax avoidance purposes rather than any interest in productive investment.

Investment flows between New Zealand and Hong Kong are heavily in Hong Kong’s favour. At March 2000, companies with a presence in Hong Kong had NZ\$1.067 billion invested in New Zealand according to Statistics New Zealand. However equivalent Hong Kong government figures show a startling discrepancy which highlights aspects of the investment relationship. As at 31 December 1998, Hong Kong authorities recorded NZ\$9.2 billion of Hong Kong-sourced direct investment in New Zealand. On inquiry, Hong Kong authorities attributed the \$8 billion difference to companies in Hong Kong seeking “tax advantages” by parking funds in New Zealand short term. Hong Kong investment flows show a very erratic pattern, and investment has fallen since the 1997 financial crisis. Hong Kong investors in New Zealand have regularly taken out more in dividends than they have earned (Rosenberg 2001:4).

### **Investment Promotion and Protection Agreement (IPPA)**

The multi-lateral agreement-like investment dangers<sup>3</sup> which are already in place through the IPPA will almost certainly be intensified by a new agreement (In April 1998, the Christchurch City Council sought a deferral of the signing of that agreement).<sup>4</sup> The New Zealand-Hong Kong Investment Promotion and Protection Agreement was signed in 1995 and has a rigidity of minimum 15 year terms (with protection to continue for a further 15 years for any investment in place if the agreement is subsequently terminated). The expropriation provisions and disputes procedure are very similar to ones at the centre of public concern in the Multilateral Agreement on Investment (MAI) (defeated in 1998 after widespread international opposition) and the North American Free Trade Agreement (NAFTA) agreement.

The expropriation provision in NAFTA has been interpreted by tribunals to include loss of an investment’s value through loss of profitability. It means that any change in environmental regulations by central or local governments which reduced the profitability of an enterprise could result in awards of compensation and perhaps reversal of a change in law or regulation. Even the threat of such costly actions is a brake on actions a government would otherwise have been taken in the interests of its citizens (Kelsey 1999).

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<sup>3</sup> For example, foreign investors have the same, or better, rights to establish, acquire, expand, operate, manage, maintain, use, sell or otherwise dispose of their investments as domestic investors in similar situations (including enforcement rights). In the MAI many traditional performance requirements were prohibited, for example requirements to hire a certain proportion of local workers or transfer technology to local companies. The MAI was intended to bind local authorities and cover privatization of local authority trading enterprises (LATEs) and other council assets (Kelsey 1999).

<sup>4</sup> Multi-lateral Agreement on Investment was defeated in OECD 1998 after widespread international opposition

There are now many cases under NAFTA. Claims by corporations regularly amount to hundreds of millions of US dollars, and settlements in the tens of millions.<sup>5</sup> New Zealand examples that could spark such investor claims include the halting of the Britomart scheme in Auckland, the renationalisation of ACC, the slowing of fast ferries in the Marlborough Sounds, and the 1998 electricity “reforms”<sup>6</sup>.

Article 9 of the IPPA gives investors the right to force such disputes to arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). Effectively this gives corporations equal standing with governments and a potentially greater right to enforce outcomes of disputes arising under the agreement than the governments themselves – an unprecedented development in the history of nations’ sovereignty. The process can be seen as a privatisation of the commercial justice system. The arbitral tribunal is appointed by the parties to the dispute. No third parties, such as a local authority, affected neighbours, or employees, have any standing in hearings, if hearings do occur (all submissions may instead be written). There is no right for the public to listen to proceedings or view evidence or submissions presented. The final “award” may be made public only with the consent of both parties” so the corporation party to the dispute can veto any decision being made public (Rosenberg 2001).

Arbitrators do not explicitly incorporate any other interests, such as environmental, social, or political concerns. Yet their decisions have enormous impacts on such concerns.

### **Treaty of Waitangi**

The discussion document has identified that, as with the CEP Agreement with Singapore (Article 74), New Zealand would wish to include a provision in any CEP with Hong Kong “safeguarding the Government’s ability, now and in the future, to adopt measures necessary to accord more favourable treatment to Maori in respect of matters covered by the CEP Agreement including in fulfilment of its obligations under the Treaty of Waitangi” (Ministry of Foreign Affairs and Trade 2001)

### **Trade and Labour**

Hong Kong applies many of the same labour conventions as New Zealand (right to organise and bargain collectively, prohibition against forced labour, employment of children etc). There is currently no statutory minimum wage. Hong Kong does not apply a statutory minimum wage and its wealth is distributed very unequally. Union membership in Hong Kong in 1999 was 20% of the workforce. Hong Kong has ratified a number of the ILO conventions. However, these do not apply to its factories in China.

The Government has indicated that it would like to see labour standards better integrated with trade agreements. However the “principled position” of the Hong Kong Government is that it was inappropriate to link such issues to any trade negotiations and agreements or to discuss such issues in any economic and trade for a (Ministry of Foreign Affairs and Trade 2001).

### **CONCLUSION**

There appear to be few benefits from the proposed agreement with Hong Kong.

New Zealand and Hong Kong have very open economies. New Zealand has made considerably more service commitments than Hong Kong in WTO. Any concessions by Hong Kong in service areas may cost highly in terms of:

- further commercialisation of our social and environmental services; or
- further tariff cuts in our textile, clothing and footwear industries, which are extremely vulnerable.

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<sup>5</sup> In one example, the Ethyl Corporation sued the Canadian government for about US\$250 million for restricting use of MMT, a petrol additive produced by the corporation, because of its danger to health and car emission systems. Ottawa was forced to repeal its ban, pay US\$13 million in damages to Ethyl and withdraw its assertion that MMT caused damage. In another case, Metalclad Corporation, a US waste disposal company, was awarded US\$16.7 million when the Mexican state of San Luis Potosi refused it permission to re-open a waste disposal facility after it was revealed that subterranean streams supplying water to the local community ran under the landfill. According to the Mexican government, “Metalclad knew the local community opposed it and they decided to force the situation, ignored the issue of the local permit and built without having a permit.” This case is doubly significant because it involved local government – not a signatory to NAFTA.

<sup>6</sup> It is particularly important to note that any company in the world could take advantage of the IPPA with Hong Kong: all they need is to own their investment through a paper subsidiary company in Hong Kong. In addition, any Hong Kong citizen in New Zealand can use it, while New Zealand citizens and companies cannot. An example (under the equivalent IPPA with China) is the principal of the Britomart project, Jihong Lu, who is a Chinese national.

The agreement may

- open New Zealand to risk of threats of litigation by corporations which dislike environmental, economic and social policies that adversely affect them.
- restrict local government's social and economic development policies.

Agreements on recognition of qualifications could be negotiated separately.

New Zealand has lowered its national trade barriers further than most countries: the Government can justifiably impose a moratorium on further "freeing" of trade, agriculture, services and other areas.

This report recommends that the Council request that the Government does not to proceed with the negotiations. However, the Council should also recommend that if the Government does proceed with the negotiations consideration be given to the issues outlined above.

We have sought comment from the Manufacturers' Association, the Distribution Workers' Union and local manufacturers and these should be available in time for the meeting.

- Recommendation:**
1. That the Council request the Government not to proceed with the negotiations with Hong Kong regarding the Closer Economic Partnership (CEP) until it has undertaken a detailed evaluation of:
    - (a) The impacts, favourable and unfavourable, on the New Zealand economy;
    - (b) The social and environmental impacts.
  2. That the Council endorse the detailed submission to the Trade and Economic Analysis Division, Ministry of Foreign Affairs and Trade (attached).

**Chairman's**

**Recommendation:** That the above recommendation be adopted.