

Reinforcing New Zealand's trade relationships after Covid-19

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Introduction

The Covid-19 pandemic and economic lockdown means many countries are looking inwards. But global cooperation will be an important lever out of the economic and social consequences of the virus. The New Zealand government should embrace the opportunity to reinforce its image as a clean, open and lawful nation.

The International Monetary Fund (IMF) has warned of the likelihood of the deepest economic downturn in nearly 100 years partly due to lockdowns across the world and also forecasted a decline in the volume of world trade in excess of 10%. The World Trade Organisation (WTO) has even worse projections (WTO, April 8).¹

The coronavirus outbreak has exposed the vulnerability of international supply chains. Insufficient stockpiles of personal protective equipment (PPE) in most countries have already caused plenty of low-level political friction which threaten to resurrect harsh trade barriers. The *New York Times* said some 69 countries have already imposed protectionist measures prohibiting the export of PPE and other goods (New York Times, April 10)².

Various types of lockdown protocols in different countries quickly changed consumer habits and sent ripples back up supply chains. While orders are still coming through, many producers in New Zealand face an extended period of recalibration in both their revenue forecasts and employment.

The crisis also revealed a dearth of international cooperation to help fix what is fundamentally an international problem. None of the expected bodies were able to take the lead to regulate or coordinate a global pandemic response which may mean that international institutions have simply stopped working. Eventually, countries may again realise that cooperation is important and New Zealand should be at the forefront encouraging this.

However, some New Zealand politicians, trade experts and economists have suggested New Zealand take the crisis as a warning sign that overreliance on free trade with China and other countries makes Kiwi businesses more vulnerable to shocks.

Yet New Zealand's hard-won and deep free trade agreements (FTA) with an open world trading system will be a key factor in resolving the coming economic downturn, along with its close ties to East Asia's largest market economies of China and Japan.

New Zealand should not retreat into outmoded interventionist responses. The Government's best long-term bet is to support, not undermine, the liberal open trading system and continue with domestic policy measures consistent with that.

¹ Trade set to plunge as COVID-19 pandemic upends global economy, World Trade Organisation, April 8, 2020: https://www.wto.org/english/news_e/pres20_e/pr855_e.htm

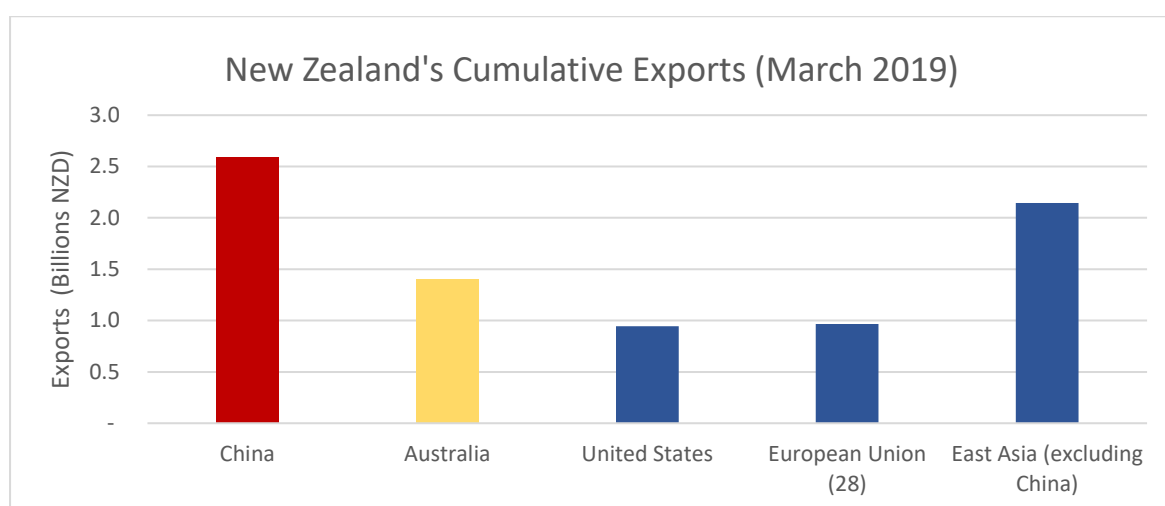
² A New Front for Nationalism: The Global Battle Against a Virus, New York Times, April 10, 2020: <https://www.nytimes.com/2020/04/10/business/coronavirus-vaccine-nationalism.html>

Protectionism rising

Trade is critical to the New Zealand economy. Last year, the total value of New Zealand's goods and services exports rose \$3.4 billion to \$86 billion, while total imports hit \$83.4 billion, up \$2.4 billion from 2018 (Stats NZ, March 3)³. Most of those exports were sent to Australia, China or the European Union.

For New Zealand's core primary sectors – meat, dairy, fisheries, wine, forestry and horticulture – between about 70-95% of the produce is exported. Without trade, between much of those industries would barely exist. New Zealand is the world's 12th largest agricultural exporter by value and the second largest dairy exporter in the world. It is also the number one sheep meat exporter, the number one dairy product exporter and the second biggest wool exporter. Services made up around 30% of New Zealand's exports, valued at \$26 billion. These include tourism, transport, education and commercial services such as IT, telecommunications, accounting and film production (ibid)⁴.

Over the past decade, China overtook Australian to become New Zealand's largest trading partner by export value. In 2019, China accounted for 33% of New Zealand's dairy exports, 41.9% of meat and contributed to 58.3% of international education earnings and 13.5% of tourism (Stats NZ, April 8).⁵



Yet former trade negotiator Charles Finny has led a warning call for New Zealand to diversify its reliance on China after the Covid-19 crisis to ensure Kiwi businesses aren't caught out in a future shock which forces Chinese firms to close down. This judgement is best made by businesses, as long as the government is not underwriting their decisions.

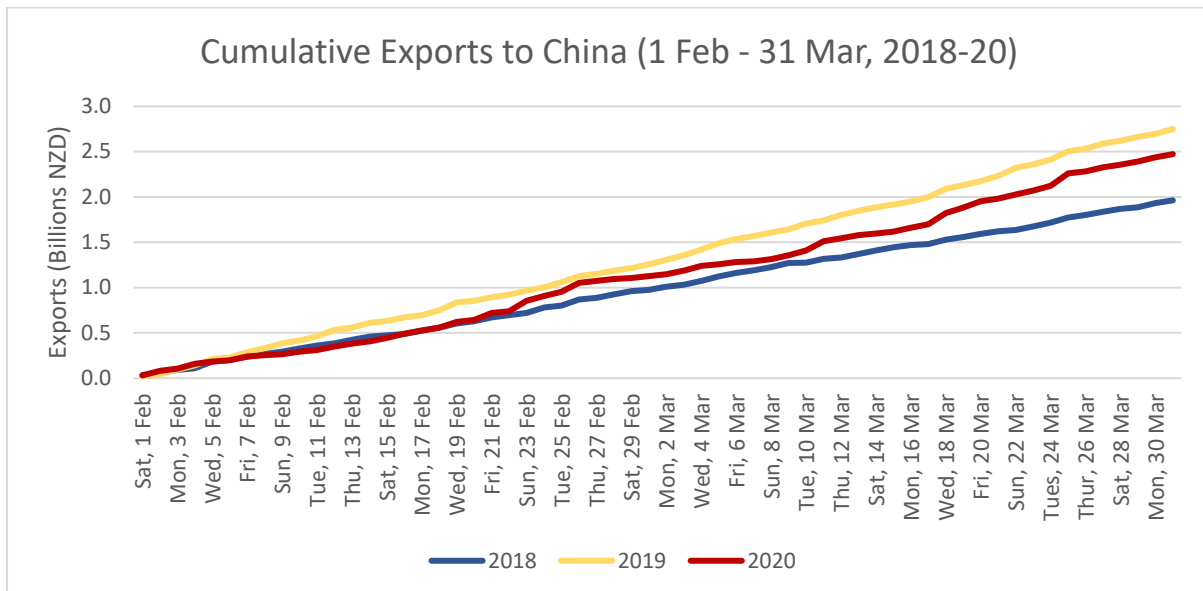
The impact of the Covid-19 upset is already clear. In the year to March, New Zealand's exports to China and Australia were down 11% and 9% respectively, for a combined loss of \$243 million. While total exports rose 2% to \$5.8 billion from \$5.7 billion year-on-year and imports were also up 3%, imports from both China and Australia did fall over the first few months. As all three economies tentatively restart, imports are rising again but New Zealand's trade with the US and Europe is now slumping (ibid).⁶

³ Goods and services trade by country: Year ended December 2019, Stats NZ, March 3, 2020: <https://www.stats.govt.nz/information-releases/goods-and-services-trade-by-country-year-ended-december-2019>

⁴ Goods and services trade by country: Year ended December 2019, Stats NZ, March 3, 2020: <https://www.stats.govt.nz/information-releases/goods-and-services-trade-by-country-year-ended-december-2019>

⁵ Data source: Effects of COVID-19 on trade: 1 February–31 March 2020 (provisional), Stats NZ, April 8, 2020: <https://www.stats.govt.nz/information-releases/effects-of-covid-19-on-trade-1-february31-march-2020-provisional>

⁶ Source: Effects of COVID-19 on trade: 1 February–31 March 2020 (provisional), Stats NZ, April 8, 2020: <https://www.stats.govt.nz/information-releases/effects-of-covid-19-on-trade-1-february31-march-2020-provisional>



According to Stats NZ, log exports were worth about \$5 billion of foreign exchange to New Zealand in 2019. In April, NZ First forestry minister Shane Jones recognised this as a vulnerable sector and suggested creating new export controls and barriers on – and perhaps even banning – the export of raw logs to China to incentivise wood processing in New Zealand. He used powerful populist language about “foreign-driven forest obliteration” to drive home his point.

New Zealand does not need to find out where such ideas might lead because protectionist tweaks to the system have already been tried over the last two centuries and failed. The country’s primary need as the Covid-19 crisis dissipates is to encourage commerce back on its feet and maintain international competitiveness. Protectionism compromises this goal by subsidising activities that are not internationally competitive (if they were, they would not need protecting). Deliberately putting obstacles in front of Kiwi exports is not a safety valve, it is a cork.

However, other parts of the Government are still sceptical of protectionist measures. This week, trade minister David Parker (together with counterparts in other countries) emphasised the need to keep markets open and avoid export controls. The trade ministers of New Zealand, Australia, Singapore and the UK jointly expressed a commitment to ensure free trade while acknowledging the importance of retaining some aspects of critical goods manufacturing domestically. Export controls and import protection are two sides of the same coin. The Government should eschew subsidies for firms competing with imports.

The four ministers said the present crisis only strengthens the need for better trading relationships and urged countries around the world to “stand still on trade barriers and, ideally, roll them back” (NZ Herald, April 28).⁷ Such positive reinforcement of an open trading system should be encouraged.

The vulnerability of New Zealand’s free trade agreements

At the bottom of the world, New Zealand has been and will always be reliant on free trade, efficient supply chains and trade relationships. Before the Covid-19 outbreak, New Zealand had developed many multilateral and plurilateral FTAs to achieve this.

A multilateral FTA refers to deals strictly between the signatories with no outside accession possibilities. In a plurilateral FTA, countries outside the initial deal can be invited or request to join.

⁷ Comment: Why restoring and deepening global trade is vital in response to Covid 19 coronavirus, NA Herald, April 28, 2020: https://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=12327765

An example of a multilateral free trade agreement is the New Zealand, Hong Kong, Chinese Taipei (Taiwan) and China deal, signed in 2008 and presently in the process of upgrade. On the other hand, the most recent plurilateral FTA signed in 2018 was the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP).

The seed of the CPTPP began when New Zealand finalised a deal with Singapore in 1999 (concluded in 2001). In 2005, that agreement was expanded to Brunei and Chile and renamed the Trans-Pacific Strategic Economic Partnership Agreement (TPSEP) or P4. In 2008, the US entered talks with the P4 which resulted in a draft TPP deal completed in 2015. A year later, the US dropped out, but the remaining 11 signatories finished the agreement and renamed it the CPTPP.

Despite years of effort by the US Trade Representative (USTR), a single choice by the incoming President Donald Trump to drop out of the CPTPP underscored how quickly hard work to create an FTA can be lost by political decisions. For New Zealand's effort, it took more than a decade to finally complete its strategy of building a free trade area in the Asia Pacific using the CPTPP deal and losing the jewel in the crown – the US – at the final hurdle was a major disappointment.

The CPTPP experience also showed the difficulties faced by countries when they were not included in FTA negotiations, but want to join after the text has been signed. When the US departed CPTPP, the remaining signatories altered key components of the text that were insisted upon by USTR in previous negotiating rounds. Those changes now make it more politically difficult for a future US administration to re-enter the CPTPP later as it will be unable to request changes to the text without reopening the negotiations. The 11 members are unlikely to do this because it implies all can now bring their own issues up again, breaking the consensus.

Trade agreements can also usher in changes in wider economic policy settings for the countries involved. New Zealand's 1983 trade agreement with Australia – the Australia/New Zealand Closer Economic Relations (CER) – is a good example. New Zealand entered the negotiations with a deeply protectionist trade policy regime and the negotiating officials had an explicit agenda of systematically phasing out those barriers over time. This encouraged the wider Kiwi business community to evolve towards the more liberal commercial environment today.

The CER also acted as an impetus for New Zealand's overall trading shift away from overreliance on the UK market (after the economic shock of the UK's entry into the European Economic Community) and towards the Asia Pacific. In the decades since the Ministry of Foreign Affairs and Trade has successfully negotiated 10 FTAs with Asia Pacific neighbors and is in the process of either ratifying or negotiating another dozen. A return to protectionism after Covid-19 risks undoing this.

Protectionist policies are anti-trade. The costs can be large. For example, the reason New Zealand is presently a top exporter of raw logs to China is the result of Russia's decision in the early-2010s to impose taxes on the export of raw logs, believing it would lead to an upsurge in processing wood products in Russia to sell to Chinese consumers (NZ Timber Industry Federation, April 2012)⁸. Instead, Chinese wood processors simply switched to buying New Zealand logs. If New Zealand elected officials enacted similar interventionist policies on raw logs, nothing stops Chinese wood processors from changing their importing preferences once again (Tombe, 2020)⁹.

Similarly, the inadequate PPE stockpiles in the early stages of the Covid-19 crisis was a situation created by the government, not markets. Public health is a core government responsibility and contagious disease is a public health issue. The government controls the District Health Boards and

⁸ Russian Log Export Tax, New Zealand Timber Industry Federation, April 25, 2012: <https://www.nztif.co.nz/russian-log-export-tax/>

⁹ Tombe, T. (2020). Better off Dead: 'Value Added' in Economic Policy Debates | Trevor Tombe. Retrieved 29 April 2020, from <https://www.trevortombe.com/publication/better-off/>

public hospitals dominate those boards. The Ministry of Health is the critical control agency for ensuring that public health preparedness is adequate. Having said that, it appears that private businesses and philanthropists played a significant role in importing critical life-saving equipment.

When preparing for future pandemics, the government should not simply focus on stockpiling sufficient PPE, it must also ensure proper rotation of this equipment because elastic and other materials do perish over time.

The danger of government intervention was a major lesson from the 1930s Great Depression. Early on in that crisis, governments withdrew international cooperation and retreated into protectionism with infamous tariff hikes such as the Smoot-Hawley Tariff Act 1930 and competitive devaluations. It was all done in the name of protecting local jobs and companies, but it blocked opportunities for mutually beneficial trade, job and income creation. The unemployment that followed was a disaster.

The lack of international will

Ultimately, Covid-19 is significant for what didn't happen.

Over the last four months, the world has suffered from an astonishing lack of international cooperation and leadership. Few events require global cooperation more than a pandemic. Yet unlike during the 2008 Global Financial Crisis (GFC), this coronavirus crisis has not been led by any recognised multilateral organisation, apart from the much-maligned World Health Organisation. Neither the UN Security Council, G7, G20, IMF, or World Bank were coordinating closely.

The obvious international institute to lead the crisis response concerning trade was the World Trade Organisation (WTO). However, the WTO entered 2020 gravely weakened.

The second US Obama administration started a process of neutering the WTO dispute mechanism settlement's upper and lower court system by refusing to supply candidates for the Appellate Body. On December 11, 2019, the Appellate Body finally lost its quorum of three members necessary for the body to decide appeals of dispute settlement panel decisions (95% of cases brought before the WTO are appealed).

The WTO's dispute mechanism court is now inoperable which brings into question the system of rights and obligations in an open trading system. The process of blocking the Appellate Body elections has been continued by the Trump administration which has also used national security arguments to impose tariffs on imports of steel and aluminum to the US. Some legal observers have pointed out the illegality of this action and the Trump administration's case that the decision was covered by the WTO's security exceptions clause – written at the formation of the General Agreement on Tariffs and Trade (GATT) in 1940 – was wrong (Reuters, March 2018)¹⁰.

Since the WTO's Appellate Body cannot reach quorum, there is no dispute settlement mechanism to call these new US tariffs into question. The lack of an effective judiciary undermines the most fundamental assumptions on which the global supply chain and simple rules under rights operate.

To bandage over these cracks, the European Commission to the WTO has led an initiative with Canada – Australia and New Zealand are associated – of an interim parallel dispute mechanism, the decisions of which each member apart from the US has agreed to respect.

But this leadership vacuum creates uncertainty about what responses are legitimate in a global crisis. Even the New Zealand Government's decision to lock the country down and stop all international flights may be legally precarious. After all, some of New Zealand's FTAs have delicate provisions on

¹⁰ Trump's tariffs head for a legal minefield, Reuters, March 17, 2018: <https://www.reuters.com/article/us-usa-trade-wto/trumps-tariffs-head-for-a-legal-minefield-idUSKCN1GS1KL>

the four freedoms of movement: people, capital, services and investment. However, these provisions have never been well regulated or defined and relied mostly on grace and favour. The recent debate with Australia about the return of Kiwis during the Covid-19 crisis is an example of how tension in a trade agreement like the CER may not necessarily evolve into a breach. But New Zealand risks falling foul of other trade provisions if the Government intervenes in other ways.

Another legal uncertainty exposed by the Covid-19 crisis was the possible human rights overlap with refugee law about who can and cannot move because of the lockdowns in destination countries. The pause in air travel also impacts New Zealand's agreements on international air transport protocols and codes. On top of that, how to deal with intellectual property and data governance during a crisis is now a fresh problem most countries have no method to deal with.

New Zealand also faces speedbumps when exiting its lockdown protocols. It will want to relax travel restrictions and other crisis measures, but this can't be done without international cooperation on deciding what it means to be a "safe person." Further, it is unclear what a "viral passport" might look like, or what guarantees a Kiwi should expect when travelling and if they can be repatriated when something goes wrong overseas.

In the late 1940s, there was a similar distrust of multilateral organisations and a rise in protectionism. The need then was to simplify ways for countries to buy and sell from one another. An institutional solution was found with GATT rules governing trade and a stable monetary system with the IMF (along with the World Bank) to provide funding. This mix was the foundation of the relatively stable international economic system over the past 70 years.

A major multilateral mission may now be required to reinvigorate coordination which might include the creation of completely new successor institutions. Worryingly, few countries are showing an appetite to complete this task. New Zealand's immediate tactic should be to find international cooperative solutions where it can to survive the coming global economic recession and perhaps encourage the creation, over time, of new international institutions.

Addressing the protectionists' valid concerns

The core worry of protectionists – that New Zealand may struggle to recover from the economic downturn if businesses do not reduce their vulnerability to supply chain shocks – merits more scrutiny.

New Zealand is in a unique spot. Unless the data takes an unexpectedly negative turn, it may be among the least affected by the health consequences of Covid-19. It also has a geographical advantage – a giant 1500 kilometer 'moat' around 'Fortress New Zealand' – as a natural defence from further intrusions by the virus. And by any relative international standards, New Zealand has a cohesive society with sound institutions and the idea of New Zealand as a 'safe sanctuary' may well grow internationally to offset some of the damage done by the crisis and entice trade to start again.

To leverage these attributes, New Zealand must jealously guard its advantage of having a network of FTAs. These agreements were set up to act as insurance for when the multilateral trading system is stressed – and that stress was building well before the Covid-19 crisis. These FTAs include coherent deals with all three WTO members which together make up the Chinese economic space: China, Chinese Taipei (Taiwan) and Hong Kong (and associated territories).

The fight to secure access for New Zealand foodstuffs – both high-quality commodities like fish and milk powder, along with highly processed manufactured foodstuffs – has been long and difficult. Central to these relationships is the trust New Zealand's trading partners have in this country's ability to assure good quality supply. New trade barriers would undercut New Zealand's reputation as a reliable partner and supplier to these regions and the negative reputational impact could go to the heart of the Kiwi export economy – food.

To set an example of how to get travel working again, New Zealand could create a travel agreement with Singapore and Taiwan so visitors are safe and it should also hold onto its travel efficiencies with Australia under the CER.

If the global pandemic continues along current lines, the concept of New Zealand as a safe sanctuary will gather strength. New Zealand's meat exports to the US dipped in 2019 by 20% to \$956 million as China overtook the US as the main destination for Kiwi meat products (Stats NZ, January 30)¹¹. However, the world's largest pork processing company, Smithfield Foods in South Dakota, which produces about 5-6% of total US pork production, has been temporarily closed due to coronavirus contamination fears (The Hill, April 28)¹². The business was sold to Hong Kong-based WH Group in 2013 (Reuters, September 2013)¹³. The recent shutdown is already causing serious concern about meat supply in the US. Filling that gap with clean and virus-free meat supplies is a great opportunity for New Zealand producers. Other similar opportunities may be opening up.

Further to this, New Zealand must prepare for when the geopolitical atmosphere of protectionism inevitably changes as people become disillusioned by the consequences of turning inward and setting up onerous travel and trade barriers in misguided attempts to solve their problems.

Despite the concerns about globalisation and inequality from economists like Thomas Piketty, fundamental Ricardian economics (comparative advantage) must remain at least a part of the solution to any new international cooperation. Redesigning international institutions from the bottom-up risks a real "baby-with-the-bathwater" situation, but it is also true that the present international system has not worked with Covid-19 and some redesign is needed. New Zealand should champion new forms of cooperation while it awaits a better geopolitical appetite for more sophisticated multilateral thinking. This probably will not come for many years.

Few are thinking of the long-term issues of living in a safer New Zealand after Covid-19 which may not have the same easy travel ability to connect with others overseas. The risk now is that when New Zealand's trading partners are happy to turn all the taps back on, Kiwi businesses and government officials may have let their relationships atrophy and potentially spoiled a chance to get back up to speed quickly because the new international rules simply do not exist. New rules need a reference point, experimentation and a good model. New Zealand can be all three.

In these tough times, New Zealand should stick with what it knows works and remember the painful lessons of protectionism from the past.

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¹¹ China overtakes the US as top beef market, Stats NZ, January 30, 2020: <https://www.stats.govt.nz/news/china-overtakes-the-us-as-top-beef-market>

¹² South Dakota governor says Smithfield meat plant could reopen 'in a matter of days', The Hill, April 28: <https://thehill.com/homenews/state-watch/495130-south-dakota-governor-says-smithfield-meat-plant-could-reopen-in-a>

¹³ U.S. clears Smithfield's acquisition by China's Shuanghui, Reuters, September 7, 2013: <https://www.reuters.com/article/us-usa-china-smithfield/u-s-clears-smithfields-acquisition-by-chinas-shuanghui-idUSBRE98513I20130907>