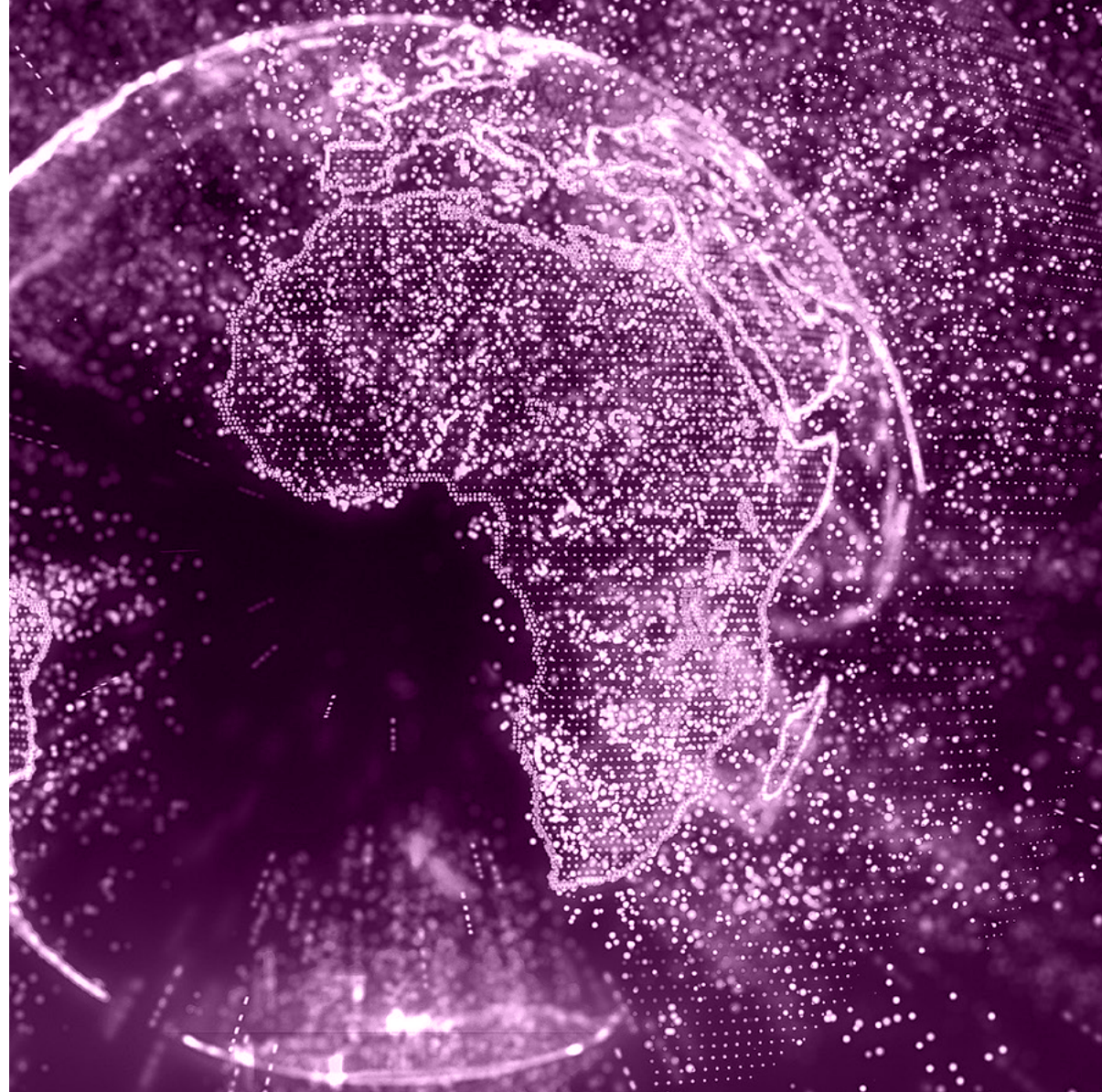


International trade

TRENDS AND INSIGHTS

December 2018

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Trade wars – counting the cost

Current predictions for 2019 anticipate that global economic growth will slow. If President Trump's trade war continues to intensify, that sentiment will deepen with self-fulfilling effect. We know that. We've been there before.

The twentieth century saw its fair share of trade wars involving the USA (US).

- In 1930, the notorious Smoot-Hawley Tariff Bill raised duties on imports to an average of 60%, provoking retaliatory action by most of the US's major trading partners.
- In the 1960s, France and Germany imposed tariffs on cheap American chickens that were flooding their markets. The US responded with tariffs on European goods, including brandy and VW trucks.
- In the 1980s, US imposition of tariffs on European pasta was countered by the European Community (EC) with higher tariffs on American lemons and walnuts.
- We also saw the US draw battle lines over cars with Japan, steel and bananas with Europe, and lumber with Canada.

Now we have President Trump's "America First" agenda.

In 2018, the US has imposed tariffs on a wide range of imports, including aluminium and steel, solar panels and washing machines. The tariffs apply not just to China but also to traditional allies including Canada, Mexico and the EU. Those countries have responded with retaliatory tariffs against US goods.

According to some commentators, the trade war between the US and China is symptomatic of something rather more sinister than Trumpian concerns about trade balances, and China's response.¹ It is, rather, a reset of economic and political relations between the US and China, the beginning of a new stage in a strategic rivalry that will have implications for the entire globe. This rivalry was laid bare in Port Moresby during APEC Leaders' Week when, for the first time in the group's 29 year history, leaders failed to issue a joint communique.

A look at the historical ebbs and flows of GDP growth tells a powerful story in this regard.

The US grew through the 19th and 20th centuries to become the largest economy in the world, just as China moved in the other direction. As recently as 1990, China wasn't even in the top 10 list of contributors to world GDP.

¹ See for example, Rana Foroohar, "US trade hawks seize their chance to reset China relations", <https://www.ft.com/content/a42e0402-bd7a-11e8-94b2-17176fbf93f5>.

² <https://www.bbc.com/news/world-43512098>.

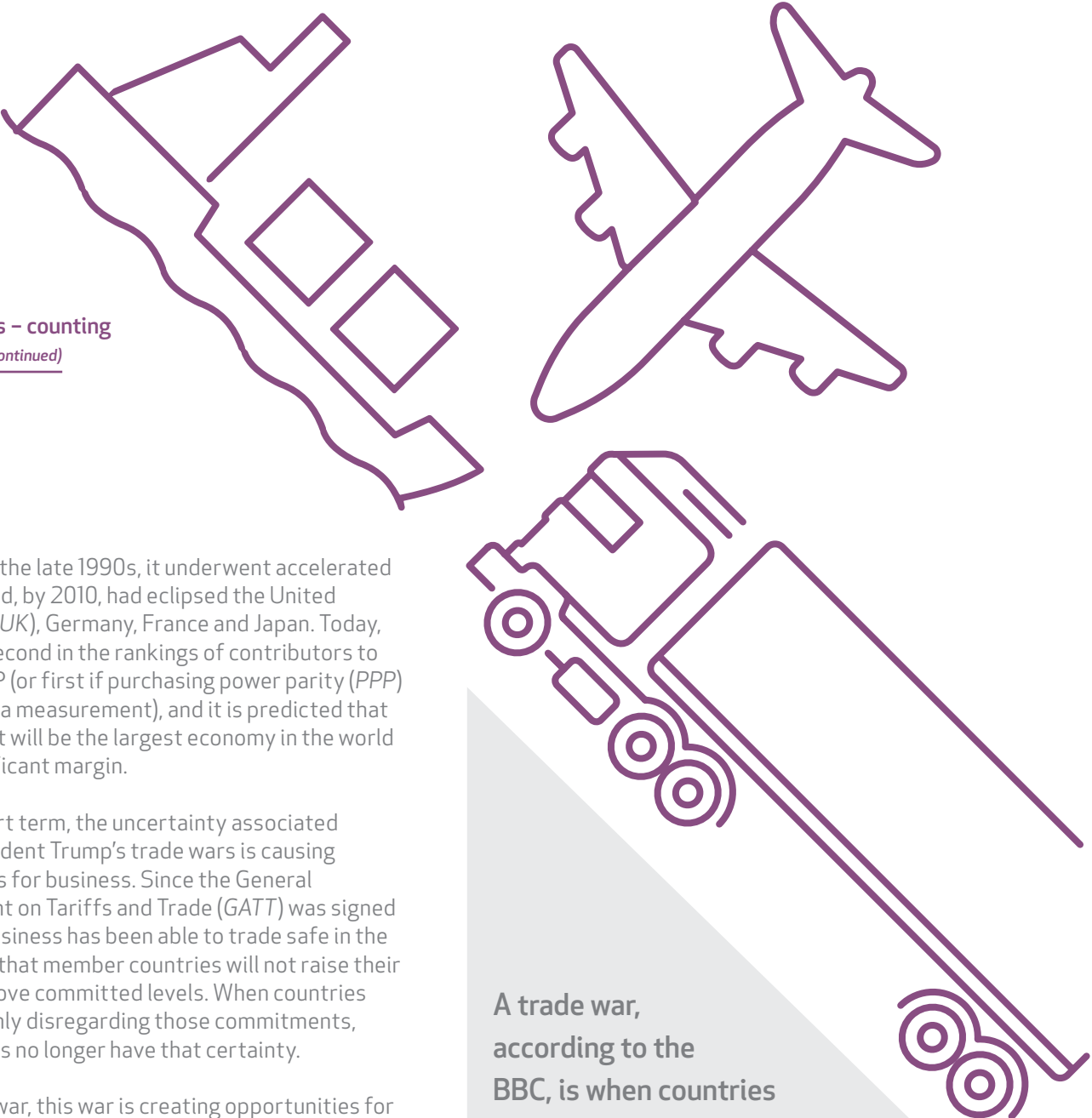
Trade wars – counting the cost *(continued)*

But, from the late 1990s, it underwent accelerated growth and, by 2010, had eclipsed the United Kingdom (UK), Germany, France and Japan. Today, China is second in the rankings of contributors to world GDP (or first if purchasing power parity (PPP) is used as a measurement), and it is predicted that by 2050, it will be the largest economy in the world by a significant margin.

In the short term, the uncertainty associated with President Trump's trade wars is causing headaches for business. Since the General Agreement on Tariffs and Trade (GATT) was signed in 1947, business has been able to trade safe in the certainty that member countries will not raise their tariffs above committed levels. When countries start openly disregarding those commitments, businesses no longer have that certainty.

As in any war, this war is creating opportunities for some. For example; Brazilian soybean farmers have seen an uptick in their export sales to China in the wake of US tariffs on Chinese imports, and reports suggest that Vietnamese firms may also be gaining market share in various items.

But overall, the outlook is not rosy for New Zealand exporters, given the nature of our export base. The best advice may be from Rabobank's head of financial markets for Asia-Pacific, Michael Every, who suggests that the best way for New Zealand's agricultural sector to cope with the possible fallout from the trade wars is to reduce reliance on individual trade partners and focus on diversification of export markets.



A trade war, according to the BBC, is when countries “try to attack each other's trade with tariffs and quotas. One country will raise tariffs, a type of tax, causing the other to respond, in a tit-for-tat fashion”.²

Trade wars – counting the cost (continued)

Below is a summary of some of the key developments in the trade war. It hasn't been easy to keep track of all the shots that have been fired in the trade war, amidst the hectic rhetoric and 24-hour news cycle. To simplify matters, below is a summary of some of the key developments in 2018.

Steel and aluminium tariffs

19 January

United States Trade Representative (USTR) says that the US “erred in supporting China’s entry into the World Trade Organisation (WTO) on terms that have proven to be ineffective in securing China’s embrace of an open, market-oriented trade regime.”

8 March

President Trump announces 10% tariff on imports of aluminium goods, and 25% on certain steel products, citing national security grounds under section 232 of the Trade Expansion Act of 1962. Temporary exemptions are given to Canada and Mexico, while other countries have to negotiate for exemptions.

22 March

President Trump announces temporary exemptions from the steel tariff for Canada, Mexico, Australia, Argentina, South Korea, Brazil, and the EU (to last until 1 May).

23 March

US steel and aluminium tariffs go into effect with exemptions for selected countries.

2 April

China imposes retaliatory duties of up to 25% on US products including aluminium waste and scrap, and food (pork, fruit, nuts and wine) as a response to the US steel and aluminium tariffs.

30 April

US extends exemption on steel and aluminium tariffs for EU, Canada and Mexico until 1 June. Korea’s exemption ends. Argentina, Australia and Brazil receive indefinite exemptions.

1 June

EU, Canada, and Mexico exemptions to steel and aluminium tariffs end.

22 June

EU announces retaliatory tariffs on \$3.2b of US goods including steel and aluminium, as well as bourbon whiskey, motor boats and yachts, motorcycles, blue jeans, corn and peanut butter.

1 July

Canada announces retaliatory tariffs on \$12.8b of US goods including steel and aluminium, as well as agricultural and food products.

16 July

US files WTO complaints against Canada, China, the EU, Mexico and Turkey, challenging the tariffs those countries imposed in response to the steel and aluminium tariffs.

10 August

President Trump announces the tariff on Turkish steel will rise to 50% because of depreciation of the Turkish lira. Turkey subsequently retaliates with new tariffs on US imports.

Trade wars – counting the cost *(continued)*

Solar panels, washing machines, and sorghum

22 January

The US imposes global safeguard measures on solar panels and washing machines.

17 April

Following self-initiation of anti-dumping and countervailing duty investigations on imports of US sorghum, China imposes duties on imports. This looks as if it might be in retaliation for the solar panel and washing machine safeguards. A month later, the duties are removed following talks between the US and China.

14 August

China files a WTO complaint against US solar panel tariffs.

US China tariffs

22 March

USTR releases a “section 301” report finding that China is conducting unfair trade practices related to technology transfer, intellectual property and innovation.

3 April

President Trump releases a \$50b list of 1,333 Chinese products under consideration for 25% tariff (largely machinery, mechanical appliances, and electrical equipment).

4 April

China publishes a list of 106 products subject to 25% tariff as retaliation for US tariffs (mostly US transportation equipment and vegetable products – soybeans).

5 April

President Trump instructs trade officials to consider whether an additional \$100b of Chinese imports should be subject to new tariffs.

15 June

USTR releases a revised list of products on which it plans to impose 25% tariff, in two phases starting on 6 July (largely covering intermediate inputs used by American-based companies).

China issues an updated retaliation list of \$50b of US imports.

18 June

In response to China’s updated list, President Trump asks USTR to identify an additional \$200b of imports for additional tariffs at a rate of 10%.

6 July

US tariffs on \$34b of Chinese imports go into effect China responds with \$34b of tariffs on US imports.

10 July

In response to President Trump’s request from 6 July, USTR releases a \$200b list of imports from China for additional 10% tariffs. Meanwhile, in an interview, President Trump says he is ready to impose tariffs on all imports from China (worth \$504b in 2017).

24 July

US announces it will subsidise American farmers for up to \$12b for lost export sales resulting from the President’s tariff actions.

23 August

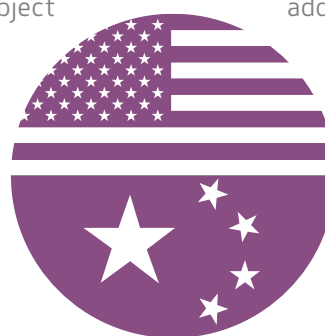
A US 10% tariff on an additional \$16b of Chinese imports goes into effect. China responds with an additional \$16b of tariffs on US imports.

24 September

US imposes a 10% tariff on a further \$200b of Chinese imports. The rate will increase to 25% on 1 January 2019.

27 November

President Trump says he is likely to go ahead with an increase on tariffs from 10% to 25% on \$200b worth of goods from China, and will impose tariffs on the rest of China’s imports to the US if talks at the G20 summit do not go well.



Targeting the World Trade Organisation

The multilateral rules-based system on which the New Zealand economy depends is at risk of being brought to its knees.

The WTO, established in 1994, is at the heart of that system, administering it and providing a negotiating forum and a venue for dispute settlement.

Although the WTO's negotiating function has struggled in recent years, its dispute settlement system has powered on, providing particular benefits to small nations such as New Zealand. But this is now running at minimal personnel levels as the US has refused to renew or make new appointments to the Appellate Body. Unless a major breakthrough is achieved, the dispute settlement system will grind to a halt in 2019 when the number of sitting Appellate Body members falls to two.

The US cites various grievances with the way in which the Appellate Body has functioned. But many of these are fairly technical and, with a bit of political will, could surely be resolved – creating the suspicion that the US refusal seriously to engage is in fact a deliberate attempt to paralyse the system.

President Trump is not alone in the US in having qualms about the multilateral system. The US has long been squeamish about the idea of submitting to a “binding” court with compulsory jurisdiction and has raised complaints about the system's operations for some time.

The task for New Zealand

The case for New Zealand to work with like-minded partners to find a solution to the WTO's woes could not be more compelling.

Trade and Export Growth Minister David Parker recently participated in a meeting in Ottawa with 12 other international trade ministers to discuss ways to strengthen and modernise the WTO. The resulting joint communiqué noted that: “the current situation at the WTO is no longer sustainable. Our resolve for change must be matched with action: we will continue to fight protectionism; and we are committed politically to moving forward urgently on transparency, dispute settlement and developing 21st century trade rules at the WTO”.

Following the Ottawa meeting, the EU along with other WTO members including New Zealand, has released a proposal for changes to overcome the deadlock regarding the Appellate Body. It will be presented at the WTO General Council on 12 December.

To what end?

At the time of writing, it remains to be seen what the outcome of the trade wars and the US attack on the multilateral system will be. Will it result in a strengthened international system? Will the US and China find a “truce”? Or will it lead to fragmentation and a return to the days before the WTO, when political clout was what mattered most?

The rules-based system is of immense value to us. It has allowed us to take on the trading giants of the world, including:

- the EU when it denied access to tariff quotas for spreadable butter
- Canada when subsidisation of its dairy industry affected our exporters, and
- the US when it imposed safeguard measures on lamb.

We have already seen other countries come together to salvage the Trans-Pacific Partnership (TPP) Agreement after the US pulled out. We must now hope that the crisis provoked by President Trump’s actions for the multilateral system leads to a similar concerted effort by others to ensure the system’s future.

There is a new tune to dance to...

Following the US mid-term elections, the passage through Congress of the US-Mexico-Canada Agreement (*USMCA*), signed on 30 September 2018 to replace the North America Free Trade Agreement (*NAFTA*), is now far from guaranteed.

President Trump's assessment that it is "the single greatest agreement ever signed" does not have many Democrat supporters and is even doubted by some Republicans. Governor John Kaisch (R-OH), for instance, described the deal as "really frankly a marginal improvement over NAFTA, it's no big change".

The Agreement has some potential pluses for New Zealand:

- Canada agreed to change aspects of its milk pricing system which the New Zealand dairy industry argues allows cheap sales of Canadian product on the world market (however the effect of this will need to be assessed as the Canadian Government has promised compensation to its dairy farmers)
- Canada has also agreed that British Columbia will remove its policy that grocery stores may only sell local wines (the US has argued in the WTO that this gives the Canadian product a competitive advantage and New Zealand has supported the US complaint), and
- the controversial ISDS system will be phased out as between Canada and the US, although it will continue to apply in a limited capacity as between the US and Mexico (as long as investors first try to resolve issues in domestic courts). It will be interesting to see if other countries follow suit in reducing the use of ISDS in future agreements.

There is controversy in the Agreement in the form of a novel provision which requires that if any USMCA Party enters into a Free Trade Agreement (FTA) with a "non-market economy" (read China), the others could terminate the USMCA in favour of a bilateral agreement with each other.

US Trade Representative Robert Lighthizer explained that if one of the USMCA countries entered into a FTA with China, it "potentially could change the economics of the deal from our point of view" and the US would want to revisit the agreement."

This is a far cry from New Zealand's approach of being open to negotiating FTAs with both the US and China and we will be interested to see whether it has any impact on our own trading relations with the US. It is another piece in the overall picture that is starting to increase the perception that, at some point, New Zealand will be forced to choose between the US and China.

Trade for All

“Trade for All” – a political play by the Labour-led Government to build public support after their embrace of the revamped TPP, or a genuine shift in trade strategy?

At Chapman Tripp, we have already suggested there is something to be said for the argument that trade agreements should serve a wider purpose, reflecting the depth of the economic and social integration they can achieve. We have suggested that climate change is one area in which such agreements might have impact – for example, by enshrining climate change obligations in their text.

But trade agreements cannot do everything, and neither should they. They are, first and foremost, a means of creating certainty for business, so that goods and services (and investment) can flow across borders to where it can be used most productively. And yet, a trade strategy goes further than the four corners of a trade agreement.

Ensuring that the wealth which a trade agreement can generate is spread across society requires supportive and progressive domestic policies – such as those that allow women to more easily re-enter the work force after having children, that make it feasible for small businesses to obtain the financing they need to grow internationally, and that ensure budding entrepreneurs are supported to develop the skills they need to take their ideas to the world. Those who lose out because of trade also need to be supported.

We hope that the current consultations on a “Trade for All” strategy will lead to innovative and new ideas to ensure that the opportunities created by the Comprehensive and Progressive Agreement for Trans-Pacific Partnership Parties (CPTPP) and other agreements can truly be tangible for all New Zealanders.

Our concept of “Trade for All” is one that continues to strike a sound balance between international rule-making and space for differences in domestic policy choices, as no trade agreement should hinder a government’s ability to regulate in the public interest.



Our 2017 predictions at a glance – how did we fare?

Prediction: CPTPP would be signed in the first quarter of 2018

What happened? The CPTPP was signed in Santiago by 11 countries (the original TPP-12 minus the US) on 8 March 2018. It has been ratified by Japan, Mexico, Singapore, Vietnam, New Zealand, Canada and Australia and will come into force at the end of 2018. There will be two rounds of tariff cuts in quick succession: the first this year and the second on 1 January 2019. New Zealand's ratification process was reasonably straightforward with the implementing legislation supported by all parties except the Greens.

Prediction: CPTPP may represent a tipping point for the shape and scope of future FTAs

The New Zealand Government is consulting the New Zealand public on the benefits of international trade, with the goal of developing a new "Trade for All" policy. The EU was already on this path, having initiated a new trade and investment strategy. "Trade for All", in 2015, and in November 2018, the "Inclusive Trade Action Group", comprised of New Zealand, Canada and Chile, met on the margins of the APEC Leaders' Week in Port Moresby (New Papua Guinea). Ministers of those countries released a statement renewing their commitment to work together to ensure that the benefits of trade and investment help reduce inequality and poverty, and that the effectiveness of CPTPP is examined according to progress on sustainable development, gender equality, the economic empowerment of women and Indigenous peoples, domestic regional economic development, SMEs, labour rights, protecting and conserving the environment, and addressing climate change.

So, we are not alone, but neither has the world joined us. One might legitimately ask why the rest of the CPTPP Parties are not part of this group. Until they are, it is difficult to claim CPTPP was any kind of real tipping point.

Prediction: Continuing global uncertainty will heighten the importance of regional and multilateral trade liberalisation initiatives

We predicted that New Zealand would have a key role in 2018, working with other WTO members to ensure the continued relevance and robustness of the international rules-based system. We're giving this a tick for reasons we discussed in the commentary section above. If anything, the momentum will increase in 2019 as continued US intransigence puts the WTO at real risk.

Our 2017 predictions at a glance – how did we fare? *(continued)*

Prediction: Continuation of New Zealand's outward trade focus combined with efforts by the Government to rebuild public support for trade liberalisation

Through its "Trade for All" agenda, the Government is making a strong effort to rebuild public support for trade liberalisation. Public consultations have been completed, and we can expect to see the new Trade for All policy in March 2019. The Government has also demonstrated its continued commitment to an outward trade focus, with ratification of CPTPP and the Pacific Agreement on Closer Economic Relations (PACER) Plus, and negotiations continuing to conclude the Regional Comprehensive Economic Partnership (RCEP), upgrade the China FTA, review the Australia New Zealand ASEAN FTA, and join the Pacific Alliance.

Prediction: New Zealand negotiators will have their work cut out for them in Geneva to ensure continued agricultural market access on favourable terms to the UK and EU27 following Brexit

In July 2018, the UK and EU circulated proposed goods schedules in the WTO. Both have apportioned the current quotas for the EU28 based on historical trade flows under each tariff rate quota. This approach has been strongly opposed by New Zealand and other agricultural trading nations, as it would reduce exporters' ability to respond to market demand by locking them into a particular level of access in both markets. Our meat industry will be particularly affected. The UK has announced that it will enter negotiations with relevant partners under GATT Article XXVIII with the aim of reaching a mutually satisfactory conclusion that maintains the balance of rights and obligations among members. Clearly much work remains.

Prediction: New Zealand's export base will continue to evolve, with the tech sector showing huge growth and distinctions blurring between sectors

It may have been expecting too much to see a significant evolution in one year, but there is nothing to suggest that this prediction doesn't remain on track. The Technology Investment Network 2018 reports that technology, New Zealand's third largest export sector behind dairy and tourism, has had record growth of 7.3% this year.

Predictions for 2019

Continuing trade wars

The trade wars will continue to create uncertainty in world markets. There will be swings and roundabouts as the US talks to China and other partners, but it is difficult to see President Trump resisting the call of battle altogether.

The WTO will survive, just

The supporters of the multilateral rules-based system will find a way to bring the US on board to allow new appointments to be made to the Appellate Body and the dispute settlement system will continue in operation, but not before we come to the brink of real disaster for the multilateral institution. The US will continue to make it difficult to find consensus on members so the Appellate Body is unlikely to be up to its full complement any time soon, leading to a continued backlog of disputes.

Back to bilaterals

At least for the US and those it seeks to negotiate with, bilateral negotiations look to be top of the agenda heading into 2019. The USTR has already notified Congress of the Administration's intent to negotiate with Japan, the EU and the UK. At APEC Leader's Week in Port Moresby, the US suggested it is in discussions with another APEC member. While even multilateralism's most ardent supporters still negotiate bilaterally (the EU New Zealand negotiations for example) a strong trend towards bilaterals is not a positive one. For those negotiating with the US, the lyrics of the Amy Winehouse's song may well be apposite, "... I tread a troubled track, My odds are stacked, I'll go back to black". For supporters of a multilateral system, too much emphasis on bilateral negotiations is just as dismal a prospect.

Brexit uncertainty will linger on and on, and on

The Brexit saga will continue to unfold long after this publication is released. Regardless of whether the UK House of Commons approves the Withdrawal Agreement between the UK and the EU that was released on 14 November, the biggest questions on trade will remain unresolved. Deal or no deal, the UK will have the legal capacity to begin negotiating its own FTAs following 29 March 2019. It will no doubt find what most other countries already know well – most trade agreements are difficult and slow to negotiate. The negotiations to agree on the future trade relationship between the EU and the UK will be no exception.

Success of 'Trade for All' will require real change in domestic policies

As we have suggested, trade agreements cannot guarantee an equitable sharing of the benefits. The intentions behind the various progressive trade, or "Trade for All" agendas are laudable but are doomed to fail unless creative domestic policies make real changes.

Sanctions on Iran

US sanctions on Iran – which have come into force and may yet be expanded – will have a chilling effect on trade with Iran as banks take a conservative approach in the face of the threat of aggressive enforcement action by US authorities.

FTA upgrade between New Zealand and China

The ongoing negotiations around upgrading the bilateral 2008 FTA may face some challenges. We are likely to see some tensions in New Zealand's relationship with China. A recent example was the Government Communications Security Bureau (GCSB)'s communication to Spark prohibiting the use of Huawei technology in its 5G network upgrade.

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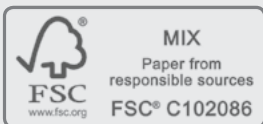
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