Don't talk about exports:

Examples of international agreements constraining New Zealand's economic development options

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A central feature of the Labour/Alliance government's economic programme is its assistance to industry and regional development. However, agreements such as those under the World Trade Organisation (WTO), the Singapore-New Zealand "Closer Economic Partnership" agreement, and CER constrain the government's ability to provide assistance to industry, particularly if it favours locally owned companies as investors or suppliers, or involves exports.

In July, CAFCA wrote to Industry New Zealand (INZ), requesting information it had on the constraints such agreements place on New Zealand's ability to favour local industry development without offering similar advantages to overseas investors. The reply indicated that some work had been done on analysing the position, but the work was surprisingly incomplete given the importance of the issues. Below are the main points in Industry New Zealand's reply.

Coincidentally, at about the same time, Professor Jane Kelsey of Auckland University wrote to the Ministry of Economic Development (MED) requesting "any analysis prepared by the MED of the impacts of the WTO agreements, CER or other bilateral agreements on the policy options available in relation to the forestry industry, including the TRIMs [the WTO's Agreement on Trade-Related Investment Measures] restrictions of performance such as local content requirements for the processing of timber". MED replied they had not yet examined the impact of the WTO, CER or other bilateral agreements specifically in relation to the forestry Industry. Instead they provided exactly the same papers as INZ supplied to CAFCA.

The covering letter from INZ to CAFCA mentions the following agreements relevant to its work:

- the WTO: in particular the Agreement on Subsidies and Countervailing Measures (SCM), and the General Agreement on Trade in Services (GATS);
- the Organisation for Economic Co-operation and Development (OECD) has "disciplines in the area of export subsidies, export credits, and domestic industry support";
- bilateral agreements with Australia and Singapore

Most of the focus of the analysis is on subsidies. Non-subsidy means of supporting local development are only briefly touched on, if at all.

For example, it is significant that the effects of TRIMs have not been analysed. TRIMS is an agreement on investment which prevents a number of performance re-

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quirements being placed on foreign investors. Such requirements have been commonly used by developing countries to gain the most local development from foreign investments. Without them, there is a high risk that foreign investors will not export as much as expected, and will use imports excessively in preference to locally produced goods. That significantly reduces any foreign exchange benefits and any gains through downstream linkages with local firms and skill and technology transfer. TRIMs gives an "illustrative list" of prohibited requirements. We are prevented from requiring foreign investors to use locally produced goods, or to limit their use of imports; neither can we impose limits on their access to foreign exchange to buy imports, or on the amount they export.

Jane Kelsey referred to the case of forestry. There, TRIMs prevents requirements on most of the major forestry companies active in New Zealand, because they are foreign owned. Clearly banned are requirements on them to use local materials in processing their timber, or to export a certain proportion of their production. It may also prevent us requiring them to process a certain proportion of their timber to ensure more value-added production takes place in New Zealand, but it appears no analysis has taken place to form a judgement on this.

It is highly disturbing that New Zealand has apparently committed to such agreements without analysing the effects on its economic development options.

INZ provides several papers prepared by the MED, which in the latter part of 2000 "undertook some general analysis on the impact of international agreements on industry policy options". The papers are detailed at the end of this article. The key one was dated 22 November 2000, to the Minister for Economic Development.

It states that "Industry New Zealand programmes developed to date have been carefully formulated so as to mitigate the risks of breaching our international obligations". Though it states that "there is a range of international commitments that need to be considered in the design and implementation of industry and regional development schemes", the focus is on the SCM agreement on subsidies.

A subsidy can take many forms such as direct transfers of funds, a tax break, government provision of goods and services, and income or price support. The focus of the SCM agreement is to prohibit "export subsidies" which are widely defined. Its primary obligation is that any subsidy

- is not contingent upon export performance or the use of domestic products over imported goods; and
- avoids the distortion of import and export markets.

To help understand the breadth of the WTO's interpretation of this agreement, the paper provides an Australian example. Australia's sole automotive leather export producer, Howe Leather, received more than $A30 million in export subsidies from 1991 to 1997. This enabled Howe to increase its proportions of exports from 7% of sales in 1988 to 90% of sales in 1997. The U.S. successfully challenged the subsidies under SCM and Australia was required to remove the subsidies. Howe asked for new subsidies, predicting that "its annual sales would mushroom from $A88.6 million in 1997 to $A214 million in 2000, '*with the lion's share of the growth coming from exports*'" [emphasis in the original]. In March 1997, Australia awarded Howe a $A30 million grant and a $A25 million 15-year, deferred payment loan. The U.S. challenged this in November 1997 on the basis that the majority of Howe's sales were exports, that it could not meet its production targets on the home market, and that therefore this was effectively an export subsidy. The WTO disputes panel agreed that the grant was an illegal export subsidy contingent "in fact" on Howe's export performance, and forced the Australian government to withdraw it. Though there was nothing in the agreements between the Australian government and the company on export requirements, public statements on the strength of the company's export performance by both the relevant Australian Minister and the company were accepted as evidence that was in fact an export subsidy.

The conclusion is that a subsidy is illegal under SCM if it has the *effect* of supporting exports, even if that was not what it was explicitly designed for.

As the MED paper says, this makes any kind of subsidy problematic for New Zealand, because New Zealand has a small economy. Thus, "growth of any significance by a business in the small New Zealand market could well lead to exporting. If a government programme has supported this growth there is a risk that this could be seen as an export subsidy."

The MED therefore warns that "reference to export performance should not be included in formal assessment criteria and questions on application forms" in INZ schemes. Further, "statements at all levels (Ministers, officials, Industry New Zealand) should emphasise the goal of increasing jobs and incomes or achieving sustainable economic growth, rather than specifically increasing exports."

In other words, no-one, from the Minister down, should even talk about programmes for increasing exports. As the paper goes on, "what you say about a scheme is just as important as what the scheme involves. In a culture that often equates exports with success, it is logical to state that industry assistance is specifically supporting export businesses. While increased exports could well be a positive result of the programmes, the government should avoid public statements that imply that assistance provided to business is contingent on export performance."

Note that this decision of the WTO disputes panel means that small economies are put at a further disadvantage relative to large economies. In large economies, companies can produce at a high level solely for the domestic market, and can therefore more easily be subsidised without risk of violating SCM.

Our small economy is one of two reasons the risks of a WTO challenge are especially high for New Zealand. The other reason MED gives is that New Zealand has stuck its neck out in opposing export subsidies in the WTO: "new schemes are always scrutinised closely, and this will be particularly pertinent for New Zealand because of the position we have traditionally taken in opposition to industry assistance. New Zealand has previously argued against use of export subsidies in international trade fora, and is a strong advocate of the elimination of all agricultural export subsidies. We can therefore expect all new industry development policies to be under close scrutiny from abroad to see if they stray into the area of prohibited export subsidies."

At the outset, the paper says that “Cabinet has acknowledged the fundamental principle that programmes administered under INZ policy must be consistent with New Zealand’s international trade policy commitments”. Those commitments clearly undermine our ability to use a range of economic development tools that are used by other countries. Nobody has apparently acknowledged the reverse principle: that international trade policy commitments should be consistent with New Zealand’s economic development needs.

The paper emphasises “significant risks” in not complying with international obligations: “breaching a WTO agreement could see us challenged and penalised under dispute settlement procedures. Mounting a defence would be resource intensive. An unsuccessful defence would require New Zealand either to reverse the measure and/or negotiate compensation with affected WTO members. Should these negotiations fail, New Zealand would likely face trade retaliation from affected parties. This would be costly, not only for the Government but also for the business that the government was originally trying to help.”

The paper also mentions “other WTO agreements, such as GATS, CER with Australia and the Singapore CEP” which may also be relevant, but gives no further details. In its letter to CAFCA, INZ mentions that GATS states that “in certain circumstances, subsidies may have distortive effects on trade in services”. Though “disciplines of subsidies have yet to be negotiated under GATS”, any country “which considers that it is adversely affected by a subsidy … may request consultations … on such matters. Such requests shall be accorded sympathetic consideration”. Though INZ does not mention it, an aspect of current negotiations on GATS at the WTO is to place stronger disciplines on subsidies.

The papers provided by INZ were to

- the Parliamentary Under-Secretary for Economic Development, “Export Subsidy Issues in Relation to Industry and Regional Development Assistance”, 4 October 2000
- the Minister for Economic Development, “International Obligations”, 22 November 2000.

In addition the Ministry was to prepare a working guide on international obligations relevant to industry and regional development policy. Only three papers were prepared:

- a Draft Guide to Key International Obligations;
- Trade Related Aspects of Intellectual Property (TRIPS);
- Trade Concerns: Technical Barriers to Trade (TBTs).