Office of the Minister of Commerce and Consumer Affairs
Chair, Cabinet Economic Growth and Infrastructure Committee

Import Tariff Levels After 2017

Proposal

1. This paper proposes that import tariffs be held at their existing applied rates [redacted], except where reduced through World Trade Organisation (WTO) or free trade agreement negotiations, [redacted]

Executive Summary

2. On 29 October 2013, Cabinet agreed to maintain import tariffs at their existing levels until at least 30 June 2017, except where they were required to be reduced earlier as a result of WTO or free trade agreement negotiations [CAB Min (13) 37/6].

3. Cabinet also invited the Minister of Commerce to report back to EGI by the end of 2016 on whether tariff levels should be reduced after 30 June 2017. The previous Minister of Commerce and Consumer Affairs deferred this report back by six months so that the matter could be considered in the context of the Government's wider review of New Zealand's trade strategy.

4. There is general agreement between officials that a tariff-free economy is desirable from an economic perspective. It should be borne in mind, however, that the issues canvassed in this paper are being considered in a context in which New Zealand's remaining tariff levels are already low. Tariff collection in 2015/16 was approximately [redacted]% of the value of total imports.

5. In terms of economic theory, movement towards a tariff-free economy would allow more efficient allocation of the economy's resources, albeit for a limited range of sectors and products, rather than encouraging resources into remaining parts of protected industries. In a tariff-free environment, firms that currently enjoy protection would need to become more internationally competitive. Competition levels are generally low in New Zealand and intensification of competition would likely increase productivity. Consumers and firms could benefit from lower prices and reduced costs and firms would have one less impediment to their participation in global value chains.

6. The outstanding question is whether a tariff-free outcome should be achieved [redacted] The evidence currently available suggests [redacted] tariff elimination could increase GDP by up to $277 million annually by 2025. Studies estimate larger increases to GDP as a result of free trade agreements. For example, the Korea-New Zealand Free Trade Agreement alone will remove almost all the [redacted] in tariffs paid on New Zealand exports to Korea by 2030.

7. I consider that removing remaining tariffs through trade negotiations is the preferred approach [redacted]

8. I therefore recommend that import tariffs should continue to be held at existing applied rates [redacted] except where reduced through WTO or free trade agreement negotiations. [redacted]

Comment

History of tariff reduction in New Zealand

9. From 1988 to 2009, successive New Zealand governments undertook a programme of gradual, unilateral tariff reduction. These reductions were based on the principle that tariff reduction reduces the costs of imports, benefitting consumers, fostering competition and encouraging firms to increase productivity and be internationally competitive. In the longer term, tariff reduction helps New Zealand trade on the basis of comparative advantage.

10. Since concluding the Closer Economic Relations Agreement with Australia in 1983, New Zealand has also followed an approach of pursuing tariff reduction through free trade agreements (FTAs) with key partners and through our membership to the WTO. This approach reduces tariffs over time, while also securing reciprocal tariff reductions from our trading partners, helping exporters gain improved access to overseas markets and facilitating their integration into global value networks.

11. In 2009 and 2013, following reviews of New Zealand's tariff policy, Cabinet endorsed a reciprocal approach to tariff reduction and decided to maintain tariff rates at existing levels except where reduced through World Trade Organisation or free trade agreement negotiations. These decisions were made primarily on the basis that import tariffs are valuable [redacted]

New Zealand's current tariff regime

12. New Zealand has low levels of tariffs remaining. Current applied tariff rates and their coverage are shown in the table below.

Tariff	Goods	Coverage (% of tariff lines)	Coverage (value of total imports)
10%	Clothing and footwear, carpet, ambulances, motorhomes	6%	[redacted]
5%	Textiles, machinery, appliances, metal and plastic goods, processed foods, and other goods where manufacturing exists or has existed in NZ	35%	[redacted]
$1.87 per kg $0.50 per litre of alcohol	Used clothing and footwear, and high-value gin and vodka	0.08%	[redacted]
Free	All other goods	59%	[redacted]

*Note this figure shows duty free access provided by New Zealand's applied zero tariff rates only, and excludes duty free access provided by preferential rates given under FTAs and to least developed and developing countries, [redacted].

13. In total, approximately [redacted] per cent of New Zealand's imports by value enter duty free under zero tariff rates, preferential rates given under FTAs and to least developed and developing countries, or [redacted]. [redacted]. Under the [redacted] regime in 2016, [redacted] in duty was foregone from [redacted] of dutiable imports. Tariffs are also reducing as FTAs are negotiated and implemented.

14. The New Zealand Customs Service (Customs) collected net [redacted] in import tariffs in the 2015/16 year. This represents approximately [redacted] per cent of the value of all imports and [redacted] per cent of core Crown revenue. This percentage has been declining over the past few years as FTAs have come into force.

Tariffs impose costs on the economy and their removal is generally desirable

15. While New Zealand has relatively low levels of tariffs remaining, these tariffs create some small distortions in the economy and impose some small costs on firms and consumers. Tariffs can result in resources being diverted to less productive areas of the economy. They can also constrain competition, investment, export performance and incentives for firms to increase productivity and innovation. Tariffs also increase costs to firms and consumers, including compliance costs.

16. As noted above, Customs collected net [redacted] in import tariff revenue in the 2015/16 year. Maintaining a tariff duty system however incurs administrative costs. It is estimated that the cost of maintaining the tariff duty system totals approximately [redacted] per annum between Customs and the Ministry of Business, Innovation and Employment.

17. Importers also incur compliance costs because of the need to ensure duties are correctly paid, [redacted] are applied where appropriate, and rules of origin for preferential tariff entry are complied with. In the absence of import tariffs, importers would not incur many of these compliance costs, although they would still need to classify and enter goods correctly for statistical and other purposes such as risk management, levies and excise duties.

18. Removal or reduction of New Zealand's remaining low level of tariffs could make a small contribution to reducing costs for consumers, increasing competition and promoting productivity, innovation and integration in global value networks.

19. For domestic industry, tariff removal may involve some adjustment costs in the form of reduced output and employment in affected industries. However, most industries are already exposed to, or should be preparing for, tariff-free competition as a result of our existing FTAs. The adjustment costs that tariff removal creates are therefore generally expected to be limited. It should be noted however that the current review did not analyse the actual or likely impacts of tariff removal on domestic industry.

Tariff removal could bring some benefits to competition intensity and productivity

20. New Zealand's weak productivity performance has limited the growth of incomes for New Zealanders since the mid-1980s. The causes of this weak performance are complex and inter-related. However, recent strategic economic policy documents from New Zealand's economic agencies and the OECD all suggest that low levels of competitive intensity in New Zealand are likely to be a contributor to the problem. New Zealand consumers are therefore suffering from both low levels of competition and the direct costs imposed by tariffs.

21. As a small economy, New Zealand potentially has more to gain from international trade to ensure there is competitive pressure on domestic firms. Intensity of competition in New Zealand appears to be lower than that of small European economies and our remaining tariffs may be a small part of the explanation. Tariffs may add some hindrance in New Zealand markets where competition is already weak compared with equivalent markets in other OECD economies.

22. There is a range of other, potentially more significant factors that influence competition intensity in New Zealand markets. However, import tariffs contribute to the problem and are one of the few direct levers the government has to influence competition levels across a range of markets. Removing remaining import tariffs would help to improve competition intensity marginally.

23. There is also good international evidence that greater trade encourages industry productivity growth, both by encouraging firms to innovate more and by encouraging less productive firms to shrink or exit, thus freeing up the labour and other resources for use by other businesses. Tariff removal could also have a small effect on some of the country comparison indices resulting in positive media commentary, signalling New Zealand is open for business and encouraging greater trade and investment. As important however is the positive image which has been generated by wide international recognition of New Zealand's willingness to conclude comprehensive and high-quality FTAs.

24. The following sections consider two approaches to tariff removal: [redacted] removal to bring some modest benefits in the near term, or [redacted] removal through trade negotiations to bring potentially greater benefits over the longer term.

[redacted] removal or reduction of tariffs could bring some modest benefits

25. The first approach to tariff removal is to [redacted] reduce applied tariff rates to zero, likely over a phased period. Evidence suggests that [redacted] removal of New Zealand's remaining tariffs could provide marginal gains to GDP from increased economic efficiency.

26. The current review did not conduct a cost-benefit analysis of the likely impacts of tariff removal and relied on previous modelling. The New Zealand Institute of Economic Research conducted modelling in 2010 of the likely effects of full import tariff removal. The study concluded that if tariffs were removed (at 2010 levels), GDP would likely increase marginally by about 0.11 per cent above baseline per annum ($162 million at 2010 GDP levels), rising to 0.19 per cent ($277 million) by 2025.

27. It is arguable that the indirect benefits of removing remaining tariffs could be greater than this as the study did not assess the ongoing dynamic effects of tariff removal from improvements to innovation and productivity. The above figures may therefore underestimate to some extent the economy-wide significance of removing or reducing remaining tariffs. However, the study also noted that the gains to GDP noted above could potentially be outweighed by a deterioration in New Zealand's terms of trade (whereby the price of our exports would decline more than the price of imports). Overall, therefore, the study suggested that the direct benefits of full tariff removal would be modest at best.

28. As noted above, low levels of competition intensity are a contributor to New Zealand's weak productivity performance. [redacted] removing New Zealand's remaining tariffs is a clear and rare opportunity to remove a marginal structural impediment to growth and make some contribution to increasing the competitive intensity in New Zealand's markets. However, given the low levels of remaining tariffs, the effect on competition in New Zealand is likely to be small.

Removal of tariffs through free trade agreements brings reciprocal benefits from trading partners while also reducing tariffs over time

29. The second approach to tariff removal is to remove tariffs over time and in a reciprocal manner through World Trade Organisation or free trade agreement negotiations. In addition to the benefits of domestic removal of tariffs, this approach also brings benefits from reciprocal removal of tariffs by our trading partners. This secures benefits not only for domestic firms, importers and consumers, but also for New Zealand exporters in the form of improved access to overseas markets and ability to build and participate in global value networks.

30. The market access benefits from completing FTAs can be significant. For example, the ASEAN-Australia-New Zealand FTA, once fully implemented by 2021, is expected to deliver at least $50 million in tariff duty savings per year for New Zealand exports. These benefits will continue to increase as trade increases and tariffs in ASEAN export markets are eliminated. A further example is New Zealand's FTA with Korea, which will eliminate duties on 98 percent of New Zealand exports by 2030, leading to substantial duty savings. In 2015, prior to the entry into force of the FTA, it was estimated that New Zealand exporters were paying around $229 million in duties each year on exports to Korea.

31. Larger regional FTAs, such as the Trans-Pacific Partnership, can deliver even more significant tariff savings. [redacted] TPP was estimated to increase New Zealand's GDP by 0.9 per cent, or $2.7 billion annually by 2030. Of this, $624 million was due to removing or reducing tariffs in export markets.

32. Removing tariffs through free trade negotiations however has some disadvantages. Trade agreements take time to negotiate and can be unclear at the outset about the benefits they will deliver, because the level of tariff removal or reduction that negotiating partners agree to undertake has to be determined through the negotiations. Tariff reductions also take time to phase in both domestically and in overseas markets. Removal of tariffs through trade negotiations can therefore result in an uncertain timeframe to secure the benefits of improved export market access, and can delay the domestic benefits of New Zealand's own tariff removal.

New Zealand exports still face significant tariffs in foreign markets

33. Compared to other WTO Members, New Zealand has relatively low levels of tariffs. New Zealand exports face higher tariffs in many foreign markets than imports into New Zealand do. While New Zealand's network of FTAs is increasing, only [redacted] per cent of New Zealand exports will enter their destination markets duty free or at preferential rates at the full implementation of current FTAs.

34. Six per cent of WTO Members have simple average applied tariffs of zero to three per cent. New Zealand sits within this grouping with its simple average applied tariff on all products being 2.3 percent. This means we have slightly lower levels of tariffs than Australia (2.5 per cent), and lower than the United States (3.5 per cent), Japan (4.0 per cent), Canada (4.2 per cent) and the EU (5.1 per cent). New Zealand currently does not have FTAs with any of these last four trade partners.

35. Tariffs on agricultural products in particular represent a significant barrier for New Zealand primary sector exporters. In the United States, for example, agricultural products attract a simple average tariff rate of 5.1 per cent, in Japan 12.9 per cent, in Canada 16.7 per cent, in the EU 10.7 per cent, and in India 13.5 per cent.

Tariffs remain valuable as "negotiating coin"

36. While New Zealand is highly open to world trade, New Zealand exporters, particularly of agricultural products, continue to face significant tariff barriers in foreign markets. Successful implementation of the various FTA agreements still in the pipeline would significantly increase duty free access. However, these benefits have not yet been secured, and still depend on New Zealand's ability to successfully negotiate meaningful tariff concessions from partners.

37. Modern free trade agreements are expanding in scope and now also target the significant non-tariff barriers (NTBs) that confront New Zealand exports. NTBs often present even greater barriers to New Zealand exports than tariffs. Nonetheless, tariffs remain a persistent and significant barrier to trade. The Government's refreshed trade policy strategy (Trade Agenda 2030) sets a target of covering around 90 per cent of New Zealand's current merchandise goods exports through FTAs by 2030. The Government's Business Growth Agenda has also set a target of increasing exports to 40 per cent of GDP by 2025. In order to meet these targets, it is necessary to continue to reduce the tariff barriers that New Zealand exports face.

38. The Ministry of Foreign Affairs and Trade's (MFAT) advice is [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

39. [redacted]

40. It is worth noting that other economies, such as Singapore and Hong Kong, have been able to negotiate high-quality trade agreements despite not having any import tariffs. However, the trade profile and geopolitical position of these economies are significantly different from New Zealand's. In particular, they do not have agricultural export sectors and therefore do not face the same challenges as New Zealand does in securing reductions in partners' levels of protection on agricultural products.

Further work is required to determine how tariffs should be removed

41. The exact economic impact of [redacted] is unclear. Current evidence suggests [redacted] removal of tariffs could deliver a marginal benefit to economic performance now, and potentially greater benefits through dynamic efficiencies over time. [redacted] removal of tariffs through trade negotiations could deliver potentially larger benefits to a wider range of stakeholders, including exporters, albeit over a longer-term and uncertain timeframe.

42. I consider that [redacted]

43. I therefore recommend that import tariffs should continue to be held at existing applied rates [redacted], except where reduced through WTO or free trade agreement negotiations. However, I further recommend that [redacted]

BGA Export Market Ministers consider that tariffs should continue to be held at existing rates for the time being

44. In November 2016, the previous Minister of Commerce and Consumer Affairs presented a discussion paper to BGA Export Markets Ministers to seek their views on possible changes to tariff levels. BGA Ministers were generally of the opinion that tariffs should be maintained at current levels [redacted]

[redacted]

45. [redacted]

46. [redacted]

Consultation

47. MFAT, the Treasury, the Ministry for Primary Industries (MPI) and Customs have been consulted in the preparation of this paper. The Department of Prime Minister and Cabinet has been informed.

48. [redacted]

49. [redacted]

Financial Implications

50. There are no financial implications from the recommendations in this paper, and any additional work as part of the report back will be funded through existing baselines. It should be noted that there will be a gradual decline in tariff revenue as New Zealand’s tariffs phase to elimination under FTAs.

Human Rights

51. There are no human rights implications.

Legislative Implications

52. There are no legislative implications.

Regulatory Impact Analysis

53. The Regulatory Quality Team at Treasury considers that Cabinet's Impact Analysis Requirements do not apply to this paper as the recommended proposals do not involve regulatory change. [redacted]

Publicity

54. If Cabinet agrees to hold tariffs at existing applied rates [redacted] except where reduced through WTO or free trade agreement negotiations, the Ministry of Business, Innovation and Employment will publish a public version of this paper on their website. Announcement of this decision is unlikely to be controversial.

Recommendations

It is recommended that the Committee:

1 **Note** that in both 2009 and 2013, Cabinet recognised the value of tariffs [redacted] and decided to maintain tariff rates at existing levels except where reduced through World Trade Organisation or free trade agreement negotiations [CAB Min (09) 34/16 and CAB Min (13) 37/6 refer].

2 **Note** that the Government's Business Growth Agenda sets a goal of increasing exports to 40 per cent of GDP by 2025, and the Government's Trade Agenda 2030 sets a goal of covering around 90 per cent of current goods exports through free trade agreements by 2030.

3 **Agree** that import tariffs are held at their existing applied rates [redacted] except where reduced as a result of World Trade Organisation or free trade agreement negotiations.

4 [redacted]

5 [redacted]

[redacted] [redacted]

[redacted]

[redacted]

[redacted] [redacted]

Authorised for lodgement

Hon Jacqui Dean
Minister of Commerce and Consumer Affairs