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**Research Report**

## New Zealand: The EU's Asia-Pacific partnership and the case for a next generation FTA

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No. 07/2015

# New Zealand: The EU's Asia-Pacific Partnership and the Case for a Next Generation FTA

by Hosuk Lee-Makiyama

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## INTRODUCTION: THE UNEXPECTED CANDIDATE?<sup>1</sup>

THE ASIA PACIFIC region has emerged as the world's new political and economic centre. The number of trade agreements and business transactions taking place within the region bear witness to this. The EU has seen the opening of several negotiations of big intra-Asian and Asia-Pacific economic integration agreements where the EU does not have a seat at the table, most notably

<sup>1</sup>The author thanks the ECIPE colleagues Hanna Deringer, Fredrik Erixon, Matthias Bauer and Michal Krol for their inputs and assistance.

## EXECUTIVE SUMMARY

Given the Trans-Pacific Partnership (TPP) and several intra-Asian agreements, the EU is focused on large-sized free trade agreements (FTAs) to avoid trade diversion and to maintain Europe's ability to set the trade policy agenda. The EU is now negotiating with all TPP countries except Australia, New Zealand and Brunei, a blind spot worth US\$1.5 trillion in GDP.

The idea of an FTA with New Zealand already enjoys the support of key EU Member States. New Zealand is consistently ranked number one on economic and personal freedom indices, and despite accounting for only 0.2% of EU external trade, New Zealand's economy is still on par with previous EU FTA partners like Peru and Vietnam. Measured in final consumption, New Zealand is larger than Chile, Malaysia and Singapore.

Agriculture is a sensitivity for some Member States in any trade negotiation. However, the EU has already liberalised New Zealand's key

export items, such as sheep meat and wool. On other meats, New Zealand pays half the regular duties. Products with full duties have either strong seasonal complementarities or specialisation, notably on kiwifruit and dairy, and none of New Zealand exports are amongst European sensitivities, e.g. grains or sugar. The existing duty-free treatments and complementarities make a case for an agreement negotiated with relative ease: If an FTA cannot be done with New Zealand, it cannot be done at all.

This is why Brussels is likely to start with New Zealand before Australia, as it often starts with the smaller (and thereby less threatening), more flexible counterpart first. Yet, EU FTAs with Australia and New Zealand (tied to a common market by the Closer Economic Relations agreement with mutual recognition) would have an economic output equivalent to NAFTA. Australia and New Zealand have also concluded the most ambitious FTA with the ASEAN bloc – the AANZFTA. This agreement

is a springboard for the EU, similar to how the P4 agreement led to the creation of the TPP for the United States.

But negotiating regulatory issues has proven to be difficult, even with likeminded countries. However, New Zealand already enjoys a high level of regulatory co-operation with the EU on TBT, SPS and data privacy, providing a starting point for negotiation that never existed with other FTA partners. Thanks to the existing level of cooperation, the EU-New Zealand FTA could provide the new template for EU FTAs, including areas where the EU is defensive in other negotiations (e.g. cross-border data flows). Europe needs a third generation FTA model to ensure that Europe's key offensive issues (including tariffs, GIs and technical standards) are not constrained by the TPP framework. The EU-New Zealand FTA would match the regulatory disciplines of the TPP, as well as open up the door towards Australia and ASEAN. And this door could very well be Europe's last chance of overtaking TPP.

the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP). Meanwhile the Association of South-East Asian Nations (ASEAN) – en route to establish a common market – has successfully concluded FTAs with Asia-Pacific actors, but has not yet concluded with the EU.

This eastern shift in the world's economic centre of gravity is undisputed, and so is the relative decline in importance of Europe's domestic markets. Both axioms form the baseline scenario of the EU's external policies. Europe's bilateral free trade agreements (FTAs), both those under the Global Europe strategy and the Trans-Atlantic Trade and Investment Partnership (TTIP) are Brussels' response to these developments. However, given that Europe's aggregate income fall from TPP will be equal to the gains the EU expects from TTIP, Europe is left with no option but to negotiate with each of the TPP and ASEAN countries to secure exports. The picture is especially worrisome for EU exporters of agricultural products.<sup>2</sup>

While seeking to rebalance the shift to the Asia-Pacific, Brussels' current fixation with scale and large-sized trade deals such as TTIP and Japan is unsurprising. For Europe, the world's largest economic bloc, only a few (if any) trade agreements could actually revive Europe's growth on the basis of exports alone. However, some EU Member States are one of the most export-dependent economies in the world, often fuelled by old-fashioned manufacturing trade.

Then why is New Zealand – only Europe's 50th largest export market, recipient of 0.2% of its exports – now a likely candidate for a FTA? Senior political leadership in Germany and the United Kingdom, two important stakeholders of EU trade policy, have already spoken unreservedly in favour of opening trade negotiations with New Zealand.<sup>3</sup> With the current impetus, the dominoes of assent from EU governments are likely to follow. Although the size of New Zealand's economy is on par with previous EU FTA counterparts like Peru and Vietnam, the rationale for the EU-New Zealand FTA cannot be explained by export increases alone – one must also look to the possibilities that this FTA would open up for the EU trade agenda overall.

Firstly, any failure by Europe to act comprehensively and in the right order would not only have high material costs in the form of loss of agenda-setting powers. This loss will only grow over time, as more parties accede to TPP and more trade disciplines are developed and find their way into EU FTAs as *fait accompli*. Given the export orientation of the EU, it has no choice but to seek parallel negotiations with all current and prospective TPP members based on its own template. The EU has concluded negotiations with Canada and Singapore, and is seeking negotiations with a number of other TPP countries but does not currently have any agreed process with Australia, New Zealand or Brunei. This is a blind spot worth US\$1.5 trillion in GDP that needs to be addressed simultaneously with the conclusion of TPP.

A EU-New Zealand FTA is the consequence of basic political imperatives essential for Europe in building its inroads into the Asia-Pacific region. New Zealand is not only the chief institutor and architect of the TPP agreement, but also the only country part of TPP, RCEP, and to have FTAs in place with ASEAN, Korea, China, Hong Kong and Taiwan.

Thirdly, New Zealand is consistently ranked number one in terms of market openness and rule of law in the world. There are a considerable number of prior bilateral agreements between the EU and New Zealand, promising a high-level result and a prompt conclusion for any comprehensive FTA negotiation. For the EU, plagued by domestic sensitivities and negotiation fatigue,

<sup>2</sup> Messerlin, Patrick, The TPP and the EU policy in East Asia, ECIPE Policy Brief, No.11/2012

<sup>3</sup> European Commission, Joint declaration by President Van Rompuy, President Barroso and Prime Minister Key on deepening the partnership between New Zealand and the European Union, Statement/14/83, 25 March 2014; The German Federal Chancellor's Office, Strengthening relations with New Zealand, November 14th, 2014; UK Foreign Secretary Philip Hammond's speech at S. Rajaratnam School of International Studies, Singapore, January 30th, 2015

the fact that very few factors militate against opening negotiations is not a lazy argument. New Zealand also has a longer experience in drafting provisions that actually liberalise markets overseas and has successfully concluded FTAs with partners beyond the comfort zone of EU Member States. The results of EU-New Zealand negotiations could be operationalised beyond Oceania by the EU.

## THE EU-NEW ZEALAND RELATIONSHIP

Previous EU trade strategies omitted both New Zealand and Australia as they failed to meet the criteria of having sufficiently high market access barriers worthy of EU's attention. In the case of New Zealand, there was no pressure from a competing FTA negotiation with the United States (as was the case with Korea) that Europe needed to match, and unlike some parts of South East Asia that also sit on the frontline of China's supply-chain influence, New Zealand is securely democratic and western oriented (although the country's exports to China have tripled since an FTA was signed in 2008).

Over the past decade, EU-New Zealand bilateral trade has been stagnating and New Zealand ranked 55th amongst EU imports and 50th in export destinations with total trade. Trade in goods amounted to €7.2bn or 0.2% of total EU external trade (corresponding to about one-hundredth of Europe's trade with China or the US), while the European market is only second to Australia in importance as a market for New Zealand, closely followed by China, the US, Japan and Korea. Despite this imbalance, the EU enjoys a considerable surplus of €1bn (14%) on its trade. In addition, trade in services amounted to €3.8bn (representing one third of all trade with New Zealand) with total trade amounting to €12bn, with FDI stocks held by the EU amounting to additional €5.4bn.

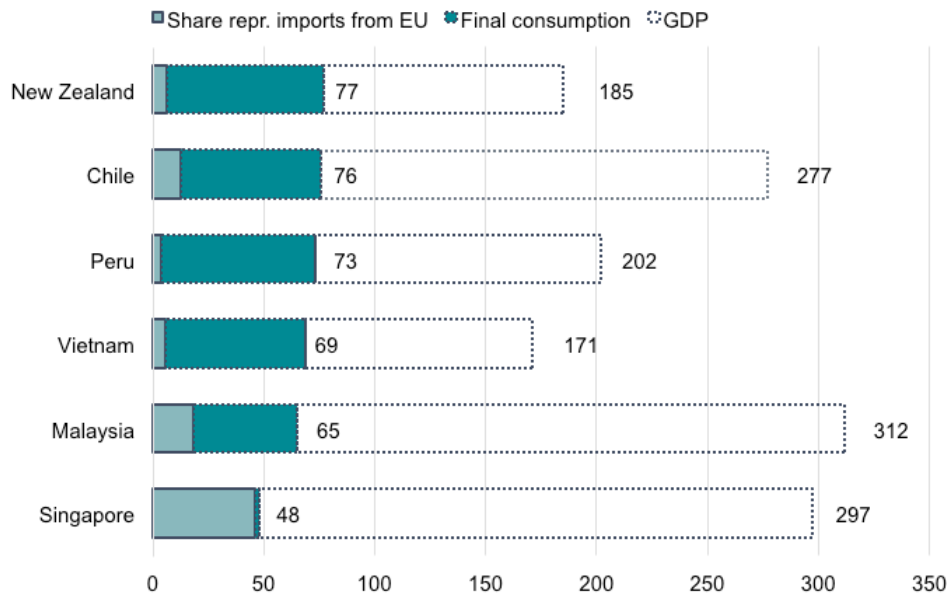
One should not stare blindly at export numbers alone. These always need to be contextualised. At first glance, the volumes may not seem major – however, even a billion euro trade surplus is not negligible when the total current account surplus of EU28 with the rest of the world is just €76 bn.<sup>4</sup> Furthermore, New Zealand's market size in economic output GDP is considerable in the region, and sits comfortably *on par* with or above other countries that the EU has already opened up FTA negotiations with – such as Peru (ratified 2013) or Vietnam (launched in 2012). Even more, GDP does not give the whole picture – by counting what the country actually consumes, a truer measure of market size, New Zealand is at the top amongst the non-G20 TPP countries. However, imports from Europe relative to the consumption are disproportionately low, even considering the distance. While it is true that geographic and cultural distance has a 'gravity' impact on trade, economies like Chile and Malaysia – that are similarly distant from the EU – import twice as much from Europe.

While exports are not the main rationale for an FTA with New Zealand, it is true that this consumption driven country provides considerable room to expand EU trade even compared to current EU negotiating priorities. New Zealand (with Australia and Brunei) is the only missing piece amongst the TPP signatories. The EU is at risk of losing this billion-euro surplus. TPP would cover 60% of world trade – which is similar to the coverage that the GATT system enjoyed just before Uruguay Round. And if GATT was multilateral then, TPP is the new multilateral today. Aside from the wholesale abolishment of tariffs, TPP is likely to set new standards on services, e-commerce, intellectual property rights (IPRs) and public procurement. The agreement would consolidate supply chains within its signatories and increase intra-firm specialisation. Undeniably it will erode EU firms' market share at the expense of investment and jobs in the EU – trade diversion from TPP would sharply reduce the entire

<sup>4</sup> Eurostat, Euroindicators, 32/2015, accessed at: <http://ec.europa.eu/eurostat/documents/2995521/6643067/2-2002-2015-AP-EN.pdf/25f0eb29-3bd2-4926-8ba5-ba8e05cbead5>

output gain of TTIP for the EU, while leading French economists have concluded that TPP poses ‘a deadly threat to European exporters of agricultural products’.<sup>5</sup>

*DP, shares of consumption and EU goods and services imports  
New Zealand compared to TPP negotiation counterparts with less than US\$1 trillion GDP*



*Source: European Commission, 2013; World Bank, 2013*

#### EXISTING TRADE BARRIERS IN NEW ZEALAND

New Zealand has an import profile that closely matches key EU export interests, with machinery (particularly machinery related to food and agricultural production), motor vehicles, pharmaceuticals, and scientific and medical equipment dominating its imports. The country applies the world’s perhaps most candid tariff schedule applying 5% tariffs for goods ‘where manufacturing exists or has existed in New Zealand’ and 10% for primarily clothing, footwear and motor vehicles.<sup>6</sup> For example, about two-thirds of all products in the motor vehicles category are dutiable. Overall, the weighted average that the EU pays on its exports to New Zealand is 2.75%, which is relatively high, given that half of all products in New Zealand’s tariff schedule enter duty-free under WTO MFN rates paid by the EU.

Even relatively low ‘nuisance tariffs’ have disruptive effects on trade, especially for complex industrial goods like electronics, machinery or automobiles that may contain components from all parts of the world. Even very low tariffs entail more thorough scrutiny of the complex calculations that are involved in determining the country of origin in order to determine the correct tariff. In this context, it should be noted that the first-ever self-declaration of conformity (SDoC) on rules of origin was introduced in the recent Malaysia-New Zealand FTA,<sup>7</sup> a practice that is likely to be a part of the next generation of FTAs.

<sup>5</sup> Messerlin, 2012

<sup>6</sup> Office of the Minister of Commerce, Import Tariff Levels After 2015

<sup>7</sup> It should be noted that going beyond their existing AANZFTA FTA; see also Vitalis, Regional Economic Integration and Multilateralism: The Case of the ASEAN-Australia-New Zealand FTA and the Malaysia-New Zealand FTA, ADBI Working Paper Series, April 2015

*Treatment of top 15 EU export categories under New Zealand tariff schedules  
HS four-digit level (dutiabale tariff lines in bold)*

<b>Export categories (Representing 41% of exports)</b>	<b>Trade value (Million US\$)</b>	<b>Simple average tariff</b>	<b>Dutiabale tariff lines in category</b>	<b>Total tariff lines in category</b>
<b>Motor cars and other motor vehicles</b>	1,011	6.40	142	216
<i>Helicopters, airplanes</i>	345	0	0	19
<i>Pharmaceuticals in measured doses</i>	303	0	0	191
<b>Tractors</b>	239	0.67	8	36
<b>Motor vehicles for transport of goods</b>	207	1.38	27	94
<i>Railway or tramway coaches, vans and trucks</i>	195	0	0	1
<i>Gas turbines</i>	131	0	0	41
<i>Vaccines and similar products</i>	126	0	0	44
<b>Parts for motor vehicles</b>	95	3.63	665	993
<b>Harvesting and threshing machinery</b>	95	1.04	69	343
<b>Cranes, ship's derricks, etc.</b>	82	5.00	29	29
<b>Meat of swine</b>	74	5.00	10	10
<i>Medical instruments and appliances</i>	73	0	0	196
<b>Trailers</b>	72	4.40	68	98
<i>Parts for aircrafts</i>	71	0	0	19

*Source: UN Comtrade, 2013; UNCTAD TRAINS, 2013*

Although New Zealand currently applies the same tariffs to US competitors, the effect of greater competition from Japan and the US would be immediate once TPP is concluded. New Zealand has also recently signed a FTA with Korea, which should make EU automobile and technology producers concerned about the risks ahead for them – and these tariffs can only be negotiated through a bilateral FTA. But the point about preferential competition applies equally to non-tariff measures (NTMs) that are common in heavily regulated sectors. These tend to be harmonised on a discriminatory non-MFN basis in US FTAs (i.e. only US exports are given national treatment), whereas the EU tends to negotiate them on an MFN basis. Pharmaceutical regulations and reimbursement criteria of New Zealand could be subject to overlap, similar to parallel commitments of Korea vis-à-vis with the EU and the US.

Aside from goods, services and investments are the defining growth areas for the EU. 24% of New Zealand's trade volumes comprise services, highest amongst TPP countries, ahead of Singapore and the US. Services are an offensive interest for New Zealand, expanding beyond the sectors of where it is historically competitive such as tourism<sup>8</sup> and into business services and other sectors.

EU-New Zealand trade is even more services-intensive than New Zealand's trade overall. Approximately one-third of EU-New Zealand's trade is in services thanks to New Zealand having the most liberalised services market amongst the OECD countries,<sup>9</sup> while goods trade

<sup>8</sup> Meehan, Lisa (New Zealand Productivity Commission), New Zealand's international trade in services: A background note, Research Note 2014/1

<sup>9</sup> *ibid.*

is still hampered by tariffs. However, some regulatory barriers in services remain, such as in telecommunications, financial services and maritime transport. These services where New Zealand scores above the OECD average, due to requirements on commercial presence (particular in financial services) and mode 4 related issues,<sup>10</sup> are also sectors of key EU export interest.

Another services related issue concerns investment-screening practices. Like many countries, New Zealand maintains foreign investment screening practices, for any foreign investment that would result in the acquisition of a controlling stake or 25 percent or more of ownership in ‘significant business assets’.<sup>11</sup> Although FDI is rarely restricted in practice, TPP will minimise such risks amongst its members on preferential basis for its signatories, leaving EU investors at a distinct disadvantage.

## EU AGRICULTURAL SENSITIVITIES

Agriculture remains a political determinant in trade policy, not the least in the EU and New Zealand, albeit for different reasons. Both are net exporters and, broadly speaking, domestic demand is saturated by local production. Their respective policy orientation has, however, distinctly different objectives: Europe directs its agriculture for the sake of supply conditions and food security, whereas New Zealand liberalised its agriculture sector to foster export competitiveness. How a diversified, major subcontinent like Europe must focus on securing supply while the much smaller New Zealand does not is perhaps a peculiarity in itself. In any case, the Common Agriculture Policy (CAP) still accounts for 40% of the EU budget, and remains a major caveat to the EU’s free trade narrative. Agriculture puts disproportionate constraints on the executive’s policy space.

However, given the fiscal trajectory of the EU even in the short term, the cuts in the current CAP budget of 13% are unlikely to be the final baseline. The phase-out of the support is already a reality for dairy, pork, wine, and sugar – which are all competitive products that have graduated to export orientation and processed agricultural products (PAPs) rather than raw commodities.<sup>12</sup> Further ‘market orientation’ of CAP through export orientation and productivity improvements for many more products is inevitable, but this entails also further investments in technology, services and market access.

Somewhat ironically, New Zealand has already undergone this evolution, and thanks to Europe: New Zealand lost its key export market for many (but not all) agricultural products when the United Kingdom joined the European Economic Community in 1973 and adopted the EU agricultural framework. The losses could not be immediately compensated elsewhere. In the 1980s, New Zealand initiated the inevitable move away from costly price distortion in the form of subsidies and tariff protection, towards smaller and more effective support of value-adding activities such as R&D, quality improvement and sustainability work. The most recent OECD Producer Support Estimates (PSEs) suggest that New Zealand’s agricultural support measures are the lowest of any developed economy at 0.5% of farm receipts.

<sup>10</sup> OECD, Services Trade Restrictiveness Index (STRI)

<sup>11</sup> See the New Zealand Overseas Investment Act (OIA) 2005: Generally understood as investments exceeding approximately €70 million or acquisitions of land defined as ‘sensitive’; see also US Trade Representatives, National Trade Estimates, 2014

<sup>12</sup> European Commission, ‘Health Check’ of the Common Agricultural Policy, accessed at: [http://ec.europa.eu/agriculture/healthcheck/index\\_en.htm](http://ec.europa.eu/agriculture/healthcheck/index_en.htm); European Commission, Agricultural Policy Perspectives, 12/2013

The unilateral reforms of CAP set a shelf life for EU agriculture, at least as bargaining chips in trade talks: on the one hand, agricultural market access to the Single Market is a key incentive for FTA negotiations with Europe, and New Zealand is likely not an exception. On the other hand, if budgetary constraints in Europe force unilaterally liberalisation, counterparts can pocket the benefits for free. Considering the relative openness of the Single Market, there are relatively few other incentives the EU could offer except agriculture, in return for the recognition of EU standards (e.g. geographic indications) it seeks in its FTAs. A seemingly logical consequence of the current state of play is to engage in rapid and parallel negotiation based on standardised FTAs – which is the strategy of the EU since 2010.

New Zealand is not only a net exporter of agricultural products, but also a thought leader on agricultural liberalisation. It champions the cause based on its own experiences (occasionally to the discomfort of some European leaders). But despite the general offensive interest of New Zealand, the reality is that its specific interests with Europe are more congenial. New Zealand exports over €1 billion of its primary export product to the EU – sheep and goat meat – where the EU is not self-sufficient and 23% of its consumption is met by imports, of which almost all (85%) is imported from New Zealand. These products enter into the EU duty-free through tariff rate quotas, negotiated following the accession of the UK into the EU, subsequently codified through the conclusion of the Uruguay Round in 1993. The threat the EU would face from liberalising its trade with New Zealand is therefore greatly exaggerated, as many of New Zealand's key imports to the EU already enter duty-free.

Subsequent diversification into other agricultural exports, like kiwifruit, was a product development driven by New Zealand's market reforms. Italy and France are extremely competitive in Kiwifruit (once rebranded from Chinese gooseberries by New Zealand farmers for global marketing purposes), Italy has even overtaken New Zealand as the world's leading exporter. Export volumes of the two EU Member States are sufficient to make the comparative advantage of the entire EU positive (above 1.00). Moreover, kiwifruits are seasonal produce, and imports from Chile and New Zealand in the southern hemisphere are complementary to local cultivation in Italy and France. Zespri, New Zealand's farmer cooperative, has invested in the EU to the extent that 11% of its overseas sales are produced in the EU,<sup>13</sup> effectively enabling year-round production and adding value to EU based production through bringing in new varieties, IP, and favourable supply chain relationships.

In all, amongst the top fifteen agricultural products imported by the EU from New Zealand (covering 79% of volumes), five tariff lines (sheep and wool) already enter the Single Market duty free. New Zealand also already enjoys lower rates on an additional three lines, at less than half the rate of current specific MFN rates (butter and bovine meat). As evident, EU consumption relies heavily on the import of these products. The remaining products (where New Zealand pays full duties) are complementary to EU domestic production, either for seasonal reasons (e.g. onions and shallots), or consumer preferences, such as wine, where the EU demonstrates extremely high export competitiveness and is by no means threatened by New Zealand imports.

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<sup>13</sup> Zespri, Annual report 2013/2014



*Top 15 imported products from New Zealand in the EU*  
*HS six-digit level and EU export competitiveness (New Zealand preferences in italics)*

Import categories (Representing 79% of agricultural imports from New Zealand)	Trade value (Million US\$)	EU export competitiveness (RCA) <sup>13</sup>	Duties paid under MFN	Duties for New Zealand in Uruguay Round
<i>Other meat of sheep, frozen, bone in</i>	371	0.14	12.8% + €90~167/100 kg	0%
<i>Meat of sheep or goats, bone in</i>	334	0.06	12.8% + €119~222/100 kg	0%
Wine of fresh grapes, incl. fortified wines	282	2.63	€13~32/hL	
Apples, fresh	231	0.98	118/100 kg	
<i>Other meat of sheep, frozen, boneless</i>	203	0.22	12.80 % + €234/100 kg	0%
Kiwifruit, fresh	183	1.13	8.80%	
<i>Meat of sheep or goats, boneless</i>	136	0.19	12.80 % + €311 /100 kg	0%
Other meat and edible meat offal, other	110	0.65	0~9%	
Wool, not carded or combed, shorn wool	81	0.48	0%	
<i>Butter</i>	72	0.69	189~231/100 kg	€70~94/100 kg
Peptones and their derivatives	63	1.04	0-3.40%	
<i>Butter, fats and oils derived from milk; other</i>	61	0.44	231//100 kg	€94.80/100 kg
Other wine of fresh grapes, incl. fortified wines	57	0.76	€9.90~32/hL	
Onions and shallots	56	0.74	9.60%	
<i>Meat of bovine animals, frozen – boneless</i>	56	0.07	12.80% + 221/100 kg	20%

*Source: UN Comtrade/TRAINS, 2013; own calculations; EU TARIC, 2015*

The remaining key export items from New Zealand, notably dairy (often in the more tradable form of concentrate, powder and cheese) belong to one of the most competitive sectors in the EU, where the EU's export orientation has expanded most quickly amongst European agribusiness. There are also strong complementarities as New Zealand export mainly whole milk powder, while the EU industry is investing in capacities in New Zealand to take advantage of the country's FTA with China. Such triangular market access is also evident in manufacturing.

<sup>14</sup> Revealed comparative advantage (RCA) or Balassa index, indicates export competitiveness where 1.00 is average value, and 2.00 indicates twice the international average in competitiveness on the product

It is true that agriculture tariffs remain the stumbling block in almost all current and remaining EU trade negotiations. However, trade with New Zealand is extremely concentrated to a few products and fairly limited. None of the exports are amongst Europe's most sensitive products, e.g. grains and sugar. Land available for agriculture in New Zealand's is continuously shrinking due to expanding tourism and urban development, and there is currently less than 113,000 km<sup>2</sup> of total agricultural land available.<sup>15</sup> In terms of arable land, New Zealand is smaller than Belgium, Estonia and Albania.<sup>16</sup> But perhaps more importantly, the existing duty-free treatments and complementarities makes a case for EU-New Zealand FTA negotiated swiftly and with relative ease. The crude reality is such that if an FTA cannot be done with New Zealand, it cannot be done at all.

#### EXISTING REGULATORY COOPERATION EU-NEW ZEALAND

The EU and New Zealand are already part of a range of trade policy geometries with each other through almost every open plurilateral in the trading system, including the WTO IT Agreement and the additional protocols on services; New Zealand has also recently acceded to the Government Procurement Agreement (GPA);<sup>17</sup> and both will eventually be the founding members of the Trade in Services Agreement (TISA) and the Environmental Goods Agreement (EGA). Assuming that these plurilaterals adequately cover the substance, the emphasis of a bilateral FTA with New Zealand would gravitate towards two extremes – namely on the most basic issue of tariffs (which we have considered carefully) and “behind the border” integration.

Regulatory issues are particularly important for market integration, and modern FTAs put fair amount of emphasis on sanitary and phyto-sanitary (SPS) issues, technical barriers to trade (TBT) and sector annexes on NTMs. The EU champions such provisions that are necessary to advance key export interests such as the pharmaceutical, chemical or automobile sectors. For example, aforementioned examples of healthcare reimbursement rules on pharmaceuticals and medical devices were negotiated in EU-Korea FTA, while various pricing and reimbursement issues are identified also in the EU.<sup>18</sup> In general, New Zealand seeks recognition of equivalence horizontally to regulatory divergences through a ‘comply or explain’ approach – and managed even to conclude such provisions with ASEAN.

Meanwhile, EU FTAs seek recognition of European conformity assessment bodies (CABs) through MRAs or FTAs that allow parties to maintain their own standards. It is also increasingly common that the EU seeks outright adaptation of its own regulations or standards. Examples of such are manifold, from car safety regulations using UNECE standards to rules on e-commerce that are copied directly from EU directives.<sup>19</sup> Unlike Europe's internal market, which is originally a construct of mutual recognition, the EU has not sought mutual recognition or functional equivalence in its FTAs.

<sup>15</sup> FAO Statistics, 2012

<sup>16</sup> *ibid.*

<sup>17</sup> WTO, Montenegro and New Zealand to join the WTO's Agreement on Government Procurement, 29 October 2014; noting that neither Australia-New Zealand Government Procurement Agreement (ANZGPA) nor New Zealand's FTAs with Korea do not reference GPA texts but the non-binding APEC Non-Binding Principles on Government Procurement that deal with transparency, ‘value for money’, open and effective competition, fair dealing, accountability and due process, and non-discrimination – overall comparable to EU chapeau on public procurement in EU-Singapore and CETA.

<sup>18</sup> See Brandt, Lisa, International reference pricing for medicines in theory and practice, ECIPE Policy Brief 04/2013; also US Trade Representatives, National Trade Estimates, 2014

<sup>19</sup> Based on UN Economic Commission for Europe (UNECE), 1958 Agreement Concerning the Adoption of Uniform Conditions of Approval and Reciprocal Recognition of Approval for Motor Vehicle Equipment and Parts, and subsequent revisions, and UNECE Working Party 29

However, New Zealand has already concluded a MRA for designated CABs,<sup>20</sup> and already compliant with UNECE standards. Moreover, New Zealand is also one of only three countries outside the European Economic Area (EEA) to be recognised by the European Commission to have an ‘adequate’ (in reality meaning an equivalent) data privacy regulation.<sup>21</sup> Disciplines on cross-border data flows and data localisation in FTAs are a controversial topic in other EU FTAs, but should not be so in a negotiation with New Zealand.

The EU is facing several controversies in the sanitary and phyto-sanitary (SPS) area. These issues include genetically modified (GM) crops,<sup>22</sup> pesticides residues,<sup>23</sup> and pathogen reduction treatment of beef or poultry. New Zealand does not present the same challenge on these issues, as some of the EU’s current negotiating partners. The agreement on Sanitary Measures between New Zealand and the EU grants full equivalence on the basis of EU standards, eliminating virtually all common bilateral issues, with a scope going beyond other agreements. On the basis of this cooperation, New Zealand was the very first country in the world to re-authorise exports of EU beef following the BSE crisis, which helped the EU to re-establish access to other markets. Similarly, New Zealand has uniquely approved unpasteurised cheeses from the EU. The parties are also cooperating on new initiatives such as e-certification and environmental issues for further dissemination on the world market.

An issue that needs to be resolved in the future FTA is geographic indications (GIs) on agricultural products. Although New Zealand is party to more MRAs and regulatory co-operation with the EU than any party (Australia included), one important exception is international agreements on wines, containing provisions on GIs. The diverging views on GIs goes back to the Doha round, when the EU tabled a proposal (W/11) to secure GI protection through TRIPS that would create *prima facie* assumptions for their legal protection amongst WTO members, while New Zealand was a part of the coalition that endorsed a voluntary system (W/10). Since then, the EU has successfully negotiated inclusion of GI protection with several of New Zealand’s W/10 coalition partners including Korea, Canada, and possibly also with Japan.

<sup>20</sup> See OJ L229 17/8/1998 and 356 22/12/2012 current y for and the US uch as Mexico, Chile ries. e towards New Zealand, way more ing window t initiated FTA ties.

<sup>21</sup> 2013/65 Commission Implementing Decision of 19 December 2012 pursuant to Directive 95/46/EC of the European Parliament and of the Council on the adequate protection of personal data by New Zealand, (2012) 9557

<sup>22</sup> See Directive 2010/0208 amending Directive 2001/18/EC as regards the possibility for the Member States to restrict or prohibit the cultivation of genetically modified organisms (GMOs) in their territory

<sup>23</sup> Regulation EC No 396/2005 on Maximum Residue Limits (MRLs)

*Mutual recognition and regulatory co-operation with the EU outside FTAs amongst certain likeminded countries*

	United States	Canada	Japan	Australia	New Zealand
<b>MRAs</b> with sectoral annexes on	1998	1998	2002	1998	1998
—Telecommunications equipment	2000	2001	2002	1999	1999
—Electromagnetic compatibility	2000	2001	—	1999	1999
—Electrical products	—	—	—	1999	1999
—Recreational craft	2000	2001	—	—	—
—Pharmaceuticals, GMP	—	—	2002	1999	1999
—Medical Devices	—	—	2002	1999	1999
—Chemicals	—	—	2002	—	—
—Machinery	—	—	—	1999	1999
—Pressure equipment	—	—	—	1999	1999
<b>Automotive</b> (signatory of UNECE 1958, 1998 agreements)	1998 agreement only	1998 agreement only	1958, 1998 agreements	1958, 1998 agreements	1958, 1998 agreements
<b>SPS agreement</b>	2003	1999 (amended 2013)	—	—	1996 (amended 1999, 2002, 2003, 2006)
<b>Data privacy adequacy</b>	— Safe harbour under review	Adequacy decision in 2001	—	—	Adequacy decision in 2013
<b>Wines (GIs)</b>	2005	2003	—	2008	—

*Source: European Commission, MRA Newsletter No 8 (2014); UNECE; European Commission, DG Justice; European Commission, DG Agriculture*

#### DEVELOPING A NEW EU FTA BLUEPRINT

Europe's difficulties in TTIP and other FTAs show that any superficial notion on 'like-mindedness' has a limited mileage once old political irritants resurface, or domestic interests are mobilised. Believing that unprecedented levels of market integration could materialise in TTIP between two equally sized partners in a vacuum on 'shared values' alone was probably a misreading of the negotiation mandates. In contrast, the pre-existing state of EU-New Zealand regulatory co-operation on TBT, SPS and data privacy provides a starting point of negotiations which does not exist with other jurisdictions. This degree of policy cohesion was never in place with Canada, Japan or the US before the negotiations started.

Historically, Europe's tariff-centric first generation of FTAs were developed as policy instruments in the EU neighbourhood policy in the similar manner that US trade policy used its first FTAs as economic aid to its strategic allies in the developing world. The second generation, starting with the EU-Korea FTA, put their emphasis on addressing non-tariff barriers based on Europe's own templates – primarily to eliminate export costs. Europe's needs to

upgrade its trade policy instruments is very much a question of sustaining agenda setting powers and advancing its own regulatory model – in head-to-head competition with other agreements that will develop disciplines that go beyond the standard of current EU FTAs.

Thanks to the existing level of regulatory cooperation, Europe could develop a template for third generation FTAs with a counterpart such as New Zealand. This is particularly true on areas where Europe has retreated to a defensive stance in other negotiations. Cross-border data flows is an offensive interest for a number of service sectors in the EU, including financial services, logistics and telecoms. Developing a discipline on data against practices such as data localisation and denial of service has been proven to be difficult in the current set of partners – as most of the data flows are technically or legally inseparable for personal information, it has proven to be impossible to negotiate. As a matter of fact, Europe has only granted adequacy decisions (allowing for cross-border transfer of data) to 14% of its services trade.<sup>24</sup> Outside of Europe, only New Zealand, Israel, Canada, Argentina and Uruguay are deemed as adequate jurisdictions to process EU citizens' data.

New Zealand lacks many of the features that often lead to defensive trade agendas – something that *dirigist* economies, federal statehoods and transitioning economies sometimes become susceptible to. There are therefore no mismatches in level of ambition, economic development, or conflicts of political structure that have hampered prior FTAs. The country ranks number one or two in almost all indices on economic and personal freedom, including the World Bank index of Ease of Doing Business, OECD Services Trade Restrictiveness Index, Index of the Freedom in the World, Economic Freedom Rating and Heritage/WSJ Index of Economic Freedom. It is ranked number one without any exceptions in all mentioned rankings amongst democracies, ahead of every EU Member State.

Therefore, developing both WTO and FTA-plus disciplines on state-owned enterprises (SOEs) and subsidy disciplines is more likely to happen in this negotiation than any other. Other experimental areas of trade policy, such as aforementioned self-certification on rules of origin (traditionally sensitive area for the textile industry) could provide major gains for SMEs. Another such area is customs valuation of services content in goods, or so-called mode 5 supply of services.<sup>25</sup> Both New Zealand and the EU have extraordinary high content of services in its goods trade, with half of their value-added coming from services.<sup>26</sup>

Moreover, while services, investments and IP are covered in depth in second generation FTAs, one area is for further work: qualification and movement of professionals (mode 4). New Zealand and Australia form the Closer Economic Relations (CER) partnership. This is the highest quality and most comprehensive FTA by two OECD partners. It is the only common market that incorporates elements that go beyond the European Single Market, and is noted for its full liberalisation of services on a negative list basis. The full mutual recognition of goods and services in the Trans-Tasman Mutual Recognition Arrangement (TTMRA) extends also to professional qualifications as a person registered to practise an occupation in each jurisdiction is entitled to practise an equivalent occupation in the other, without the need for further testing or examination.<sup>27</sup>

Obviously, New Zealand's bilateral FTAs do not reach the same standards of CER, but its agreements are far more comprehensive than EU FTAs, including in mode 4. New Zealand's FTA with Korea contains work programmes for recognition of professional qualifications

<sup>24</sup> See Bauer, Lee-Makiyama, The Economic Importance of Getting Data Protection Right, US Chamber of Commerce, 2014

<sup>25</sup> See Cernat, Kutlina-Dimitrova, Thinking in a box, Mode 5 approach to services trade, March 2014; New Zealand Productivity Commission, Boosting productivity in the services sector 1st Interim Report, 2013

<sup>26</sup> OECD-WTO TiVA Database

<sup>27</sup> See Principles G2; Part V, Operations of the Scheme. Occupations

(e.g. engineering, architectural and veterinary professions). On movement of natural persons, agreements secure due process in administering visa applications for professionals,<sup>28</sup> commitments on transparency and binding sectorial commitments. In comparison, EU FTAs traditionally request mode 4 within sectors where it is also allowed to invest but did not negotiate mutual recognition until CETA in 2014 that deferred the questions to the regulated professions to initially negotiate MRAs amongst themselves.

Europe's agenda-setting powers depend on its ability to negotiate a high-quality, third generation agreement that would set a benchmark for further EU negotiations in the Asia-Pacific, against the competition from TPP and major powers like China. The reality is such that there are very few prospective partners for such exercise.

#### **ENABLING NEW POLICY OPTIONS EU-CER AND EU-AANZFTA**

Trade policy is not about conquest of territory, but a game of chess where the merit of each move is valued on the new opportunities it creates, and each piece on the table has different roles and characteristics. In the era of competitive liberalisation and multi-track trade policy, each FTA negotiation forms a pillar of a country's foreign economic policy that unleash controlled chain reactions internally into other policy fields – such as industrial policy or agriculture – or externally amongst other counterparts.

Starting with the EU-Korea FTA, Europe has engaged in bilateralism out of necessity to catch up with US FTAs. A similar competitive logic is now extended to all the TPP signatories, where the EU is using its standardised model texts. However, the EU did not choose to make Korea its first FTA candidate because of the KORUS negotiations alone. The agreement on offer was probably higher than the larger countries in the Far East, while creating a competitive pressure to bring the rest of the region to the negotiating table. Most notably, an agreement was a necessity in order to proceed with Japan, an economy four times larger than Korea, which at that stage had not entered into negotiations with the US.

For Brussels, sequencing happens out of caution rather than out of strategic thinking: The EU is likely to repeat the Korea/Japan formula in its approach to Oceania, starting with the smaller (and thereby less threatening) and more flexible counterpart. While the market potential of Australia is larger in terms of GDP, Australia's agriculture trade is far more diversified into products where reforms in the EU are still pending. Australia's exports into the EU are three times larger from Australia than New Zealand, and less of its trade currently exempt from duties.

Sequencing aside, the EU is bound to negotiate with both countries in the coming years due to the sheer market value of these two economies tied by the CER agreement. A single market created by EU FTAs with both Australia and New Zealand would create a common market with an output equivalent to ASEAN and NAFTA where the economic disparities within EU-CER would not exceed the already existing differences within Europe. Moreover, both EU and CER have pre-existing models for mutual recognition on products and services, which are provisionally tied by MRAs between them. Like New Zealand, Australia has signed a MRA on CABs (the first signed by the EU),<sup>29</sup> and with sectoral annexes on medical devices, pharmaceuticals, telecom equipment, electronics, machinery and automotive products.<sup>30</sup> But in addition, New Zealand enjoys a comprehensive SPS agreement and a data privacy adequacy decision that opens the data flows which are essential for delivering services.

<sup>28</sup> Including intra-corporate transferees, business visitors and contractual services suppliers.

<sup>29</sup> OJ L229 17/08/2998 and L 359 29/12/2012

<sup>30</sup> OJ 359/2 29/12/2012

The CER contains regulatory cooperation that is facilitated through a number of unilateral recognition of laws, far-reaching mutual recognition, information-sharing, and inter-agency meetings leading to mutual recognition of goods, services and occupations. The principle of mutual recognition within CER also builds on a decentralised approach on existing judicial institutions and procedures rather than supranational institution building (although a joint food safety agency has been set up). The CER approach is far more suitable in the context of trade agreements. The first full recognition of equivalence outside the Single Market on all goods and services negotiated on negative list basis is not only a realistic target. It is the next incremental step after the EU's existing MRAs with the two countries.

Further ahead lies the next common market, namely ASEAN. Its FTAs traditionally prioritise completion before ambition. The joint-FTA of Australia/New Zealand with ASEAN (AANZFTA) is the most ambitious concluded by the ASEAN bloc. On goods, the agreement phases out import tariffs on nearly 96% of tariff lines, and 99-100% of trade flows, simplifies rules of origin, and sets up co-operation on trade facilitation and SPS. Moreover, the agreement liberalises services significantly – notably in educational services, and with annexes on financial and telecommunication services providing transparency and national treatment, limiting anti-competitive practices in key offensive sectors of the EU.<sup>31</sup> AANZFTA also contains horizontal commitments on domestic regulation (for authorisation, licensing and standards), facilitation of business movement, and investment rules (with ISDS), electronic commerce, intellectual property and competition policy.

As the EU and ASEAN are expected to engage in a stocktaking exercise some time during 2015, lessons should be drawn from both Europe's own failed venture to negotiate a region-to-region FTA, as well as the construct of TPP. The latter originated from the Pacific-4 (P4) agreement between New Zealand, Brunei, Chile and Singapore as the first attempt at a multi-party and trans-regional FTA, a conceptual idea first conceived by senior officials in New Zealand and brought into reality through a soft power based statecraft and alliance-building. Wellington generally thinks through its positions that tend to be more than mere outputs of domestic political processes – and there is no doubt that Wellington senior officials are experienced in using treaties to liberalise overseas markets. AANZFTA has created a similar platform to the P4 agreement that allows for customisation based on EU trade policy priorities into a wider regional agreement.

#### **CONCLUSION: RAISING THE LEVEL OF AMBITION ON NEXT-NEXT GENERATION FTAs**

Wellington – located more than 10,000 km from Beijing Geneva and Washington DC – is perhaps a somewhat unusual point of origin for a number of overlapping circles, being part of TPP, RCEP, AANZFTA, TISA, EEA or to be the first developed country to ever conclude a FTA with China. Given the existing degree of liberalisation and harmonisation, New Zealand should not provoke any protectionist instincts within Europe – and in otherwise complicated issues, such as data privacy and agriculture – there is a very rare opportunity for Europe to develop its own disciplines in the area. The EU is likely to reach a high-level of comprehensivity and quality in a FTA with New Zealand that would go beyond any current or past negotiation, TTIP included.

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<sup>31</sup> Vitalis, 2015

It was said at the outset that exports are not the principal rationale for the FTA, although it is worth noting that the EU has negotiated with far smaller markets than New Zealand. More importantly, economic benefits aside, this FTA opens up multiple policy options that would otherwise not be available, or at least much less attractive. This calls for an orthogonal view of Europe's blind spot in the Asia-Pacific. What possibilities will be opened up with a counterpart that can unequally support ambition?

The answer to this question must be more than just a kneejerk answer about GIs. Firstly, a negotiation with a liberal economy like New Zealand will allow the EU to refresh its FTA model – to create a third generation FTA that is at least on par with TPP and that goes beyond the current one which is modelled on EU-Korea. As it currently stands, the US seems not to have introduced the provisions from the TPP negotiations and play them as cards in TTIP negotiations. As crude as it may seem, the US may not even do so until TISA is concluded, in order to receive as many concessions as possible from the EU. Moreover, Asian economies typically do not advance the TPP template as their own FTA model, and are unlikely to do so against the EU or unfit to be a part of a Single Market-like mutual recognition. Meanwhile, the pre-existing state of EU-New Zealand relationship on SPS, technical barriers and data privacy goes well beyond the standard of most FTAs that Europe have recently negotiated.

Secondly, this FTA can be done in a quick and clean fashion – as opposed to slow and dirty. Europe is about to become haplessly stuck: TTIP is likely to be a mid or long term prospect, and few (if any) of the EU's FTAs are likely to be concluded before the groundwork on TPP is cemented. Europe's ongoing difficulties in concluding and ratifying its FTAs simultaneously with the TPP will lead to some of its existing trade and opportunities being diverted – or worse: that Europe's key offensive issues (including tariffs, GIs and technical standards) will be constrained by the TPP framework.

Finally, the sequencing of FTA partners beginning from the least intimidating may be an unfortunate part of trade negotiation practice. However, Europe has already liberalised most of its agriculture towards New Zealand, unlike towards the rest of the world. This opens up a door towards the other TPP partners (including Australia) while retaining the option to use New Zealand's extensive network of FTAs including China and ASEAN as vehicles for Europe. And this door could very well be Europe's last chance of overtaking the TPP.