Old friends, New opportunities

A discussion paper on the potential for a UK-NZ FTA

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New Zealand International Business Forum

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This report was prepared for the New Zealand International Business Forum by Associate Director Stephanie Honey. Nothing in this report should be taken as necessarily representing the views of any individual NZIBF member, nor of any of those who generously provided interviews or assistance in the preparation of this report.

EXECUTIVE SUMMARY

The United Kingdom (UK) is one of New Zealand's oldest and closest trade and investment partners, with flows of goods, services and capital dating back to New Zealand's earliest colonial history. As the UK looks to reorient itself more towards global markets post-Brexit, the New Zealand business community wants to preserve as well as to build on this well-established relationship. New Zealand business sees a strong case for the development of new architecture for the bilateral trade and investment relationship in the form of an ambitious, comprehensive and high-quality free trade agreement (FTA). This would satisfy commercial, economic and strategic objectives, and would better reflect the way that the UK and New Zealand do business, trade and live in the 21st Century.

A bilateral FTA should achieve both ambitious trade liberalisation and expanded cross-border investment in order to enhance productivity and innovation, generate dynamic gains and help to create jobs and raise living standards in both economies. Reflecting the nature of modern business, the FTA should include not just comprehensive new market access for goods and services (including by eliminating non-tariff barriers) but should also seek to facilitate trade and address 'next generation' issues such as intellectual property, government procurement, regulatory coherence and the digital economy. An FTA would at the same time help to ensure that the playing field remains level on both sides in light of new third-country trade deals.

The UK is already New Zealand's sixth-largest export market, our eighth-largest source of imports and a substantial investor, but there is scope to expand both collaboration and opportunities in a number of sectors, including food and beverage, niche manufactured products and specialised services as well as in the digital economy and in responding to consumer concerns on sustainability. There is also potential to deepen existing commercial partnerships and develop global value chains into third markets, especially in Asia where New Zealand has well-established FTAs. There is also significant potential to grow two-way flows of skilled professionals for mutual economic benefit.

Beyond immediate commercial considerations, the FTA would provide opportunities to strengthen inclusion in trade – a core social and economic objective for both sides – including for small businesses, women entrepreneurs, regional communities and Maori.

Strategically, an ambitious FTA would serve to demonstrate the UK's global trade-liberalising credentials, not least with a view to creating a building block for UK membership of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), as well as a step along the path to an eventual Commonwealth-wide trade arrangement.

It is clear that awareness of the potential impacts and risks of various Brexit scenarios, including an untidy 'no-deal' outcome, is low among New Zealand businesses. This could usefully be a focus for outreach and awareness-raising alongside FTA consultations.

About the New Zealand International Business Forum

NZIBF is a coalition of senior business leaders working together to promote New Zealand's engagement in the global economy. For more detail, see www.tradeworks.org.nz.

A prospective New Zealand-United Kingdom FTA

New Zealand and the UK have a long and deep history, leavened with shared language, culture, values and legal systems. This has built a solid foundation for the present-day bilateral relationship, which is characterised by extensive people-to-people links, easy business relationships and a process of regular policy dialogue. New Zealand exporters have long seen the UK as a springboard into Continental Europe, particularly for primary sector products, and likewise New Zealand has been seen as an attractive destination for investment as well as tourism, and a modest but attractive niche market for British exports.

There is however scope to transform what is already a very good bilateral connection into a dynamic, modern and mutually-beneficial relationship through an FTA that better reflects the evolution of the way that we each live, do business, and thrive as societies.

"Global Britain": FTAs in prospect

As a result of the UK's decision to leave the European Union (EU), the potential now exists for a bilateral FTA between New Zealand and the UK. In July, the British Government announced that it wanted to prioritise FTA negotiations with New Zealand, Australia and the United States, along with accession to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, or CPTPP, and launched a consultation process (to which NZIBF contributed).[1] The UK wants to move quickly to launch negotiations with new partners once it has exited the EU.

The UK is a sophisticated market of over 66 million people, with the fifth-largest economy in the world and the second-largest in the EU, worth USD$2.94 trillion.

The UK is a member of both the G7 and the G20.[2] It is a global leader in services trade, particularly financial services; it is also the largest market for information and communications technology in Europe (and indeed one of the largest in the world), and there is strong policy support for the continued development of the digital economy and a vibrant British tech sector.[3] This global leadership in services builds on the UK's traditional strengths in goods, particularly in agriculture and in sophisticated manufacturing, especially automobiles and machinery. The UK ranks 7th in the World Bank's Ease of Doing Business ranking.

As for New Zealand, despite its small size, it is a strong economic performer offering useful niche opportunities. British exports to New Zealand are growing at 16.8%, a faster pace than the UK's global average and far outstripping export growth to the EU.[4] New Zealand is ranked first in the World Bank's ease of doing business ranking, and is forecast to enjoy growth of 3 percent for the next two years – by comparison GDP growth in the Euro area is less than 2 percent and for the UK is only 1.2 – 1.3 percent over the same period.[5]

[1] https://www.gov.uk/government/news/new-public-consultations-announced-for-future-trade-agreements.
[2] https://www.weforum.org/agenda/2018/04/the-worlds-biggest-economies-in-2018/
[3] https://www.export.gov/article?id=United-Kingdom-Infornation-Communication-Technology-ICT
[4] https://www.gov.uk/government/news/new-public-consultations-announced-for-future-trade-agreements
[5] http://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2018-Full-Report.pdf; for economic outlook see OECD, http://www.oecd.org/newzealand/new-zealand-economic-forecast-summary.htm

Brexit and New Zealand business perceptions

In March 2017, following a referendum on whether to 'leave' or 'remain' in the EU, the UK triggered Article 50 of the Treaty on the European Union, beginning a process of formal withdrawal. The UK is scheduled to exit the EU on 29 March 2019.

The UK and EU have negotiated a draft withdrawal agreement, along with a political declaration that maps out the broad shape of a future trade arrangement. The deal needs approval both from the British Parliament and the European Parliament before the necessary implementing legislation can be passed. Deadlines for achieving this are rapidly approaching; securing Parliamentary approvals are far from a given. Most commentators suggest that the latest a final deal could be struck between UK and EU negotiators is December, or perhaps as late as January 2019, in order to pass the legislation and achieve an orderly departure.

Should the deal be agreed and implementing legislation passed, the UK will formally leave the EU on 29 March but with an agreed "transition period" in place at least until the end of 2020 (if not longer – there is recent speculation that this could be extended to 2022). This transition period will mean that current arrangements, including existing terms of access for New Zealand, stay in place while the future UK-EU trade arrangements are negotiated. The UK will also be free to undertake FTA negotiations with third countries during the transition but not implement outcomes until the UK definitively leaves the EU Customs Union.

However, should there be a "no deal" outcome, the UK would leave the EU on 29 March without any bilateral trade rules in place, nor any transition period. At that point, the UK would be treated as a third country by the EU and its access would be under the EU's WTO Schedule (including tariffs and tariff rate quotas) and associated EU rules.

One of the most difficult "withdrawal" issues is whether there will be a "hard" border between Northern Ireland and the Republic of Ireland, subject to Customs and other checks. The withdrawal agreement includes a binding "backstop" for the UK to remain in a temporary customs union with the EU to avoid this. However, the UK can only leave the backstop with the EU's agreement, and has committed to "level the playing field" by also pledging to abide by EU rules on state aid, competition, taxation and the environment while in a customs union – both controversial elements in the UK. In addition, there is unhappiness over the signals in the Political Declaration of a possible future trade arrangement between the UK and EU, which implies close alignment with the EU. Some in the UK are calling for a second referendum.

Impact on third countries

Given the multiple potential scenarios for Brexit, the situation facing third-country exports is far from clear. Much depends on the nature of future UK-EU arrangements. If a formal withdrawal agreement can be finalised before 29 March, the *status quo ante* will apply to third-country trade until the end of the transition period in December 2020. After that, an orderly move to a new UK-EU trade arrangement would have likely minimal impact on third countries. However, should future UK-EU arrangements *not* be concluded in the transition period, the post-2020 situation would again revert to one of uncertainty.

Should the UK leave the EU with "no deal", this would have a significant impact on third-country trade. At a minimum, there would be significant disruption at the border (due to pressure on infrastructure, capacity and regulatory requirements), and in the market as a result of UK-EU trade reverting to WTO 'most favoured nation' (MFN) terms.

Brexit and New Zealand business perceptions – continued

Interviews with New Zealand stakeholders suggest that:

- New Zealand primary sector exporters are watching Brexit very closely. Many have started contingency planning for a possible no-deal outcome, given the likely extent of market disruption, particularly for those with complex supply chains and investments across the UK and Continental Europe. A no-deal outcome would potentially have a significant impact on both the value and volume of exports, at least in the short term;
- many others in the New Zealand business community are aware of Brexit but not significantly across the detail of the potential risks of a no-deal outcome;
- although to date the impact of Brexit uncertainty on the UK economy has been surprisingly modest, a number of New Zealand businesses are already reporting headwinds – for example, British customers scaling back investment, and a general slow-down in economic activity, with consequent impacts on demand, particularly for high-value consumer goods and even in government procurement
- several of those interviewed commented on how challenging the "massive Brexit uncertainty" was for business, regardless of the shape of a final outcome.

The difficult issue of TRQs

Brexit should not see existing WTO market access opportunities for agriculture products diminished or undermined in either quality or quantity, including through the splitting of existing Uruguay Round tariff rate quotas (TRQs). This would take away exporters' ability to adjust the destination of exports in order to respond responsibly to market conditions. It is important for UK and EU producers as well as those from New Zealand that exporters are able to take account of dynamic markets, domestic production and consumer demand as they evolve. The TRQs form part of the EU's and UK's legally-binding WTO commitments and must be respected. As a separate matter, any access negotiated under an FTA should take as a starting point and build on the existing WTO commitments and administrative arrangements.

The bilateral trade and economic relationship

The UK is still New Zealand's sixth-largest single export market for goods and services, despite the substantial diversification in export destinations that has taken place following the UK's entry into the European Economic Community in 1973. The UK remains an important destination for agriculture products, food and beverage, high-value consumer goods and specialised manufactured items such as medical technology and boats. The UK is also our eighth-largest source of imports (and an important supplier of vehicles and machinery) and a substantial investment partner. Overall there is a modest trade surplus in New Zealand's favour.

The New Zealand business community strongly supports the strengthening of the existing trading relationship. Businesses still see the UK as a valuable market and one in which it is easy to do business, with relatively few trade-related headaches. Many commented that it would be a priority to see that mutually beneficial relationship continue.

In a recent Export New Zealand/DHL Export Barometer, 30 percent of New Zealand exporters said that they currently exported to the UK – with Britain even edging out China from the rankings. However, only 21 percent of exporters in the survey said that the UK would be their top export destination in two years' time.[6] This suggests that the UK could become relatively less important to New Zealand unless the current dynamic can be energised, for example through actively promoting new trade and investment links through an FTA.

> *"These days people talk about Asia – but the UK still really matters."*
>
> New Zealand business organisation

The UK interest

While New Zealand is a relatively modest trade and investment partner for the UK, British economic interest clearly lies in at least maintaining trade and investment flows – and ideally, as the UK turns outward, to growing them, particularly for niche high-value products such as food and beverage. As an investment destination and potential value chain partner for the UK, too, it is also worth noting that New Zealand enjoys strong sustained economic growth and consistently rates at the top of the league tables for ease of doing business. The latter is an important ingredient for participation in global value chains, reflecting that GVC intermediate inputs are in effect "domestic", such as business services, telecoms, or financial services, for which a favourable domestic environment is key.

Commercial opportunities: the importance of ambition

The UK currently faces some seminal choices in setting its post-Brexit trade policy direction. Much remains to be resolved about how closely the UK may in future be aligned to the EU's trade policy and regulatory approaches, and whether that alignment applies to services as well as goods. There is likely to be tension between, on the one hand, adhering closely to EU approaches, and on the other, exploring flexibility to pursue maximally ambitious FTAs with third countries. Currently the EU and UK policies and regulations, supply chains and markets are deeply intertwined, but as part of its "Global Britain" approach the UK is likely to come under pressure from trading partners to move away from elements of current EU policy; at the same time, the 'political declaration' signaled likely future close alignment between the UK and EU, especially for goods trade.

As for the New Zealand-UK relationship, there are clear complementarities across sectors, in production approaches, seasonality and demand – in the primary sector (including for wine and other beverages, horticulture, meat and meat products, dairy, fish and seafood and processed food); in niche manufacturing including medical equipment and agri-tech, and in services such as ICT, tourism, professional and business services, financial services, education, and more specialised areas such as environmental services and agriculture-related services.

New Zealand business would want to see an ambitious and commercially meaningful market access outcome in a UK FTA, involving the rapid elimination of all tariffs, significant expansion followed by elimination of tariff rate quotas (including elimination of all in-quota tariffs) and the removal of other barriers to trade, including regulatory impediments to goods and services trade and other non-tariff barriers.

Equally important to liberalisation measures will be trade-*facilitating* provisions such as simple, streamlined rules of origin and Customs procedures and well-designed regulatory measures. Freeing up market access would provide manufacturers with

[6] https://www.exportnz.org.nz/__data/assets/pdf_file/0004/156622/2018-ExportNZ-DHL-Export-Barometer.pdf

improved access to high-quality inputs, including not just intermediate goods but also back-office and technical services. Consumers would benefit from access to a greater variety of high-quality, competitively-priced products.

New Zealand businesses would also want to see included forward-looking provisions for deeper economic cooperation, such as investment, regulatory cooperation and coherence, competition policy, intellectual property, labour mobility and government procurement. This would help to support both sides' goal of more inclusive growth by creating new opportunities for small and medium-sized businesses.

> *"The UK is a great market – it's relatively easy to do business and leverage partnerships there, and we have seamless access around the EU. A major goal would be to see that continue".*
>
> New Zealand manufacturing firm

Importantly, for both sides an FTA would help to preserve a relatively level playing field in each other's markets; trade does not stand still and nor should trade agreements. New Zealand is in the process of negotiating and/or upgrading preferential trade agreements with other important trading partners (including China, Korea, Japan, Canada and ASEAN) in a way that could set UK exporters at a competitive disadvantage in the New Zealand and other markets in the absence of an FTA. Similarly, potential future UK FTAs could disadvantage New Zealand in the UK market without an FTA.

Global value chains: a wealth of possibilities

Modern production models such as global value chains (GVCs) demand more open, predictable and transparent trade and investment regimes and relatively low trade costs. The combination of high trade costs and the 'tyranny of distance' between the UK, New Zealand and Asia have meant that the potential in this area has not been fully exploited.

An ambitious FTA would present both sides with greater scope to participate in GVCs by leveraging areas of comparative advantage and linking into Asia.[7] Accessing New Zealand's FTA portfolio in the Asia-Pacific through investment and value chains is likely to be a useful short-cut for the UK while it negotiates its own suite of trade agreements in the region.[8] There may also be flow-on benefits from enhanced value-chain activity in the form of a more competitive services sector (given the centrality of services to GVCs) and a more receptive environment for innovation in information and communications technology

> *Case study: global value chains*
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> One New Zealand F&B business undertakes manufacturing activity in the UK, using New Zealand intellectual property and sourcing ingredients from around the UK, the EU and third countries, packages the product on the Continent using European materials, and distributes to food service customers throughout the EU. Should there be a no-deal Brexit or low-ambition UK-EU deal, new tariffs and non-tariff barriers could have a significant negative impact on this profitable business model.

[7] OECD analysis suggests areas of NZ strength in global value chains include intermediate goods in agriculture and services including business services, transport, logistics and ICT. http://www.oecd.org/sti/ind/GVCs%20-%20NEW%20ZEALAND.pdf See also OECD, 'Trade Policy Implications of Global Value Chains', May 2013

[8] New Zealand has FTAs and/or is in the process of upgrading or implementing FTAs with China, ASEAN, CPTPP economies, Korea, Hong Kong and Australia. New Zealand is negotiating with the EU, with the Pacific Alliance including Colombia, and with the participants in the Regional Comprehensive Economic Partnership negotiations including India.

"The FTA gives us a chance to show the world what can be done, especially on progressive trade issues – this is an important strategic opportunity for both of us"

New Zealand business organisation

The bigger picture: broader economic benefits

A bilateral FTA would potentially offer economic benefits beyond immediate commercial gains. An FTA which covers intellectual property, the digital economy and investment could foster greater cross-fertilisation of ideas, technology, people and capital, with benefits in terms of competitiveness, productivity and eventually better living standards in both economies. The regulatory cooperation that an FTA would generate would contribute not just to an enabling business environment but also could address important societal outcomes including for the environment and human, animal and plant health and safety. There is also scope to present a more powerful united voice internationally on issues of shared concern such as sustainability and environmental issues, animal welfare and non-tariff barriers in third markets such as unscientific or onerous biosecurity requirements.

The FTA would also provide an opportunity for both sides to strengthen inclusion, seeking to foster more, and more successful, participation in trade by small businesses, women, regional communities and Maori. Likewise, the FTA should be oriented towards sustainable development, with a view to ensuring that trade and environmental policies are compatible and mutually-reinforcing.

The strategic opportunity

A bilateral FTA would fill an important gap in New Zealand's trade architecture. Along with the EU FTA currently under negotiation, modernising arrangements with the UK will contribute to ensuring that New Zealand has deep, future-proofed connections with all of its most important economic partners. (It should be noted that there are likely to be some interesting questions around speed, sequencing and ambition arising from the fact that New Zealand is currently negotiating with the EU, hopes to negotiate with the UK, and that the EU and UK are in negotiation with each other.)

More broadly, an ambitious FTA could serve to burnish both sides' credentials as forward-looking and creative negotiators. It could be seen as a building block towards membership by the UK of CPTPP – something that a range of CPTPP partners have indicated that they would welcome – as well as an eventual Commonwealth trade arrangement. That said, there are likely to be some sequencing challenges: in particular, CPTPP members may first want to know what relationship the UK will have with the EU before proceeding. The CPTPP approach on financial services, e-commerce, regulatory cooperation and SPS measures, for example, is rather different to existing EU approaches.

Sectors: Opportunities and challenges

New Zealand exported just under NZD$1.5 billion of goods and just over NZD$1.5 billion of services to the UK last year. Most New Zealand goods exports to the UK are agriculture and food and beverage, but other important exports include machinery and equipment, marine vessels and other manufactured items. New Zealand services exports include tourism, transport, business services, ICT and intellectual property-related charges, financial services and education. (See Annex I for more detail.) The UK supplied around NZ$1.7 billion of imports to New Zealand last year, including vehicles and parts of all sorts, propellers, spirits, medicines and books, machinery and a range of services.

Given these current trade profiles and areas of comparative advantage, there would seem to be scope to grow mutually-beneficial opportunities in the following sectors in particular:

- agriculture, food and beverage;
- digital and ICT including cybersecurity and creative economy exports;
- agri-tech and niche manufacturing (for example, marine vessels, medical equipment);
- professional services, specialised services and education, and partnering models for services provision that take advantage of the time difference to supply third markets;
- goods and services that include a strong element of "sustainability" and "ethical production"

Agriculture, food and beverage

The UK is New Zealand's fifth-largest food and beverage export market, reflecting the very long shared history of New Zealand as the UK's "food basket".[9] Major New Zealand agri-food exports include sheepmeat, wine, apples, honey, shellfish, beef, offal, vegetables and fruit including onions and boysenberries, processed ingredients, prepared foods and beverages. New Zealand products have a well-deserved reputation for high quality and value.

While on average across the board UK tariffs are relatively low, by contrast in the agri-food sector, tariffs tend to be much higher – despite the welcome efforts that the UK and the broader EU membership have made to reform domestic policies. Products of significant export interest to New Zealand continue to face high tariff barriers or access effectively only through volume-limited tariff rate quotas – some of the latter with in-quota tariff rates that make even exports within the quota uneconomic. This is the case even where the UK is itself be a significant internationally-competitive exporter and where consumer demand remains high, for example for dairy and meat. In the horticulture sector, products face seasonal tariffs which distort prices and marketing decisions. But even where tariffs are relatively low, competitors may enjoy better terms of access.

[9] NZTE, *The United Kingdom Market Guide*, May 2018

Primary sector market access: scaling the peaks

- New Zealand honey faces a tariff of 17.3%; competitors enter duty-free;
- In-quota tariffs on butter and cheese and complex quota administration requirements constrain regular trade; MFN duties on dairy products can range to over 600%
- MFN tariffs on meat range up to nearly 300%;
- Tariffs on fish and seafood average 12.5%, while competitors may be duty-free;
- Apples enjoy a tariff-free entry period but at other times face a tariff of 10.4%; Southern Hemisphere competitors enjoy preferential access;
- Tariffs on wine are between around 6% and 20%
- The average tariff on processed foods is 14.6%;
- Non-tariff measures and private standards on "sustainability" and SPS measures are a big factor in market access. One estimate puts the impact of tariffs and non-tariff measures on agri-food imports at the equivalent of around 54%
- Although New Zealand is generally very open, UK producers may have concerns around some non-tariff measures, for example on spirits

(Figures in the box above, including calculations of 'ad valorem' tariff equivalents, from various sources[10])

New Zealand is a counter-seasonal producer in both the livestock and horticulture sectors, and there is potential for British and New Zealand producers to work together to offer year-round shelf-supply in a range of markets, grow brands and consumption, and to develop innovative and complementary approaches that draw on the best expertise, ideas, resources and areas of comparative advantage in each economy. This partnering could supply not just each other's markets, but also third countries, especially in the Asia-Pacific. New Zealand product can also help to provide supplementary supplies in times of UK market shortfalls, including for the food service and food manufacturing sectors.

As noted earlier, a bilateral trade agreement provides the opportunity to drive increased UK participation in global value chains, including by leveraging off New Zealand's FTAs and linking with value chains in Asia. This is particularly the case in the area of agricultural trade, where the production of high-quality and safe food by both the UK and New Zealand provides significant opportunity for deeper commercial partnerships and collaboration, aimed at increasing competitiveness in third-country markets including in the Asia-Pacific region. The removal of tariff barriers, supported by trade-facilitating rules of origin, are critical to ensure such benefits are fully captured by exporters.

[10] See for example Huan-Niemi E, 'Sensitive Agricultural Products in the EU under the Doha Round, 12th Congress of the European Association of Agricultural Economists, 2008; https://www.adelaide.edu.au/press/titles/eu-trade/eu-trade-ebook.pdf, page 179 – 180

Food & beverage partnership in action

NZ-UK partnerships could include:

- Year-round shelf-supply of apples, other fruit and vegetables, including into third markets, and relationships to develop co-commercialisation of new varieties;
- "Best in season" lamb during each market's off-season;
- Dairy sector partnerships and joint ventures in manufacturing and exporting dairy ingredients (such as whey derivatives and components for infant formula) and finished consumer goods into Asia and elsewhere – reflecting in particular both New Zealand and UK strengths as dairy exporters; the UK is the world's fifth-largest dairy exporter;
- Investment and partnerships in the agri-food sector in both directions, for example in the wine, dairy, horticulture, agriculture and plant genetic material, processed food and beverage sectors;
- Scope to share technology and intellectual property in the agriculture and horticulture sectors, including around plant breeding, dairy standards, processing technologies and agri-tech;
- Global leadership on quality, animal welfare and sustainable production across the agri-food sector

There may be sensitivities on the British side in relation to a small number of agriculture products – but for many such products, the UK is an efficient, internationally-competitive and high-quality producer; and New Zealand production – limited by our natural resource endowment – in fact makes up only a small fraction of British consumption.

The UK is also at a crossroads on the future direction of its agriculture policy, including the nature of future government support for agriculture. The New Zealand agriculture

sector is keen to share its own positive experiences of more market-oriented and less production-distorting farm policies and more open markets. The potential for expansion of the UK farm sector outside of the EU also creates new scope for knowledge-sharing as well as great commercial opportunities to supply high-quality New Zealand agri-tech and other relevant goods and services.

Non-tariff measures and non-tariff barriers

Studies show that non-tariff barriers can significantly impede trade, even where cross-border activities may not be a target. Moving towards more efficient, cost-effective and compatible regulations can deliver significant gains for both profitability and innovation.[11] Agriculture, food and beverage is no exception to this trend. The full benefits of new market access can only be realised through provisions that seek to minimise or eliminate non-tariff barriers. At the same time, non-tariff measures should be designed to enable trade, including through the use of WTO-plus approaches to sanitary and phytosanitary (SPS) measures, standards and labelling.

New Zealand is recognised as an international leader for its high-quality production and food

[11] WTO, *World Trade Report 2012*, *Trade and public policies: A closer look at non-tariff measures in the 21st century*, 2012. See also Centre for Economic Policy Research, '*Reducing Transatlantic Barriers to Trade and Investment – an Economic Assessment*', March 2013, page 97ff (hereafter "CEPR"). The study concludes that as much at 80 percent of total potential gains from an EU-US FTA come from NTBs, liberalizing trade in services and public procurement.

safety standards in both its industry and regulatory systems in agriculture and food. New Zealand is also consistently ranked as having some of the highest and best-practice regulatory standards in the world on matters such as animal welfare. For example, New Zealand was ranked first equal (alongside the UK) in animal welfare by the World Animal Protection's 2014 Animal Protection Index Incorporated Index. New Zealand's approach is well understood by the UK and others in the EU, as evidenced by the now twenty-year-old EU-New Zealand Veterinary Agreement.[12] The New Zealand business community would want to see such a framework continue post-Brexit in respect of the UK, as well as an acknowledgment of equivalence on animal welfare and outcomes-focused regulatory approaches.

There may also be scope to develop mutual recognition of other standards in agri-food, for example in relation to delegated authority for compliance with recognised horticulture production standards, organic certification, wine-making practices or sustainability.

On the latter, British consumers and retail chains place a very strong emphasis on product integrity, provenance, quality and sustainability. Retailer requirements – for example, for animal welfare or "environmental friendliness"– have in some cases become an effective floor on standards in the market, even though they may not have been developed or implemented in a transparent, robust, science-based or minimally trade-distorting manner, as would be the case for government requirements.

> *"There's a big shift in the UK towards sustainability. That creates real opportunities across all sectors, but particularly in food and beverage."*
>
> New Zealand F&B business

By their very nature, such "private standards" would fall outside the scope of an FTA. However, given the potential for adding significant costs to trade, there would be merit in establishing a regular dialogue among business, retailers and regulators on the development of private standards and the concept of "equivalence". This would not just benefit exporters, but also the retail sector and consumers – and would also reflect the shared interests of both agri-food sectors around sustainability and the environmental footprint of agricultural production.

The mouse that roared: New Zealand's tiny share of world production

- New Zealand produces less than 3% of the world's milk, while global demand is expanding. EU imports of New Zealand cheese and butter accounted for less than 0.2% of total EU cheese consumption and less than 1% of EU butter consumption. The UK, a highly efficient producer in its own right, is in the world's top 3 dairy importers by value, 2nd-largest net importer and world's largest cheese importer.

- New Zealand accounts for only 6% of world sheepmeat production and less than 1% of global beef production

- New Zealand is responsible for 0.6% of global production of apples; the EU 14%

- New Zealand produces 0.46% of global wine production

[12] The Veterinary Agreement, which has been officially in force since 2003, facilitates trade in animal products and live animals while safeguarding public and animal health.

Niche manufacturing

In general tariffs are low on manufactured goods in both markets. However, the weighted average that UK exporters pay on their exports to New Zealand is still relatively high and potentially disrupts trade especially for high value-added goods.[13] UK exporters may find themselves at a tariff disadvantage in the New Zealand market for key manufactured items such as automobiles, auto parts and machinery (where New Zealand retains some modest tariff peaks), pharmaceuticals and equipment as a result of other NZ FTAs.

More important than tariffs, however, will be frameworks designed to facilitate trade in manufactured goods, including streamlined Customs procedures, simple and transparent Rules of Origin, and evidence-based technical requirements and standards consistent with WTO rules and international norms. WTO-plus approaches to technical measures could include sectoral annexes, for example CPTPP-style approaches to mutual recognition of winemaking practices or mutual recognition of medical technology standards, conformity assessment and good manufacturing practices. Duplicating and expanding the existing (limited) EU-NZ Mutual Recognition Arrangement would also be useful.

Services, digital trade and investment

It is not widely known, and runs counter to New Zealand's general export profile, that New Zealand exports (slightly) more services than goods to the UK. Important services exports include tourism, transport, business services, telecoms and computer-related services as well as intellectual property-related charges. While New Zealand and the UK both already have relatively open and competitive services sectors, an FTA could offer gains by locking in these current policy settings; trade costs are reduced by greater certainty and stability in services market access.

Looking at the picture in greater detail, while UK services trade barriers are generally low, there are relatively higher restrictions in respect of a number of sectors of commercial interest to New Zealand, including air services, accounting, architecture and engineering services. For all of these sectors, there are salient restrictions in relation to the movement of people. For accounting and auditing services, there are also barriers in relation to the validation of professional qualifications and the use of professional titles.[14]

The UK also maintains restrictions with regard to aspects of transport, logistics and distribution services: these have a disproportionate importance given the large distance between the UK and New Zealand, the predominance of bulky goods in bilateral trade and rising global shipping costs due to consolidation in the industry.

Other areas where some restrictions remain include motion pictures (where subsidies and tax relief for the production of films are only available for British productions), legal services, broadcasting services, and computer services – the latter including barriers in regulatory transparency and cross-border data flows, as well as restrictions on people movement.[15]

[13] European Centre for International Political Economy (ECIPE), 'New Zealand: the EU's Asia-Pacific Partnership and the Case for a Next Generation FTA', July 2015

[14] The UK has below-average scores for services trade restrictiveness in all 23 sectors, according to the OECD's Services Trade Restrictiveness Index database, 2017; see http://www.oecd.org/tad/services-trade/STRI_GBR.pdf

[15] The UK has below-average scores for services trade restrictiveness in all 23 sectors, according to the OECD's Services Trade Restrictiveness Index database, 2017; see http://www.oecd.org/tad/services-trade/STRI_GBR.pdf

Ideally the FTA would be based on an ambitious negative-list approach with provision for ongoing review and progressive liberalisation over time; it should also incorporate mechanisms to ensure that the FTA keeps pace with wider liberalisation efforts, including a ratchet clause and MFN provisions.[16] Such efforts could use as a starting point progress in the Geneva-based Trade in Services Agreement negotiations, which generally reflect best FTA commitments.

Securing a more liberal trading environment for services would have benefits not just directly for services exporters but also reflecting the key role that services play in supporting goods trade, including in GVCs, and embodied and embedded in manufactured items including for example in agri-tech and medical equipment. Enhancing the international competitiveness of core sectors such as transport, telecommunications, financial services and the digital economy also underpins overall competitiveness of and productivity in both economies. New Zealand's high-quality economic governance will contribute to substantial mutual benefits in regulation-intensive areas of services.

For New Zealand exporters, there may be scope to expand trade in a number of sectors including computer and ICT services; creative economy exports including film, music and design; tourism; professional and business services including engineering and accountancy, design and legal services; healthcare financial services; education, and more specialised areas such as environmental services and agriculture-related services as well as New Zealand's world-leading research and development.

Examples of current innovative New Zealand offerings in the services sector include collaboration around the use of cloud-based digital technologies in the tourism sector and sharing of specialised knowledge in seismic and geothermal engineering

In the other direction, fintech and other financial services, professional services and services relating to infrastructure all have potential to expand into the New Zealand market, for mutual benefit. The potential for a fintech bridge should also be explored and could help New Zealand firms to become more agile and scale up. Likewise, the importance of financial services for intermediation with regional value chains at both ends should not be underestimated. Ironically, many of those interviewed identified the rigid banking system as a major business headache – sometimes one that could last for months – in the UK market.

Two important elements in facilitating greater trade in services are mutual recognition of qualifications and licensing, and the streamlining of visa processes for business visitors and other Mode 4 services providers (including intra-corporate transfers, contract services suppliers and others). The United Kingdom applies labour market tests to intra-corporate transferees or independent suppliers seeking to provide services in the country on a temporary basis. The UK has relatively higher barriers on the movement of people in respect of a number of sectors

[16] For a discussion of barriers to EU/UK services exporters, see Hosuk Lee-Makiyama, 'New Zealand: The EU's Asia-Pacific Partnership and the Case for a Next-Generation FTA', ECIPE July 2015; the OECD STRI reports that the biggest relative barriers in the New Zealand market include aspects of transport, logistics and distribution services, air transport and recognition of qualifications for professional services. See http://www.oecd.org/tad/services-trade/STRI_NZL.pdf

including accounting, legal, architecture and engineering services.[17]

> *"The FTA could in effect act as a key talent acquisition and retention strategy."*
>
> New Zealand financial services sector commentator

Many businesses emphasised the value-adding contribution of professionals and skilled staff moving between the two markets – particularly in sectors with very specific sophisticated skill-sets, such as high-tech manufacturing, digital services and tech start-ups. The future needs of UK companies in this area may increase after Brexit as the current easy access for young European professionals becomes more restricted; likewise, the attractiveness of New Zealand as an employment destination for a few years for lifestyle reasons could also encourage skilled UK professionals to transfer. One stakeholder described the FTA as offering the potential for a "rich exchange of human capital".

However current visa processes are widely seen as expensive, time-consuming, overly-burdensome and unpredictable, and potentially discouraging to cross-border investment – particularly for smaller businesses, for which, of course, the burdens of cost and time fall disproportionately heavily. This is the case even for accredited/registered visa sponsors.

One suggestion was for a new user-friendly provisional visa category for skilled workers with guaranteed job offers, to enable them to start work quickly while waiting for more longer-term visa arrangements to be approved; others suggested multiple-entry visas for businesses where a lot of cross-border personnel movement is taking place. Others also commented on the value of keeping borders open in both directions for genuine visitors, for all the tourism-related and broader economic benefits that this could generate.

There is also scope to deepen partnerships outside of physical presence. The digital and ICT revolution means that New Zealand and UK services firms could combine forces to exploit what has long been seen as the disadvantage of geography. The time difference between the two economies means that there is potential to provide customers in third countries with round-the-clock service, whether in software or computer services, legal or accounting services, or consulting – for example, supplying services to customers on the East Coast of the United States from the UK, and the West Coast from New Zealand; or similarly providing services customers in different parts of Asia. This is already happening in a small way.

Digital trade

New Zealand and the United Kingdom have the opportunity to set new benchmarks for the digital economy, an area where global rules frameworks are lagging far behind technology and business activity, but which is increasingly reshaping traditional commercial models.

While most current bilateral trade is in more 'traditional' services, there is clearly significant potential to expand in the digital arena. An FTA should seek to include binding non-discriminatory digital trade rules – negotiated with an eye to progress in broader global settings such as the WTO as well as existing models such as that in the CPTPP, in order to avoid contributing to a "digital noodle bowl" of fragmented regulatory approaches and markets.

> *"We should try to make this FTA the gold standard for digital services."*
>
> New Zealand financial services sector

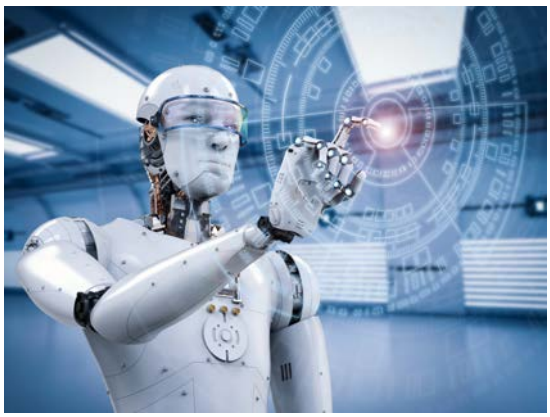
[17] http://www.oecd.org/tad/services-trade/STRI_GBR.pdf

Central to this will be rules for the free flow of data across borders, including a prohibition on forced data localisation, while also ensuring that legitimate objectives including privacy, consumer protection and cyber security are met in the least trade-restrictive manner. This seems likely to require a departure for the UK from current EU policy settings in this area.

UK business has a commercial interest in securing EU recognition of "adequacy" on data protection (something which New Zealand already enjoys). There are accordingly strong reasons for the UK to remain closely aligned to the EU's Digital Single Market, which covers the data flows, cybersecurity, privacy, ICT standards and intellectual property, and to the EU General Data Protection Regulation (GDPR).

Some New Zealand businesses noted high compliance costs for GDPR (and the potential for unforeseen consequences from some of its provisions), and of data localisation requirements – for example, requiring medical data to be stored within a market, potentially impeding trade in healthcare services. A number commented on the costs even just to secure the legal advice to be confident that they were compliant.

On e-commerce, the CPTPP approach is a good basis – including commitments not to impose duties or other charges on digital products; provisions on e-authentication and recognition of e-signatures; quick, transparent and predictable e-border processes, a high *de minimis* Customs threshold; cooperation on interoperability and conformity assessment; and consultation with stakeholders on new standards.



There are also likely to be opportunities in cloud computing, cybersecurity, IT services, artificial intelligence, augmented reality and virtual reality and the Internet of Things.

Modern economies, modern rules

- Restricting cross-border data flows adds costs and disincentivises cross-border trade in digital services, especially for SMEs
- Regulation of the digital economy and services should be innovation-friendly – regulatory sandboxes can support the development of new models of business, and systems should be designed to be interoperable
- Quick, smooth and cost-effective visa processes are vital to enable businesses to offer a full range of services to customers
- Mutual recognition of professional qualifications and licensing is also critical to smooth the wheels of services trade and broader economic competitiveness

Investment

On investment, the bilateral relationship is already strong. The UK is the fifth largest single investor in New Zealand and the largest European investor, while the UK is New Zealand's fourth-largest outward investment destination. New Zealand currently discriminates against UK (and EU) investors in terms of its investment screening threshold, which is considerably higher for UK investors than for many other trading partners.

The business community recognises the value of inflows of foreign capital into New Zealand, and similarly the importance of outward investment in important markets, including the UK, to expand the value of trade. Business also recognises that trade agreements should provide appropriate protection and certainty for foreign investors and investment (both inward and outward), while preserving the

Government's continuing right to regulate in the public interest.

Accordingly business would want to see an ambitious investment element (including services-related investment) in the FTA. It is worth noting that UK investors may end up in an advantageous position vis-à-vis their European counterparts, since this is an area of 'mixed competence' for the EU and accordingly aspects of investment (including portfolio investment, investment promotion and investment dispute settlement) will be excluded from the EU-NZ FTA negotiations.

Other "Next Generation" issues

To maximise dynamic gains, the FTA should set new benchmarks on a range of "next generation" issues, including government procurement, intellectual property, and regulatory coherence.

Government procurement is a potentially very large market and offers a significant opportunity for New Zealand exporters. Some of those interviewed already compete for government procurement opportunities in the UK but have found that these can be challenging, expensive and time-consuming processes with an inherent bias towards local suppliers, even when the rules appear straightforward. Access would also be enhanced if UK government procurement websites recognised company registration in New Zealand for eligibility for government contracts.

On intellectual property, approaches should be designed to be trade-enabling rather than trade-restricting and should foster innovation.

On food-related "geographical indications" or GIs, the business community acknowledges that GIs have a role in international trade law to protect the intellectual property rights of truly specialised products like wines and spirits that possess a unique and strong tie to a single geographical location. However, New Zealand exporters could not accept an approach in which the use of generic names or terms for products widely in commercial use or production and distribution were restricted in New Zealand or third markets. [18]

In the area of R&D and science and technology, New Zealand already has a bilateral cooperation agreement and a high proportion of New Zealand international research collaboration already takes place with European (including British) entities; by deepening links at the business-to-business level, an FTA would generate greater impetus in those relationships and the potential for dynamic commercialisation of research in key areas. A number of those interviewed talked positively about the R&D tax credits that the UK offered, which helped to generate a more innovative mindset.

Finally, business considers that a modern FTA should include provisions aimed at regulatory coherence, be it through mutual recognition, equivalence, harmonisation or a process of progressive convergence. Business was only too aware that regulatory divergence across markets could add significant costs and red tape to business. New Zealand and the UK could establish consultative mechanisms to deliver greater transparency and engagement in the development of regulations, taking particular account of the importance of timeliness, the counter-seasonal nature of New Zealand's trade, our distance from the market and our small but skilled labour force. Some also called for greater coordination on tax policy.

While endorsing the concept of regulatory coherence between the UK and New Zealand, several stakeholders noted the risk of the creation of a "noodle bowl" of divergent regulations as between the UK and EU, and the impact that this could have on New Zealand exporters to both markets.

[18] Geographical indications (GIs) are a kind of intellectual property protection – a certified "GI" has exclusive rights to use the geographical name from which it originates, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin.

Conclusion

New Zealand business sees a strong case for an ambitious, comprehensive and high-quality FTA with the UK. There would be immediate commercial payoffs and scope to deepen trade and partnerships in a range of sectors, including agri-food, niche manufactures and specialised services as well as in the digital economy; there would seem to be particularly good prospects for deeper global value chains in the agri-food sector, including into Asia. There is significant potential to grow two-way flows of skilled professionals for shared economic benefit, and to expand trade in the digital area. An FTA would at the same time help to ensure that the playing field remains level on both sides in light of other new trade deals that each may strike with third countries.

Beyond those short-term gains, however, an FTA could contribute to broader economic objectives – including more sustainable and inclusive approaches to trade – and to longer-term strategic objectives. An ambitious FTA would serve to demonstrate the UK's global trade-liberalising credentials, not just for bilateral agreements but also with a view to acting as a building block towards UK membership of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), as well as a step along the path to an eventual Commonwealth-wide trade arrangement. Overall, a bilateral FTA could help enhance productivity and innovation, generate dynamic gains and help to create jobs and raise living standards in both economies

Annex I: The current trade and investment picture[19]

The UK is already a significant trade and investment partner for New Zealand. Total two-way trade was NZD$5.55 billion, with a modest trade surplus in New Zealand's favour.

Table 1: Two-way New Zealand-United Kingdom Trade, Year Ending December 2017

	Exports to the UK (NZD$ billion)			Imports from the UK (NZD$ billion)		
	Value	Rank[20]	% of NZ exports to EU	Value	Rank[21]	% NZ imports from EU
Goods	$1.45b	7th	28%	$1.66b	12th	16%
Services	$1.52b	5th	43%	$0.93b	5th	26%
Total	**$2.97b**	**6th**	**34%**	**$2.58b**	**9th**	**19%**

Last year, the UK was New Zealand's fifth-largest single destination for goods and services exports – sixth-largest if you include the EU as a whole in the tally – with a total value of nearly NZD$3 billion. The UK accounted for just over one-third of all New Zealand goods and services exports to the EU, contributing over one-quarter of our goods exports and over 40 percent of our services exports to the EU.

New Zealand exported just under NZD$1.5 billion of goods to the UK last year. Most New Zealand merchandise exports to the UK are food and beverage, including sheepmeat, wine, apples, honey, edible offals and shellfish, and associated agriculture sector products (wool, non-edible offals, animal blood products). Exports of dairy products, once New Zealand's major export item to the UK, have dropped markedly in recent years, although dairy still makes up a significant share of New Zealand's top 20 exports to the EU, and indeed remains New Zealand's top global export. Other important exports include machinery and equipment (including medical equipment), plastic items, phones, motor vehicles, yachts, metals (ferrous scrap, aluminium) and pharmaceuticals.

New Zealand exported just over NZD$1.5 billion of services to the UK last year. Important services exports include tourism and other travel (including business travel and education), transport, business and professional services (including computer services and ICT, legal, architecture and engineering services), and intellectual property-related charges. Financial services, cultural and recreational services, Government services and education were also notable.

Both New Zealand and the UK have similar profiles in terms of a high proportion of domestic value-added in services and manufacturing, according to the OECD's Trade in Value-Added database (which looks at the value added by each country in the production of goods and services, so reflecting the modern global value chain business model). In other words, for both economies, showing a greater relative importance of services value-added and manufacturing value-added than agriculture in both cases.[22]

The UK supplied around NZ$1.7 billion of imports to New Zealand last year. Important imports from the UK include vehicles and parts (including motor vehicles, tractors, trucks and vans, bulldozers and

[19] Unless otherwise specified, statistics in this section come from Statistics New Zealand, *Global New Zealand Year Ending December 2017*, https://www.stats.govt.nz/reports/global-new-zealand-year-ended-december-2017 or Infoshare tool, www.stats.govt.nz.
[20] Rank of New Zealand export destinations, Including the EU as a separate destination in the rankings
[21] Ranks of sources of imports, including the EU as a separate source in the rankings
[22] OECD/WTO TiVA Database, for 2011, https://stats.oecd.org/index.aspx?queryid=75537

excavators and public transport vehicles), turbo-jets and propellers, trailers, spirits, medicines and books, machinery (including dishwashing, sorting and grinding machinery), medical instruments, plastics, valves, cosmetics and agricultural chemicals. Imports from the UK of services included tourism, insurance, broadcast rights and business services.

The UK is New Zealand's fifth-largest export destination for agricultural products overall; our largest market for apples; second for sheepmeat and wine; third-largest export destination for meat and meat products and for wool; and eight-largest for fruit and vegetables. For non-agricultural products, the UK is our ninth-largest market for non-agricultural products overall, fifth-largest market for textiles, clothing and footwear, and fifth-largest for machinery.

The UK is the fifth largest single investor in New Zealand and the largest European investor. As at 31 December 2017, the UK held NZD$5.66 billion in New Zealand, accounting for around 5.3 percent of all foreign direct investment. The UK is New Zealand's fourth-largest ODI destination. New Zealand had NZD$1.32 billion invested in the United Kingdom as at 31 December 2017, around 5.2 percent of New Zealand's total investment abroad.

In the year to December 2017, there were over 28,000 British short-term visitor arrivals (13,000 departures) and around 15,000 permanent migrants. This was just over 11 percent of total permanent or long-term arrivals.

Annex II: Consultation

In preparing this paper, interviews were conducted with over 40 stakeholders, commentators and think tanks around New Zealand and a small number in the United Kingdom. Stakeholders included representatives from the agri-food sector (including meat, dairy, horticulture, fisheries, wine, processed food, beverages, agricultural equipment and technology), manufacturing, services and digital trade, and business and member organisations. Interviews took place from August to November 2018. **No specific view expressed in this paper, in whole or in part, should be taken as necessarily representing the views of any individual or organisation.**

A small number of those interviewed preferred not to be named in this report or did not consider that they had a substantive comment to offer. Interviews included:

ANZCO Foods
Apples & Pears New Zealand
Beef + Lamb
Beca
British New Zealand Business Association
Business New Zealand/Export New Zealand
Chambers of Commerce of New Zealand
Dairy Companies' Association of New Zealand
Douglas Pharmaceuticals
Education New Zealand
FinTech New Zealand
Fonterra
Hello Digital
Horticulture New Zealand
Karma Cola/All Good Organics
LIC
LIC Automation
Magic Memories
Meat Industry Association
Medical Technology Association of NZ
Method Recycling Ltd
New Zealand Horticulture Export Authority
New Zealand Winegrowers
Orion Health
Russell McVeagh
Sealord
Snapper
Waikato Milking System
WeCreate

We warmly acknowledge the very useful background conversations we had in the process of researching this report with a range of think tanks and other commentators in New Zealand and in the UK, including the New Zealand Institute of Economic Research, the Centre for European Reform, UK in a Changing Europe and Open Europe, as well as reviewing discussion papers from a wide range of current UK commentators and other think tanks. Nothing in this report should be taken as representing any specific view expressed in those conversations.

We are most grateful for the informal discussions and support provided by the New Zealand Ministry of Foreign Affairs and Trade, New Zealand Trade and Enterprise, the British High Commission in New Zealand and the UK Department for International Trade; again, no views in this report should be attributed to any party. The kind assistance of NZIBF intern Elzanne Bester in preparing this report is warmly appreciated.

About NZIBF

NZIBF is a coalition of senior New Zealand business leaders working together to promote New Zealand's engagement in the global economy. NZIBF receives no direct government funding for its operating budget but from time to time receives funding for jointly-funded projects. Funding is also provided in respect to the policy advice and support NZIBF provides to the New Zealand members of the APEC Business Advisory Council (ABAC). The views in this paper are those of the New Zealand International Business Forum as a whole. Individual NZIBF members may have different views on specific issues. For further information please see www.tradeworks.org.nz.