

Chair
Cabinet External Relations and Defence Committee

NEW ZEALAND-HONG KONG CLOSER ECONOMIC PARTNERSHIP NEGOTIATIONS : SUBMISSIONS ON DISCUSSION PAPER

Proposal

This paper summarises submissions to date in response to the discussion paper released in April on a possible Closer Economic Partnership with Hong Kong, and highlights consistent themes to emerge from initial consultation meetings around the country.

Executive Summary

2 Of the substantive submissions received to date on the CEP discussion paper, 15 oppose the initiative, 15 support it, while 7 take a neutral stance, but highlight issues for particular attention. Business is broadly in favour of a CEP, while manufacturers in sensitive sectors that might lose tariff protection on competing Hong Kong products focus on the controls needed to prevent an influx of duty-free products from neighbouring countries. Unions also identify this as a challenge, but have reserved their position on the CEP overall. A number of submitters have indicated a wish to make further comment in light of actual progress in the negotiations. Submissions supporting the initiative have generally emphasised the CEP's role in boosting New Zealand's profile in Hong Kong for investment and tourism, securing continued access for goods exports and expanding opportunities for services exports throughout North Asia.

Major issues raised to date include:-

- the effect of tariff removal on imports from Hong Kong on New Zealand clothing, footwear and textiles manufacturing;
- the perceived vulnerability of central and local government to compensation claims by Hong Kong investors if environmental safeguards are applied;
- the possibility New Zealand might have to open 'sensitive' public services to competition from Hong Kong providers;
- the scope and timeframe of the consultation process, and whether it will influence New Zealand's negotiating position.

Background

3 On 17 April, New Zealand and Hong Kong announced their decision to commence formal negotiations for a possible bilateral CEP. To coincide with that announcement, the

Government released a discussion paper, "Hong Kong and New Zealand: Initial Analysis of the Bilateral Trade and Economic Relationship as Background to a Possible Closer Economic Partnership Agreement." A copy was also placed on the MFAT website. It invited submissions by May 25, a deadline since extended by several weeks. This report provides an overview of the comments received to date. A summary of the submissions is attached at Annex A. A compilation of the all submissions received to date is available from Cabinet Office.

4 In addition to the release of the discussion paper, officials have been conducting an extensive nationwide consultation process, involving business, unions, local government, NGOs, Maori and interested public. This consultation process will continue throughout the period of negotiation with Hong Kong and further periodic reports will be submitted to Cabinet.

Comment

5 Business is broadly in favour of a CEP, citing both specific opportunities in some sectors and a CEP's contribution towards building momentum for regional and global trade liberalisation. Retailers highlight the benefits to consumers of cheaper products from a major source of imports. Much of the support for a CEP is grounded on the perceived strategic gains of securing an economic beachhead in North Asia and stimulating momentum towards global trade liberalisation. The most significant increases in market returns are seen to be in professional services. Manufacturers in the tariff-protected clothing, footwear and textiles sectors identify the need for robust criteria for duty-free entry and policing of those criteria as crucial to their future. They are working constructively with officials on possible measures to achieve this. Unions have voiced a range of concerns but overall the CTU has reserved its position, and says the credibility of rules of origin and the treatment of labour standards alongside a CEP will influence their stance. Others, including the Green Party of Aotearoa New Zealand, and a number of prominent academics, researchers and university groups, have voiced outright or strong opposition. Concern has focused on the adjustment costs to factories and services that might face greater competition under a CEP, and on the perceived vulnerability of regulators to compensation claims by investors. Much of the opposition to the CEP has been a philosophical objection to further trade liberalisation without, it is claimed, substantial and obvious immediate reciprocal gains to the New Zealand economy.

6 Initial consultations have been held in the five main centres with a wide cross section of the public, including representatives from affected industries/parties (business, including the textiles, clothing and footwear industries, unions, Maori and concerned NGOs including environmental groups and education sector representatives). This - and the commitment to regular updates on the negotiations - has helped to elicit extensive practical input on finding solutions to some key issues, and has also been welcomed by most as a demonstration of openness and a sincere effort to keep stakeholders informed. This programme of consultations is continuing in step with the bilateral negotiations, and is making a material contribution to the development of New Zealand's negotiating position. Doubts have been expressed in some quarters about whether the consultations are a genuinely open process that could help shape an eventual CEP or

even lead to its being abandoned, if the likely overall outcome were judged unfavourable to New Zealand.

Substantive Issues:

Rules of Origin

7 Several submissions queried the benefits of a CEP with an economy that already has zero tariffs. They maintained that New Zealand can only lose by opening the door to duty-free competition in sectors that are still protected by significant tariffs. The likely removal of remaining duties on imports from Hong Kong under a CEP is seen by some submitters as a breach of the Government's commitment to freeze tariffs until at least 2005 (the element of 'reciprocity' in tariff elimination is overlooked). In three sectors with remaining significant tariff protection, textiles, clothing and footwear (TCF), duty free entry for competing products from Hong Kong is seen to impinge on their continued viability and threaten jobs, particularly if robust rules of origin are not devised and enforced.

8 Both these sectors and commercial interests who favour further trade liberalisation with Hong Kong agree it will be crucial to devise a robust formula to ensure products claiming Hong Kong preference are genuinely of 'Hong Kong origin. They seek a very tight definition of the term to ensure Hong Kong doesn't become a channel of convenience for products from third countries - particularly China - to circumvent New Zealand tariffs. The submissions stress these rules must be practical, easy to understand and credible. They should not only reflect Hong Kong's unique relationship with China, but also should provide a template rules of origin regime that will be consistent with emerging global practice.

9 Key submissions suggest a mixture of New Zealand's minimum added value approach and Hong Kong's substantial transformation test should be considered. The result, some suggest, might include variable regimes for different aspects of TCF and/or recourse to the immediate, temporary suspension of duty-free entry of TCF items claiming Hong Kong preference if imports exceed a certain volume. Similarly on trade remedies, all submissions that mention anti-dumping action say recourse to this should be retained under a CEP. Some submissions also emphasise the importance of New Zealand's biosecurity regime. They say maintaining its integrity and adequately policing this and the rules of origin is likely to require extra resources.

Services

10 Although Hong Kong is among the most open markets in the world to New Zealand services providers, several submissions identified this sector as offering the greatest opportunity for New Zealand to gain under a CEP - given the dominant role of services in Hong Kong's economy and the prospects of using Hong Kong as a launching pad into North Asia if preferential access were gained under a CEP. Some submissions note that, because New Zealand's commitments to liberalise services under the World Trade Organisation far exceed those of Hong Kong, a CEP would help to put New Zealand and Hong Kong firms on a more equal footing. One example is postal services, with the New Zealand Post subsidiary, Transend, pressing for the

CEP to open access to Hong Kong's postal market. Firms doing business in Hong Kong say some significant obstacles remain, including the extent of self-regulation by professional bodies - creating 'closed shops' - and the extent of 'red tape' many New Zealand firms encounter in their dealings with Hong Kong. They identify the lack of consistent competition law and of mutual recognition of standards and qualifications as major impediments to gaining customers in Hong Kong, and say these should be key aims under a CEP. They link future success in selling services to Hong Kong with more favourable tax treatment on investments in New Zealand (see below).

11 Liberalisation of services is also seen as a risk by some commentators and services providers, particularly if a CEP opens the door to competition on equal terms from Hong Kong firms. Although these risks are based on perceptions rather than a reading of any declared intentions, major concerns focus on increased competition in core public services, particularly health, education and environmental services. Some submitters warn that, if taken to logical extremes, it could make the competitive model in these services irreversible and could lead to privatisation. Another concern is the possibility that Hong Kong entities - and those using Hong Kong shell companies - could bid on equal terms for scarce 'public good' funds in education, research and health, and that governments could lose the ability to pursue national interest goals through the allocation of funding.

Investment

12 New Zealand's perceived vulnerability to compensation claims by Hong Kong-registered investors features prominently in submissions. Their focus, however, is more on the 1995 Investment Promotion and Protection Agreement (IPPA) than on the proposed CEP, which they are concerned may increase the risks. The concerns under the IPPA draw on North American case law under the North American Free Trade Agreement (NAFTA), citing instances where corporations have initiated legal action against state and federal governments in Mexico and Canada. The litigators claimed that proposed environmental safeguards would reduce their corporations' profitability, and that under the provisions of NAFTA they were entitled to compensation. Several submissions claim New Zealand regulators are vulnerable under comparable clauses of the IPPA. They are also concerned at the disputes provisions, which could allow an investor to take the New Zealand Government to international arbitration. They claim the result would be to curb local and central government's willingness to enact environmental protections and would undermine New Zealand's sovereignty.

Local Procurement

13 While investment is of concern to the one local authority to make a submission, the Christchurch City Council, the Council also argues local government should remain free under any CEP to pursue "social ends" in awarding major contracts, including favouring local investors over Hong Kong investors. Several submissions claim that a CEP would weaken the ability of central and local government to progress such national interest goals as regional development and environmental integrity. In this regard, the Royal Forest and Bird Protection Society argues that environmental services - including the public provision of recreation and tourism facilities - be

exempted from the CEP, in much the same way defence was exempted from the CEP between New Zealand and Singapore.

Trade and Labour, Trade and the Environment

14 While these are separate issues being dealt with in different ways in relation to the CEP, both are being considered in the context of a New Zealand bilateral trade agreement for the first time. Industry groups oppose the consideration of trade and labour, even as a process ‘separate but parallel to’ a CEP. They argue labour standards could be misused as a trade barrier, and are best addressed through the International Labour Organisation. That view is countered by some submissions, including that of the Council of Trade Unions, which argues that labour conditions have a direct bearing on the production costs of goods that will compete with New Zealand products, and therefore should be an integral part of the CEP. Similarly, the inclusion of environmental standards within the CEP - with the exception of biosecurity issues - drew warnings from some industry groups that such standards might be used to restrict competition. Forest and Bird welcomes the inclusion of environmental standards as “a clear change from previous policy”, but says the benchmarks should be set by New Zealand, with no prospect of levelling down to conform with lesser Hong Kong standards.

Exemption for the Treaty of Waitangi

15 While key export-oriented organisations (Business New Zealand; Federated Farmers, Employers’ and Manufacturers’ (Northern), Business Roundtable and the Meat Industry Association) oppose this exemption as unnecessary and liable to be misunderstood as favouring one group, Maori contacted as part of the initial consultations have given support. One iwi organisation, Tainui, describes the clause as “fundamental” in determining whether the negotiation produced opportunities or “further disenfranchisement.” Some Maori groups have asked for more detail on the practical effect of the treaty exemption, and have undertaken to contribute their views.

Taxation

16 Concerns about the incompatibility of New Zealand’s and Hong Kong’s tax regimes - and the stifling effect this is having on investment and business immigration - has surfaced strongly during the initial consultations. The key issues include:

- The lack of a double taxation agreement with Hong Kong, or at least “grey list” status. The result is Hong Kong firms or individuals investing in New Zealand face steep tax disadvantages, including high non-resident withholding tax on dividends and tax on interest on investment funds in New Zealand.
- The taxation, on an accrual basis rather than on received earnings, of investments by Hong Kong companies and individuals that become tax-resident in New Zealand, plus interest tax on

their bank deposits in New Zealand. For a Hong Kong holding company based in New Zealand this tax is payable on the earnings of all subsidiaries around the world.

The combined effect of these and other New Zealand tax treatments is said to deter Hong Kong investment in New Zealand, both in practice and by 'sending the wrong signals', with the result New Zealand is failing to tap into the large pool of Hong Kong investment capital.

Competition Policy

17 Submissions on competition policy highlight the need for ease of entry and participation in each market under a CEP. Hong Kong lacks generic competition law, meaning much regulation focuses sector by sector. There is concern that this, and Hong Kong's low level of commitment to liberalise services under the WTO, could be an impediment to New Zealand firms competing on even terms in the Hong Kong market. Other concerns include the undermining of competitiveness through Hong Kong financial assistance to domestic industry - as is evident in Australia and Singapore, despite their closer economic partnerships with New Zealand - and the prevalence of 'red tape'. This underscores the need to harmonise standards and reduce transaction costs. A CEP is seen as a means to promote greater transparency and discipline in competition law. Business New Zealand suggests an overarching competition framework within the CEP, backed up by a disputes resolution framework. The New Zealand Stock Exchange seeks mutual recognition of qualifications to enable brokers to offer services in Hong Kong and vice versa. Some New Zealand services providers say this cuts both ways, and will likely meet resistance from some New Zealand professional bodies they say operate 'closed shops.'

Process Issues

18 Most submissions that mention process - and the feedback from initial consultations - endorse the Government's commitment to consult, including the longer timeframe and more-extensive scope of the activities. A minority of submissions - albeit substantial ones - reflect deep-seated cynicism about the sincerity of the exercise, claiming it will have no material impact on New Zealand's negotiating position or the eventual outcome. Even submissions that don't take a position opposed to the CEP say meaningful consultation requires circulation of the draft negotiating texts and the opportunity for relevant groups to comment on those aspects that effect them. Another criticism is the perceived lack of rigorous analysis on the benefits and costs of a CEP with Hong Kong, under various possible scenarios, with some submitters arguing the negotiations should not proceed without this information. Consultations with iwi and Maori business groups are continuing and are providing valuable input in view of the lack of written submissions from Maori to date. Maori responses so far range from consistent interest in the process and welcoming the opportunity to consult, to one criticism that Maori are not included as a partner in the negotiating team.

Comment

19 The consultation process to date has been invaluable in identifying concerns and issues which negotiators will need to address or take account of in the negotiations. The comments received on rules of origin are already being considered by officials. Other views are less easy to address, in particular where submitters take diametrically opposing stances on desirable negotiated outcomes. Further reports to Cabinet as the negotiations proceed should report back on how the key issues identified by submitters are being addressed or tackled. While it will clearly not be possible to meet the expectations of all submitters on negotiated outcomes, regular feedback can be provided to interested parties through the on-going consultation process. New Zealand's eventual position is likely embody a balance of sectoral interests, set in the context of underlying national development goals.

Financial Implications

20 None at this stage. However a number of submitters note that enforcement of tight rules of origin to protect New Zealand industry and to enforce the biosecurity regime may require additional resources eg in the New Zealand Customs Service. This will be addressed in subsequent papers depending open negotiated outcomes.

Human Rights Implications

21 None

Legislative Implications

22 None

Regulatory Impact and Compliance Cost Statement

23 Not required.

Publicity

24 Given the likely media and public interest in this issue, officials recommend that the Committee authorise the Minister for Trade Negotiations to release publicly this paper, the summary of submissions attached at Annex A and the compilation of submissions received.

Consultation

25 Treasury, Economic Development, Customs, Agriculture and Forestry, Labour, Te Puni Kokiri, have been consulted and agree with the recommendations.

Recommendations

26 It is recommended that Cabinet Policy Committee:-

- 1 note that submitters on the Hong Kong/New Zealand CEP negotiations have voiced both support and opposition for the CEP or have identified a range of key issues and concerns (eg relating to rules of origin, services, investment) which they would like addressed in the course of the negotiations;
- 2 direct officials in subsequent reports on progress in the negotiations to report back to the Committee on how (or whether) these issues and concerns can be adequately addressed in the course of the negotiations;
- 3 agree that officials should continue the programme of domestic consultations as the negotiations proceed to provide feedback to interested parties;
- 4 agree, in view of the likely media and public interest in this report, to the release by the Minister for Trade Negotiations of this report, the associated summary of submissions and the compilation of submissions.

Hon Jim Sutton
Minister for Trade Negotiations