EDITORIAL ESSAY

ECONOMIC INTEGRATION AFTER COVID-19: THE CASE OF FREE TRADE AGREEMENTS BETWEEN NEW ZEALAND, AUSTRALIA AND EUROPE

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Introduction

The last decades have been characterized by a boom in international agreements promoting economic integration among countries around the world. This integration has been the result of political cooperation among like-minded countries or the tool of a foreign and development policy. The recent paralysis of the World Trade Organization, the multilateral institution that deals with the rules of international trade, has resulted in the flourishing of plurilateral, regional, and bilateral agreements as alternative options of cross-border economic integration.

The Covid-19 pandemic has resurrected ‘national security’ as a justification for protectionism and industrial policy, especially for the critical sectors of food and health-related goods and services\(^1\). In the case of personal protective equipment (PPE), for example, the European Union (EU) Commission first restricted their export, then invited Member States to be vigilant against foreign acquisitions of PPE manufacturing, and finally launched a consultation in 2020 to develop a new “strategic autonomy” that combined the commitment to free and fair trade with the need to produce essential goods on the European territory. Other countries are also reconsidering the nature of their global trade and investment policies, with a real possibility of a global decoupling between the US and China and their respective allies.\(^2\) Some analysts have even suggested that a new world order is emerging, pitting democracies (“the rule of law”) against authoritarian (“the law of rulers”) countries.\(^3\)

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The new inward-looking policies of many governments are also related to the strategic actions of firms, including re-shoring of value creation to home countries. Some observers have suggested a possible retreat to relatively less globalized value chains. These trends of “de-globalisation”, structural reshaping of globalisation and regionalisation have raised concerns (among both international institutions and scholars) about escalation of autarkic plans which can jeopardize the cross-border cooperation required to fix international problems.

Despite the Covid-19 travel restrictions, lock downs, and rising anti-globalist sentiments, trade negotiations progressed between the EU, New Zealand, and Australia, following the 2018 decision of the Council of the EU to authorize the opening of negotiations for EU-New Zealand and EU-Australia Free Trade Agreements (FTAs). It is important to consider the implications of this changing policy context for both FTAs between the EU, New Zealand, and Australia, in other areas of trade and economic activity, such as the strategies of international businesses. Business relations between Australia, New Zealand and the EU are increasingly characterized by knowledge flows, cooperation for innovation and

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strategic diversification.\(^{10}\) The dangers of over-reliance on relations with China have been sharply illustrated, for example, in the escalation of the trade war between Australia and China.\(^{11}\) A reliance on China as a strategic partner is increasingly questioned given the evolving (and arguably increasing) authoritarian nature of its political system.\(^{12}\)

**EU trade agreements in Australasia amidst new political risks**

This special issue offers several angles on the topic of economic integration after Covid-19. The first article, by Maureen Benson-Rea, is entitled “New Zealand-EU trade: Looking back, looking forward”.\(^{13}\) It analyzes trade relations between New Zealand and the EU both from a historical perspective and with a forward-looking lens. This article is an important contribution that provides a background and context to understanding the free trade agreement between New Zealand and the EU, signed in mid-2022 (although it had not been ratified at time of writing). While this agreement was inevitably a compromise (for example, some of New Zealand’s and the EU’s farmers’ associations have criticized it), it must be viewed in the context of wider political realities. For example, New Zealand was aware of the likely increasing protectionism in Europe (e.g., France) following the emerging signs of record inflation and the cost-of-living crisis of 2022. Moreover, both parties to the deal were cognizant of the new geopolitical environment following the Russian invasion of Ukraine, with both the EU and New Zealand keener to develop trade relations with “like-minded” (democratic) countries.

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\(^{11}\) Stevens, K. (2020). Grim warning that Australia is just a ‘little boat caught between two rocks’ in the US-China trade war as Asian superpower’s attitude switches from ‘assertive to aggressive’. *Daily Mail* (11 November, 2020).


Stefano Riela’s contribution to this special issue, titled “The risks of politicization of trade”, tackles this topic in depth. Riela dissects the international trade environment with an incisive analysis, showing that the global market concentration of exports has risen in labour-intensive, resource-intensive, low-skilled, and technology-intensive sectors. Advanced economies such as the EU, New Zealand, and Australia increasingly rely on global value chains that include emerging economies with political-economic systems vastly different from their own. In a sobering warning about the risks of a decoupling between democracies and authoritarian regimes, Riela reveals that the share of democracies in world economic output has been falling between 2006 and 2021, while authoritarian regimes’ share has been rising (although it still accounted for less than a half of global gross domestic product in 2021).

Of course, the line between democracies and authoritarian regimes is often blurred and many countries are somewhere in the middle. However, this underscores the worrying trend of democracy being challenged, not just by the rise of authoritarian and semi-authoritarian emerging economies, but also in the West (for example, in the January 6 attack on the US Capitol and in the rise of authoritarianism in the EU, e.g., Hungary). Riela brings home the fact that, with globalization and the international trade links that we have built in the last 30 years, there is simply no way back to 1989 and the costs of breaking up the world into two or more blocs would be enormous to all of us. For example, close to 40% of the EU’s imports (extra-EU) came from authoritarian regimes in 2021, compared with less than 25% in 2002. In particular, while reducing its reliance on imports from Russia may be possible for the EU following Russia’s war in Ukraine (that has shaken the foundations of

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post-World War II Europe), extricating the EU from trade with China may be near impossible.

New Zealand, which relies on trade with China to an even larger degree than the EU, has so far walked a fine line in preserving this fruitful economic relationship while remaining politically aligned with liberal democracies such as the US and the EU. Some have pointed to a need to rebalance this “asymmetric hedge” (counterweighing economic reliance on China with political alignment with the West), perhaps towards less economic reliance on China.\textsuperscript{15} While not delivering everything New Zealand wanted (especially for the dairy and meat industries), the trade deal with the EU does offer an opportunity to increase the strategic diversification of New Zealand’s economic ties, in what New Zealand Prime Minister Jacinda Ardern called a “bloody messy world”.\textsuperscript{16} This could provide a long-needed impetus to modernize and diversify the country’s economic base, reduce its reliance on the primary sector (which is the main exporter to China), and further develop advanced industries such as sophisticated manufacturing, information technology and other high-value services (which often cater to a larger degree to the advanced economies such as the US and the EU).

Australia has been more even more assertive and critical than New Zealand in its relationship with China. As a result, it faced more trade backlash in its economic relationship with this rising global power. It has also been a bit slower than New Zealand in finalizing its trade deal with the EU (perhaps not willing to concede as much as its smaller trans-Tasman neighbour). The trade deal was also delayed because of France’s dismay at Australia’s decision to cancel a major French submarine contract.\textsuperscript{17} However, both Australia and New

\textsuperscript{17} EU postpones long-planned trade talks with Australia over submarine row. 1 October 2021. \url{https://www.france24.com/en/europe/20211001-eu-postpones-trade-talks-with-australia-amid-submarine-row}
Zealand were quick to strike a trade deal with post-Brexit United Kingdom, itself keen to show it could act in a much more agile manner without the ‘cumbersome’ EU (and perhaps accordingly giving its former colonies “sweet deals”). Overall, the recently renewed prospect of an FTA between the EU and Australia shows how the trappings of history and politics might be side-stepped by a stronger sense of economic benefits.\(^{18}\)

The third article in our special issue, titled “European Union’s normative free trade agreements with Australia and New Zealand: Are they a booster for the Global Gateway Project?”, suggests that these agreements go beyond economic benefits and have broader goals in bolstering EU’s intentions to build common norms and a safe ground in international cooperation. One of findings of this research by Zafer Efmez and colleagues is that normativity is instrumental in EU institutions' emphasis on common identity and partner countries' instrumentality in providing legitimacy before public opinion. Another finding is that the EU can realise the Global Gateway project with contribution of normative FTAs to demonstrate how democratic values offer certainty and fairness for investors, sustainability for partners and long-term benefits for people around the world.\(^{19}\)

**European integration and foreign direct investment after Covid-19**

This special issue posed a key question about whether global economic integration will be the same after Covid-19, and which of the impacts will be short-term and which long-term. While the Covid-19 pandemic seemed to have slowed down the EU-Australia trade negotiations somewhat, the quick signing of trade deals between the UK, New Zealand and Australia in 2021 and the signing of the EU-New Zealand trade agreement in the emerging

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\(^{18}\) Mascitelli, B., & Wilson, B. (2018). Against the odds—a free trade agreement between the European Union and Australia?. *Asia Europe Journal*, 16(4), 333-349.

post-Covid-19 world in 2022, appear to indicate that economic integration can remain alive and well post-Covid-19. The geography and nature of some of the trade deals may change in the future though, with more stress on environmental issues (e.g., in the EU trade agreement with New Zealand), digital trade (e.g., New Zealand’s Digital Economy Partnership Agreement with Chile and Singapore), resilience (e.g., the US-initiated ‘Indo-Pacific Economic Framework’) and perhaps security (e.g., ‘Partners for the Blue Pacific’ Initiative for the Pacific region).

In terms of implications for European integration, the Covid-19 pandemic may be possibly a boost to EU economic integration, at least in the medium term. The EU initiatives that were a response to the pandemic are creating deeper economic integration. For example, the Next Generation EU Initiative, estimated at 850 billion euros, will be financed by EU issued and guaranteed bonds. It was called Europe’s ‘Hamiltonian’ moment, in reference to the first Treasury secretary of the US and federalization of the debt by US states. The related European Green Deal will likely make the EU the world’s largest issuer of green bonds, with over 200 billion euros over the next few years to fund its recovery plan. The European Green Deal is seen as a ‘lifeline out of the Covid-19 pandemic, with one third of the 1.8 trillion-euro investments from the Next Generation EU Recovery Plan earmarked for it, and the EU’s seven-year budget financing the European Green Deal’.

In terms of implications of Covid-19 for foreign direct investment (FDI), a key aspect of international economic integration, the Covid-19 pandemic has had short-term negative impacts on FDI in 2020, but in 2021 the flows of FDI across borders recovered to pre-

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pandemic levels.\textsuperscript{22} In the future, partly due to the uncertain global environment\textsuperscript{23}, the geography of FDI flows may change, with a move away from some countries perceived to be too risky or uncertain\textsuperscript{24}. For example, while China and Hong Kong were the no. 2 and no. 3 economies for FDI inflows in 2021 (after the US), three-quarters of global FDI growth was in developed economies in 2021 and there may be further shift from China and Russia (which was the no. 9 FDI destination in 2021, according to the UNCTAD) to other, safer emerging economies such as India and Mexico. There may also be a continued shift to non-equity modes of foreign market entry that have been evident in many sectors such as hospitality for some time.\textsuperscript{25} Global FDI flows have already peaked pre-pandemic in 2007 and 2015 (about US$ 2 trillion) compared to about US$1.6 trillion in 2021, according to the UNCTAD.

In the initial phases of the Covid-19 pandemic, over a quarter of surveyed multinational enterprises indicated that the rules for business operations and market entry for foreign investors had become less business-friendly in their country of operation as a result of Covid-19, according to a World bank October 2020 survey.\textsuperscript{26} Moreover, the EU’s Foreign Investment Regulations Review addressed the growing concerns in the EU stemming from the rising number of acquisitions of EU companies operating in sensitive and strategic sectors by non-EU investors, in particular Chinese companies.\textsuperscript{27} The Covid-19 crisis emphasised the importance of building resilience in the health sector and the need to protect EU strategic assets. FDI screening is one of the priorities of the revision of the EU trade policy, launched

\begin{itemize}
  \item \textsuperscript{22} https://unctad.org/news/global-foreign-investment-recovered-pre-pandemic-levels-2021-uncertainty-looms
  \item \textsuperscript{26} https://blogs.worldbank.org/psd/impact-covid-19-foreign-investors-evidence-second-round-global-pulse-survey
\end{itemize}
in mid-2020. Additionally, the ground-breaking EU-China Comprehensive Agreement on Investment was not ratified by the European Parliament in 2021 amid worsening relations between China and the EU (and the US) and sanctions from both sides related to human rights abuses in Xinjiang and Hong Kong.\textsuperscript{28} This agreement would give the EU some of the best conditions for FDI in China, including relaxation of some of the rules on joint ventures (JVs) and technology sharing.

Beyond the EU, we see some countries using the Covid-19 pandemic to revamp their FDI policy to attract certain sorts of FDI and to benefit from the increasing “diversify away from China” sentiment around the world. For example, FDI equity inflows into India increased 13\% in the financial year ending March 2021, with the Indian government seeking FDI specifically from companies intending to diversify manufacturing operations away from China. India’s pharmaceutical sector has received a notable share of $30bn FDI inflows that year, and attracted increased global attention as a manufacturing hub for pharmaceuticals.\textsuperscript{29} New Zealand has also embraced selective FDI incentives to attract key projects such as the production of Amazon’s \textit{Lord of the Rings} series, which was allocated $160m in subsidies on its $650m project.\textsuperscript{30} In spite of the generous subsidies for the first season, Amazon ultimately decided not to shoot the second season of the series in New Zealand in spite of considerable effort by the New Zealand government to persuade it otherwise.\textsuperscript{31} New Zealand also gave exemptions to wealthy investors to enter New Zealand during the pandemic and expected over 200 wealthy investors to arrive in 2022 and invest ‘millions of dollars.’\textsuperscript{32}

\textsuperscript{28} \url{https://www.china-briefing.com/news/european-parliament-votes-to-freeze-the-eu-china-comprehensive-agreement-on-investment/}
\textsuperscript{29} \url{https://www.thepharmaletter.com/article/india-set-to-attract-fdi-and-exploit-covid-19-created-opportunities}
\textsuperscript{30} \url{https://www.stuff.co.nz/business/opinion-analysis/300282656/does-our-amazon-deal-set-a-dangerous-precedent}
\textsuperscript{31} \url{https://www.nzherald.co.nz/nz/amazons-lord-of-the-rings-new-zealand-exit-a-tourism-nightmare/BT6ELYZPLOE2YTD7XBYHNSNYAG4/}
\textsuperscript{32} \url{https://www.rnz.co.nz/news/national/442690/wealthy-investors due-to-arrive-on-new-border-exemption}
Conclusion

Overall, one can expect that the retreat to more protectionist policies towards FDI will somewhat subside after 2022, when the need for economic recovery will become even more apparent. FDI will likely be again viewed as a boost to economic growth in most countries. The EU-China FDI deal, however, could be substantially delayed or even not pursued at all given China’s tacit support for Russia in its war in Ukraine and the EU’s increasing reservations about China’s political system. There is a high chance that the souring of sentiment towards (and screening of) Chinese acquisitions will continue or increase in advanced OECD economies including the US and the EU. Similarly, China may likely retaliate with foreign direct investment restrictions of its own. Overall, the economic benefits of FDI will continue to be recognized, but also the increased risks and institutional distance between many home and host nations of FDI. Reshaping of global supply chains will likely take place, but it may not happen fast. A new wave of regionalization in value chains is possible, and geopolitical considerations influenced by the Russia-Ukraine war may exacerbate this trend. In a “bloody messy” post-Covid-19 world, economic integration will continue to be a productive path to increasing prosperity and wellbeing, but will have to be balanced with security and environmental concerns, and it may have to be accompanied by geopolitical hedging and strategic diversification both at the national and corporate levels.

36 https://www.abc.net.au/news/2022-03-06/why-global-supply-chains-will-be-rewritten-in-coming-years/100875330
References


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