INTERNATIONAL TRADE
BY THOMAS MANNING

Latin America possess advanced industrial and technological capabilities

Force majeure

After emerging in Wuhan the Covid-19 virus has turned global trade on its head by disrupting critical supply chains from China to international markets in a classic example of 'force majeure' which the Oxford Dictionary defines as a legal term for "Unforeseeable circumstances that prevent the fulfilment of a contract".

The health emergencies Covid-19 has caused across the globe are accurately described by Oxford's alternate definition of "Irresistible compulsion or greater force".

China has markedly slowed Covid-19 infections by aggressively quarantining entire cities and closing factories & ports, but this has been at a huge and as yet unpaid cost to its economy and trading partners.

Outside of China fears of rising contagion has led to border restrictions and quarantines including in New Zealand where the border is closed indefinitely to all but returning citizens and permanent residents and the population has been confined to their homes for four weeks.

A severe contraction in tourism and hospitality is underway as global aviation scales-back in the face of falling demand and draconian border restrictions with Air New Zealand suspending 95% of its international routes (including Buenos Aires) and cutting domestic flights drastically (as have Aerolineas Argentinas, Aeromexico, Avianca and LATAM airlines in Latin America).

As unemployment rises and consumer demand falls, central banks across the world have shored-up their economies by spending trillions in bond markets & quantative easing, cutting interest rates and on business and worker support schemes (NZD 12.1 billion in New Zealand).

World stock markets are on a panicked roller-coaster ride as fears of Covid-19's negative economic consequences dent confidence, which in turn has been exacerbated by a dispute between Saudi Arabia and Russia, which has halved crude oil prices to the detriment of oil-producer nations and the global energy industry in particular.

World Health Organisation epidemiologists expect a Covid-19 vaccine will be developed within 18 months but in the meantime, its eventual cost in human life aside, the virus has dealt a mortal blow to China's pre-eminence in global trade.

Kenneth Rapoza, Forbes Magazine international trade commentator believes coronavirus will be China's swan song and says "there is no way China can be the low-cost, world manufacturer anymore, those days are coming to an end".

The shuttering of China has graphically proven that over-reliance on just one manufacturing hub is a recipe for disaster as widespread shortages of Chinese-manufactured auto parts, electronics and pharmaceuticals attest.

A good example of over-reliance is India's pharmaceutical industry, which has suspended the export of 26 active drugs and formulations for lack of raw materials from their Chinese sole-suppliers.

India supplies 20% of the world's generic drugs and their export ban has sparked panic buying and global shortages of common drugs from paracetamol to antivirals even as far afield as New Zealand where paracetamol is being rationed.

China's rise as an industrial powerhouse began 35 years ago on the back of its incomparably cheap labour costs and economies of scale, but demand has driven labour costs up beyond those in other emerging economies (e.g. Latin America where the regional average monthly minimum wage in 2019 was NZD 525 compared to China's NZD 615).

Well before the Covid-19 emergency, Western manufacturers were already moving to cheaper labour markets which will accelerate once health emergencies subside as China's shutdown has highlighted just how intricately world trade has become a hostage to China's well-being.

Supply chains are only as strong as their weakest link - the longer the supply chain, the bigger the risk, so it makes sense for new manufacturing hubs to be closer to Western markets and in this respect Latin America fits the bill.

Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay all possess advanced industrial and technological capabilities which can be scaled-up to accommodate increased demand and at lower labour and operational costs than in China.

Mexico is the box seat as it is already a top producer and exporter of airplane engines, micro-semiconductors, trucks, cars, televisions, & computers, while Brazil is a world leader in pharmaceutical and cosmetics production (notwithstanding its mind-bogglingly complicated tax system and Kafkaesque bureaucracy which are barriers for foreign investors).

With few exceptions all Latin American nations have free-trade manufacturing zones in which inflows of raw materials & components and outflows of exported final goods are not subject to tariffs, non-tariff barriers or company taxes.

Another option in El Salvador, Mexico, Nicaragua and Paraguay is a 'maquiladora' manufacturing plant which can import and assemble components for export on a tariff & tax-exempt basis.

Added incentives for manufacturing in Latin America compared to China are that English is more widely spoken, foreign investments qualify for 100% tax breaks in a number of nations (notably Costa Rica), profits can be repatriated freely and as North American and European markets are closer, shipping costs and carbon footprints are less (especially from Mexico).

The New Zealand government showed remarkable prescience in identifying the folly of putting all its trade eggs in one Chinese basket when it released a 'Trade Strategy Initiative' in 2015 which included a "pivot" in focus to South America.

In 2017 the government went further when it issued a 'Trade Strategy Refresh', which led to a new embassy in Colombia, a push for associate membership of the Pacific Alliance (a free-trade union comprising Chile, Colombia, Mexico and Peru) and a beefed-up presence in the region for New Zealand Trade and Enterprise and Education New Zealand, all of which will stand New Zealand businesses in good stead during the coming retreat from reliance on China (which will accelerate once the Covid-19 emergency abates).

A majority of New Zealand manufacturers either produce their products in, or import components from China and they need to pay heed to Covid-19's lesson that relying on just one region as a manufacturing/supply hub is fraught with extreme risk (now proven).

It behoves New Zealand's manufacturers and importers to take a good look at what Latin America has to offer in the interests of diversifying their supply chains to make them less vulnerable to forces majeures.

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