Where next for New Zealand's trade policy?

Sense Partners Discussion Paper
October 2023

SENSE PARTNERS
DATA LOGIC ACTION

Key points

TABLE 1 SUMMARY OF RECOMMENDATIONS

	Track	Recommendation
1	All	Reposition New Zealand's trade policy objectives in terms of reducing businesses' transaction costs and improving New Zealanders' wellbeing.
2	All	Recognise that with a limited pool of trade negotiations and diplomatic resources, agencies need to be clear-eyed in their resource allocation decisions and explicitly consider the trade-offs involved.
3	Unilateral	Revisit the 'negotiating coin' logic for retaining New Zealand's remaining tariffs considering the non-trivial costs they impose on households and businesses.
4	Bilateral	Aside from the US, India and GCC countries, consider saying "no" to bilateral FTAs unless they offer a comprehensive commercial opportunity and can be negotiated rapidly.
5	Regional	Use RCEP & CPTPP as the main vehicles to engage with new FTA partners.
6	Bilateral & regional	Seek to upgrade existing FTAs rather than seeking new bilateral FTA partners.
7	Regional	Engage with IPEF provided greater clarity emerges on potential benefits and resourcing challenges can be managed.
8	Bilateral	Consider some 'grand gestures' to deepen the bilateral relationship with India.
9	Open plurilateral	Increase resources devoted to using open plurilateral approaches to address emerging trade issues with like-minded economies.
10	Multilateral	Retain the current level of engagement with the WTO, recognising its value as arbiter of disputes and promoter of transparency of policy measures. Lift engagement with APEC and the OECD as vehicles to test novel solutions to new trade issues.

New Zealand's approach to trade policy has long been shaped around a 30-year old strategy

- The 1993 strategy[1] set out a framework for New Zealand to pursue unilateral, bilateral, regional and multilateral trade liberalisation. It has driven New Zealand's trade policy direction for decades.
- By all measures, the 1993 strategy and the trade policy it shaped should be judged a considerable success. Over 80% of New Zealand's goods trade is now with markets with whom we have a bilateral or regional Free Trade Agreement (FTA).

The time is ripe for a new strategy that confronts the new economic realities facing Kiwi consumers and businesses

- The global trade environment facing Kiwi businesses has changed substantially over the past three decades.

[1] Ministry of Foreign Affairs and Trade [MFAT]. (1993). 'New Zealand Trade Policy: Implementation and Directions: A Multi-Track Approach'. Wellington: MFAT. Quotes from the 1993 Strategy are in blue, bold, text throughout this report. Many are remarkable in their foresightedness.

- The average applied tariff globally has fallen by 2/3, from 7.5% to 2.5%.[2] Developed world agricultural subsidies have halved as a share of farm gate income.[3] Commercial services are becoming increasingly important to cross border trade.
- Non-tariff measures (NTMs) are becoming more prominent, costing Kiwi exporters around $12bn per year. And climate policy and industrial policy are increasingly being used by major powers to promote domestic production and reduce reliance on imports.

The Strategy's objective should centre on reducing transaction costs

- Looking at trade policy primarily through a tariff-only lens that highlights the value of 'duties saved' from FTAs makes little sense.
- Non-tariff measures, digital trade restrictions, inefficient customs procedures and barriers to services trade will harm Kiwi firms much more than tariffs. These trade frictions push up New Zealand businesses' transaction costs and reduce their overall competitiveness.
- A future trade Strategy might therefore be targeted at reducing Kiwi firms' transaction costs along their supply chains, both within New Zealand and offshore.
- In this paper we put forward options to reduce Kiwi firms' transaction costs through trade policy, using the four 'tracks' that shaped the 1993 strategy (unilateral, bilateral, regional, multilateral), to which we have added 'open plurilateral' (small coalitions of like-minded countries who are keen to use novel approaches to address emerging trade issues).

Unilateral liberalisation: is it time for remaining tariffs to go?

What is technically correct and sensible economically is politically improbable[4]

- There have been no economy-wide tariff reductions in New Zealand outside of FTAs since 2009. The argument has been that we need to retain tariffs to act as negotiating coin in future FTAs.
- This no longer makes sense. We have signed 15 FTAs with most of our major trade partners covered. The chances of potential FTAs with the US, India and Gulf Cooperation Council (GCC) economies are unlikely to be materially affected by unilateral tariff removal. These countries' trade policy decisions won't be driven by better access to New Zealand's very small market.
- New Zealand's average applied tariff rate is now 0.24%. Remaining tariffs are little but a nuisance for customs officials and importers. They provide very little protection to any New Zealand business and raise just $175 million in tax revenue per year (0.17% of the overall tax take).
- Drawing on cost estimates per dollar of tariff revenue from the Australian Productivity Commission, we estimate retaining the current patchwork tariff regime imposes

[2] World Bank measure of 'Tariff rate, applied, weighted mean, all products'.
[3] OECD measure of 'Producer support estimate as a share of farmgate income'.
[4] MFAT (1993, p.76).

administrative costs for government and compliance costs for New Zealand businesses of around $90 million to $260 million per year.

- In addition, these tariffs impose small economic efficiency costs as they inhibit resources flowing to their most valuable uses. These efficiency costs – based on a back-of-the-envelope calculation – amount to perhaps $320m per year.
- The economic costs of retaining tariffs are not enormous. And we are mindful of the 1993 strategy's views on 'sensible economically' but 'politically improbable' ideas. But it is poor policy to continue imposing such costs without strong supporting logic.

Bilateral liberalisation: we are reaching peak FTA

Wishful thinking is a poor basis for long-term policy making[5]

- The chances of New Zealand entering a bilateral FTA with the US, India or GCC economies that offers commercially meaningful outcomes in priority sectors such as dairy and meat seem slim for two key reasons:
    - Domestic politics in all three target markets are not conducive to a bilateral FTA with a very small and distant agricultural exporter.
    - The precedent of New Zealand signing an FTA with the EU and the CPTPP before that which both have limited new market access opportunities for most dairy and beef products will pose challenges for New Zealand negotiators.
- Of course, we should not give up on India and the US. They are too important economically and strategically to drop.
- Sometimes domestic political conditions can shift, the global geopolitical situation can work in our favour and New Zealand might just be in the right place at the right time to secure a high quality, comprehensive FTA, as we were with China in the mid-2000s.
- However, that seems like wishful thinking right now.
- Beyond these existing targets, it is hard to get excited about the potential economy-wide gains from future bilateral FTAs, relative to the resource costs of negotiating them.
- Unless future bilateral FTA partners offer a quick, clean and comprehensive bilateral negotiation package to New Zealand, we recommend gently saying "no" to their approaches.
- Resources might be better directed at upgrading existing FTAs, removing duplication of overlapping FTAs and enhancing economic diplomacy in-market to help Kiwi businesses take advantage of the commercial opportunities presented by our existing agreements.

[5] MFAT (1993, p.3).

Regional liberalisation: CPTPP as the main vehicle for new market access

Our practical experience over many years has taught us to be open to ideas and opportunities that seem difficult today because they may be possible tomorrow[6]

- Securing better market access with new FTA partners – including the US and India – might more efficiently be done through New Zealand's two key mega-regionals: CPTPP and RCEP. The Pacific Alliance offers another regional opportunity.
- CPTPP is expanding across continents and there is a long list of potential entrants waiting in the wings, some of which will offer new market access opportunities for New Zealand.
- Whether the US-driven Indo-Pacific Economic Framework for Prosperity (IPEF) materialises into anything commercially valuable for New Zealand remains to be seen. There are non-trivial risks of IPEF soaking up a lot of negotiating resources with little of genuine economic substance to show at the end. Implementation could also be resource-intensive, which will need to be carefully managed.
- That said, it is positive to see US engagement in the regional trade architecture again after the Trump Administration's isolationist wrecking ball approach. To the extent IPEF brings key players in the Indo-Pacific region together to discuss trade issues and deepen institutional relationships, it could play a useful role.

Open plurilaterals: where innovation meets ambition

Trade policy, to some extent, is a gamble on the future[7]

- New Zealand has a reputation for innovative trade policy. Such innovation is borne out of necessity – New Zealand doesn't have the economic size or geopolitical clout to incentivise trade partners into agreements.
- What we *can* do is to spot emerging trade issues that are not being dealt with effectively in other fora and find like-minded countries – often small and ambitious ones – who are keen to come aboard new initiatives that put forward creative solutions. Recent examples include the Digital Economic Partnership Agreement (DEPA) and the Agreement on Climate Change, Trade and Sustainability (ACCTS).
- These initiatives are a 'suck it and see' approach to trade policy. There is often no existing playbook to follow in such negotiations. But that is the point: if we can be at the table when discussions begin on new trade policy issues, we have a better chance of promoting our interests should larger countries join (e.g. Korea with DEPA) and momentum build.
- Not all these initiatives will bear fruit straight away. Some may never really get off the ground. But they should be seen as long-term, more speculative investments in keeping ahead of the game.

[6] MFAT (1993, p.74).
[7] MFAT (1993, p.74).

There is a tendency to understate the importance of ideas in trade policy…[and] like fashion, ideas spread[8]

- Ideas for new open plurilaterals could include:
    - Exploring more Mutual Recognition Agreements that seek regulatory equivalence for New Zealand's goods, services and people.
    - Initiating an 'Agreement on Reducing Business Costs', focused on improving the efficiency with which non-tariff measures are imposed. These measures pushed up global trade costs by NZ$2.4 *trillion* in 2019.
    - DEPA Mark II, building on enhanced engagement with New Zealand's multitude of digital providers.
    - A group that explores best practice design of Carbon Border Adjustment Mechanisms, given the potential for a costly and fragmented trading environment should multiple, conflicting CBAM designs be implemented globally.
- The role of APEC and the OECD will likely become more important as incubators in terms of testing novel approaches to modern trade issues and identifying potential coalitions of the willing for new open plurilaterals.

Multilateral liberalisation: keep on keeping on, but manage expectations

When law fails to provide effective limits, power steps in to fill the gaps[9]

- As small country, New Zealand cannot afford the multilateral rules-based system to atrophy. We need to keep pressing for progress at the World Trade Organisation (WTO) on e-commerce, trade facilitation, reducing agricultural subsidies and greater transparency on trade measures, to name but a few.
- While the prospects for further multilateral trade liberalisation are dim, especially given the return to power-based trade policy currently being experienced, the WTO remains important as a vehicle for the arbitration of trade disputes. As such it plays a key role in protecting the hard-won gains New Zealand has secured in the past few decades.

Next steps

- Officials will be busy preparing their Briefings for Incoming Ministers ahead of the October 2023 general election. Regardless of the outcome, the new government will be keen to hear ideas to promote New Zealand's economic interests through trade policy.
- We hope this paper can contribute in some small way to such discussions, and would welcome the opportunity to discuss it with officials, Ministers and other stakeholders.

[8] MFAT (1993, p.49).
[9] MFAT (1993, p.64).

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1. It's time New Zealand had a new trade strategy

So far, so good – but what next?

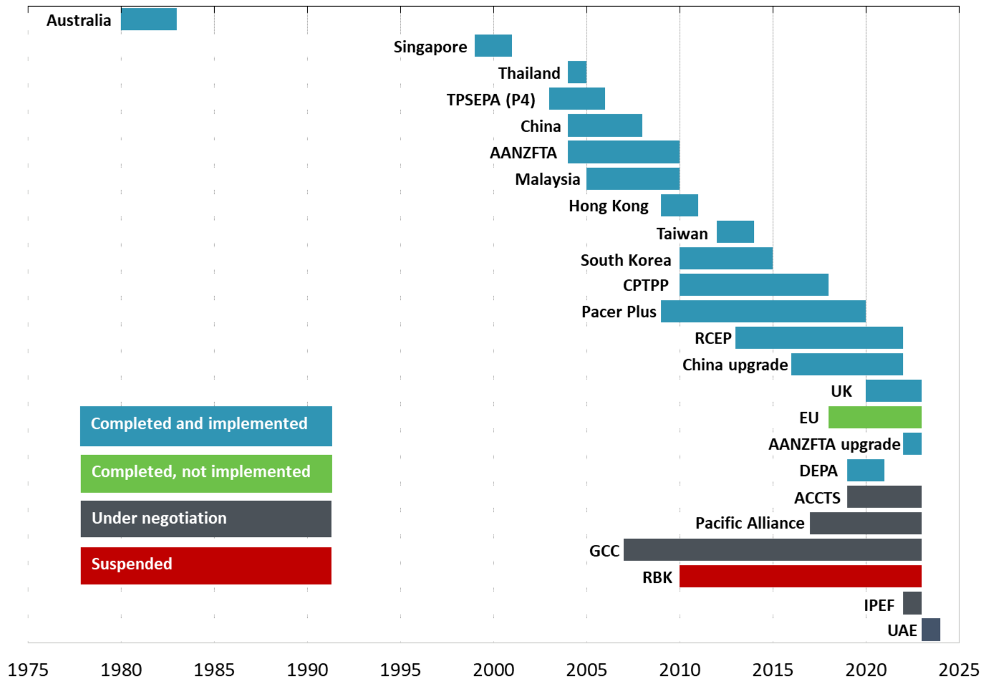
Most observers would agree that New Zealand's trade policy has been a success over the past 40-odd years.

The WTO recently stated that since its 2015 review of New Zealand's trade policy, "New Zealand continued to strengthen its position as one of the most open economies in the world"[10]. The OECD notes "New Zealand is a small, open economy that ranks highly globally in terms of its trade policies, both in terms of its policies at the border and those that facilitate trade".[11]

As Figure 1 shows, New Zealand has signed 15 bilateral or regional free trade agreements (FTAs) since the early 1980s, as well as upgrading the China FTA and AANZFTA. It has also been active in leading novel open plurilateral agreements such as the Digital Economic Partnership Agreement (DEPA) and Agreement on Climate Change, Trade and Sustainability (ACCTS).

FIGURE 1 TIMELINE OF NZ'S TRADE AGREEMENTS

Bars show period from start of negotiations to the agreement entering into force



SOURCE: COLLATED FROM INFORMATION ON MFAT WEBSITE

[10] WTO (2022, p.7).
[11] OECD (2022, p.i).

New Zealand's FTAs now cover markets accounting for around 77% of its goods exports and 83% of its goods imports. [12]

TABLE 2 GOODS TRADE WITH MARKETS WITH WHOM NZ HAS AN FTA

Year	Export coverage	Import coverage	Total coverage
1990	19%	20%	19%
1995	20%	22%	21%
2000	20%	22%	21%
2005	23%	26%	25%
2010	44%	49%	46%
2015	51%	52%	52%
2020	68%	63%	65%
2023 *	77%	83%	81%

* 2023 estimate incorporates EU FTA even though it is not yet implemented

SOURCE: SENSE PARTNERS CALCULATIONS BASED ON STATS NEW ZEALAND TRADE DATA

The prospects for further major FTAs are slim

New Zealand's trade policy is now at a crossroads. With the UK and EU FTAs concluded, and little prospect of 'traditional' bilateral FTAs being negotiated with the US and India (at least in the foreseeable future), it is unclear where the balance of effort from our trade negotiators might best be directed over the next decade or more.[13]

The global trading environment is challenging, to say the least

Complicating matters, geopolitical tensions and a return to active (read 'protectionist') industrial policy by major players are making life very difficult for small, open economies like New Zealand. Trade liberalisation has fallen out of favour in many parts of the world, with resilience, strategic autonomy and placating domestic stakeholders taking priority.

The trading environment is more driven by defensive interests, populism and risk avoidance than the promotion of new business opportunities offshore.

Existing trade policy documentation lacks strategic intent

New Zealand's trade policy direction is presently driven by two key government initiatives, summarised below in Figure 2.

Both documents are pragmatic and necessary responses to the immediate challenges of the day (the risk of losing the social license to negotiate, and COVID-19, respectively). Yet neither

[12] However, not *all* New Zealand exports to these markets are free of tariffs or other trade barriers, especially in dairy and meat, so these figures are over-estimates. This points to the importance of upgrading existing FTAs in which tariffs and other trade barriers remain.
[13] While agreements with markets such as the United Arab Emirates, announced recently, might be helpful at the margin, they are unlikely to have significant economic impacts.

looks beyond the short term, considers agencies' resource constraints or contemplates doing anything particularly different.[14]

FIGURE 2 DOCUMENTS GUIDING NEW ZEALAND'S TRADE POLICY

The Trade For All Agenda

- This initiative seeks to "rebuild public consensus around New Zealand's trade policy while successfully navigating the turbulent global environment to advance and protect our trade interests".
- The Agenda is largely a response to the public backlash against the TPP negotiations. Much of its focus is on distributional and environmental matters.
- It has some high-level objectives related to multilateral trade negotiations being a first-best outcome, followed by open plurilateral approaches and more regional and bilateral FTAs.
- But there is little specificity on priorities or strategies beyond the very short term.

The Trade Recovery Strategy 2.0

- This strategy was initially developed to guide policy thinking following COVID-19 (the 1.0 version) and has since been updated in June 2022.
- It centres on promoting the Trade for All Agenda, providing support to exporters, investing in the global trade 'architecture' (WTO, OECD, APEC, implementing FTAs and negotiating new agreements) and building resilience against future trade shocks.
- The new trade agreements referred to are the Indo-Pacific Economic Framework for Prosperity (IPEF), Pacific Alliance, GCC, AANZFTA upgrade [since completed], and the WTO e-commerce negotiations. India is listed but with no specific initiatives. The RBK FTA is listed as being suspended.

SOURCE: MFAT WEBSITE

These factors all point to the need for a new trade strategy

According to someone who is well placed to know, "there has only ever been one trade strategy in New Zealand"[15], and that was released in 1993.[16] Quotes from it are shown in italicised blue font in this report.

It is remarkable how well the 1993 strategy has stood the test of time.[17] Perhaps that shows there are no new trade policy problems, only new people to think about them 30 years later.

But given the evolution of New Zealand's trade agreement coverage, the increasingly complex global economy, and greater interest in trade policy from a range of domestic stakeholders, we would argue New Zealand needs a new, modern, forward-looking trade strategy to shape policy thinking over the next decade at least. This paper seeks to prompt a broader discussion amongst businesses, officials, researchers and other stakeholders on what a new trade policy strategy might look like.[18]

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[14] The last more forward-looking trade strategy was the 'Trade Agenda 2030', released in 2017, which sought to "provide a long-term directional guide to leverage growth and prosperity through trade" (see Vitalis, 2017, for an overview). It is no longer available on the MFAT website and is unlikely to be formally guiding policy direction.

[15] Vitalis (2016, p.199). Note this quote preceded the release of the short-lived 2017 Trade Agenda 2030.

[16] MFAT (1993).

[17] Our thanks to Hon. Tim Groser for lending us his last remaining hard copy of the strategy.

[18] Parts of this paper draw on a discussion starter memo provided by Sense Partners to the New Zealand International Business Forum. For the avoidance of doubt, the opinions presented here are those of Sense Partners, not the Forum or its members.

2. Defining NZ's trade policy objectives

Recommendation 1: Reposition New Zealand's trade policy objectives in terms of reducing businesses' transaction costs and improving New Zealanders' wellbeing.

Recommendation 2: Recognise that with a limited pool of trade negotiations and diplomatic resources, agencies need to be clear-eyed in their resource allocation decisions and explicitly consider the trade-offs involved.

Greater wellbeing, not export growth, should be the objective…

New Zealand's trade policy should always be about improving outcomes for its people. As far back as the 18th century, economists such as Adam Smith, David Ricardo and John Stuart Mill emphasised the role of trade and trade liberalisation in maximising 'welfare', or wellbeing in the parlance du jour.

The tendency in recent decades for the conclusion of FTAs to be met with New Zealand Ministers trumpeting expected export gains has obscured the real benefits of those deals. Increased exports are the means to the more important end of improving living standards, primarily through the channels of real wage growth and higher returns to capital as resources are more efficiently allocated.

…which entails retaining some self-imposed regulatory constraints

It is reassuring to see a recent confirmation from MFAT that "New Zealand's core objective in trade policy is to improve wellbeing and living standards for all New Zealanders, while safeguarding the Government's right to regulate in the interests of New Zealand and our people".[19] The 1993 strategy also had improving living standards as its objective.

The MFAT objective above is somewhat Pollyanna-ish in glossing over the fact that *all* policy changes result in winners and losers (at least in relative terms). Yet it is a good starting point.

It is a constrained maximisation objective function in the sense that the need to retain regulatory policy space will necessarily place limits on what might be negotiated. There are always factors not directly related to trade that need to be considered, recognising that wellbeing is not simply about economic outcomes.

For example, New Zealand's negotiators had no mandate from Cabinet to move on patent term extensions in the recent EU FTA negotiations. This priority for EU businesses (and hence negotiators) was an area where New Zealand politicians wanted to retain the "right to regulate" due to domestic concerns over the effects of term extensions on medicine prices.

This choice[20] constrained the negotiations as the EU's market access offer was calibrated on how far New Zealand would move on what matters most to European stakeholders. Since we

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[19] MFAT (2022, p.20). Consistent with this, MFAT's 'Productive, Sustainable and Inclusive Trade Channels Framework', which seeks to shape its thinking on, and analysis of, trade agreements, also has "households, whānau and hapū" at its core (Mellor, 2021).

[20] And others, such as the extent to which New Zealand could move on other EU priorities such as copyright extensions and GIs. See Ballingall (2023) for an overview of the key features of the EU FTA.

couldn't give much on these issues, the EU didn't feel compelled to give much in areas such as dairy and beef.

Another constraint is the availability of negotiating resources

Trade negotiators are a scarce resource. While New Zealand's are widely regarded as some of the best in the world, they only have so many hours in the day – "they understand that they cannot do everything or be everywhere on all international economic and trade issues".[21]

Unless there is a concerted initiative to expand the pool of available negotiators over time, MFAT and other agencies involved with trade policy (e.g. MPI, MBIE, Customs New Zealand) will continue to have to make tough choices about where to focus their efforts.

This entails trade-offs – a negotiator engaged full time in (say) multilateral initiatives at the WTO will not be available for other initiatives such as IPEF, bilateral FTAs or building a deeper relationship with India.

FTAs are great, but they don't solve all of businesses' problems

New Zealand businesses selling offshore, importing and/or participating in global supply chains face a raft of transaction costs and trade distortions, not all of which are well-suited for FTA negotiations.

FTAs play an important role in reducing tariffs, reinforcing multilateral commitments, avoiding back-sliding towards protectionism, and creating institutional links to deal with any emerging trade irritants. This delivers a degree of certainty to businesses, but it is questionable whether FTAs have significant impacts on business transaction costs along the length of their supply chains.

For example, FTAs have traditionally been less effective at:

- Reducing stocks of **non-tariff measures** (NTMs) or improving their efficiency of implementation. FTAs set up consultative processes to discuss NTMs and prevent egregiously trade-distorting new ones being introduced, but it is not obvious how effective these are for reducing the negative impacts of existing NTMs.
- Opening **services markets** to any great extent. FTAs tend to lock in existing GATS commitments, with the odd small improvement in specific sectors to ensure they are seen to be 'GATS+'.
- Materially improving **trade facilitation.** FTAs focus on customs cooperation and – more recently – encouraging the digitisation of customs paperwork.
- Reducing **trade-distorting and/or environmentally-harmful subsidies** (the EU and UK FTAs are outliers in this respect, and CPTPP also introduces fish subsidies disciplines).

[21] Vitalis (2016, p.202).

- Addressing emerging **digital trade matters** such as cross-border flows of data and data localisation requirements.

These trade and behind-the-border frictions remain in place, pushing up New Zealand businesses' transaction costs and reducing their overall competitiveness. In turn, this hinders the efficient allocation of resources across firms and industries, which will constrain overall wellbeing improvements.

Redefining the problem: from improving market access to reducing the costs of doing business; and then wellbeing

Given the above, we – businesses, researchers and officials – may need to think differently about trade negotiations and diplomacy.

This starts by officials getting a better understanding of the range and scale of costs faced by New Zealand businesses. These discussions need to include a wider range of business representatives than solely trade policy experts (who will default to what they know best – tariffs, quotas, etc.).

Discussions with (say) those in logistics, finance, sustainability or IT might be useful for identifying the less visible but potentially highly material costs of doing business overseas, for example. While firms are already incentivised to minimise the costs they can control, some costs will be related to regulatory or policy settings over which they have less influence and where intergovernmental engagement could be beneficial.

Officials can then start to identify where they might be able to deliver the most cost savings to businesses and what types of engagement with their offshore counterparts might best deliver them. This is unlikely to be in the form of traditionally-negotiated set-piece FTAs.[22]

It is necessary to have priorities. It makes nonsense of any strategy to treat all issues as being of equal importance[23]

Unless one thinks it makes sense to try to do more of everything with no additional resources, we suggest New Zealand's trade policy objective could be defined as:

> *Allocate scarce negotiating resources to reduce businesses' transaction costs and maximise New Zealanders' wellbeing over the long run, including by retaining the ability to regulate in the broader interests of New Zealand.*

Recognising there are many trade policy initiatives already under way, from which a withdrawal might be problematic, this paper is essentially about the balance of our trade policy efforts over time – what we might want to focus on relatively more and what we might want to do relatively less of to maximise long run wellbeing.

[22] AIG (2022, p.26) suggests "Australia will need to make regulatory issues the top trade priority. The main obstacles to trade today are non-conventional issues, such as subsidies, local content rules and domestic regulations. And for issues such as digitalisation, carbon pricing and supply chain resilience, solutions lie in finding harmonised approaches that enable rather than constrain trade flows".
[23] MFAT (1993, p.80).

The remainder of this paper looks at potential actions New Zealand might take to meet this objective in terms of unilateral, bilateral, regional, plurilateral and multilateral trade initiatives.[24]

[24] The 1993 strategy had the same structure, albeit without plurilateral initiatives.

3. Unilateral reform: Has the time come to eliminate?

Recommendation 3: Revisit the 'negotiating coin' logic for retaining New Zealand's remaining tariffs, considering the $410m - $580m costs they impose on households and businesses.

New Zealand's average applied tariff is just 0.24%

While most of New Zealand's applied MFN tariffs are already zero, pockets of 5%, 7.5% and 10% tariffs remain on specific products, such as some clothing, footwear, textiles, furniture and automotive parts. Import markets facing these MFN tariffs include the US, India, the UAE, Switzerland and South Africa.

As shown in Table 3, tariff revenue has averaged around $175 million since 2010, despite nominal imports increasing 91% over this period. Tariff revenue now accounts for 0.17% of total government tax revenue.

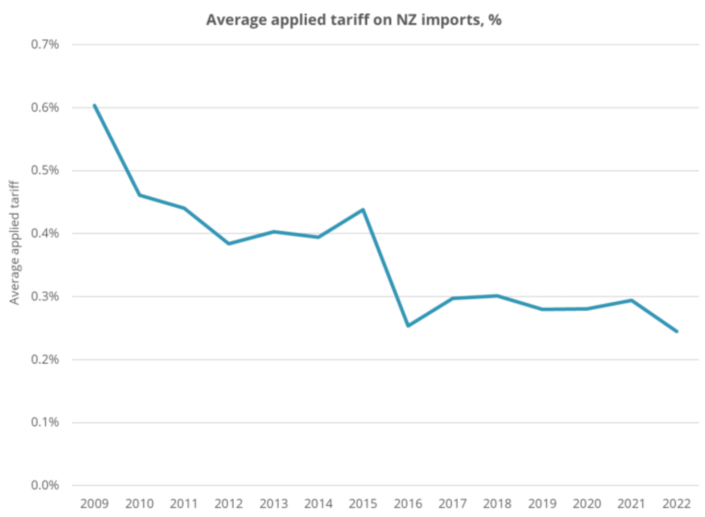
TABLE 3 TARIFF REVENUE IN NEW ZEALAND

Fiscal year	2010	2012	2014	2016	2018	2020	2022
Tariff revenue, $millions	175	173	187	127	172	164	178
Share of total tax revenue, %	0.35	0.32	0.32	0.18	0.22	0.19	0.17

SOURCE: TREASURY GOVERNMENT FINANCIAL STATEMENTS

The average applied tariff across all imports has declined from 0.60% in the year to June 2009 to 0.24%.

FIGURE 3 NEW ZEALAND'S AVERAGE APPLIED TARIFF OVER TIME



SOURCE: AUTHOR'S CALCULATIONS BASED ON TREASURY GOVERNMENT FINANCIAL STATEMENTS (TARIFF REVENUE) AND INFOSHARE (IMPORT VALUES)

No unilateral tariff cuts since 2009 as we've kept our powder dry

Outside of FTAs or as an emergency response to COVID, New Zealand has not reduced economy-wide tariffs for the past 15 years.[25]

The key reason provided by government for New Zealand keeping its remaining tariffs is that "tariffs remain valuable as 'negotiating coin' " (MBIE, 2017, p.6). That is, we need to keep some tariffs in place to give our trade negotiators leverage in future FTA discussions.[26]

The logic has been along the lines of "Why would we unilaterally remove these tariffs when we can instead use them as bargaining chips in bilateral or regional FTAs to incentivise other countries to reduce their tariffs on New Zealand's exports?".

The implicit equation is that the expected value of economic benefits from future FTAs (that are contingent on having some tariffs as negotiating coin) is greater than the costs imposed on domestic consumers and firms by retaining tariffs.

The negotiating coin argument holds less weight now the EU and UK FTAs have been completed

Our market is of little consequence to other countries. This limits the options available to us[27]

As the next chapter discusses, New Zealand's remaining major FTA targets are the US and India. If the argument to retain MFN tariffs is that New Zealand needs them as negotiating coin for these two FTAs, decision-makers need to be confident that:

(i) An FTA with the US or India could happen any time soon.

(ii) New Zealand's tariffs are a major factor in getting the US or India to the negotiating table.

(iii) The benefits from the FTAs are sufficiently large to justify the costs imposed by retaining tariffs in place while we wait.

In our view, while the potential benefits are high, the chances of the US or India offering a bilateral FTA in the short term is slim to none. And even if they did, it would be for broader reasons than a desire to get improved market access to New Zealand's market.

Although reciprocity counts in the often Mercantilist world of trade negotiations it is doubtful if securing minor improvements in preferential access to New Zealand's very small and distant economy was really a key factor in the conclusion of recent agreements. [28]

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[25] Tariffs were also removed on 120 essential goods (e.g. medicines, medical goods, surgical equipment) as a response to COVID-19 in early 2020.
[26] Reciprocal tariff reductions could also occur multilaterally through the World Trade Organisation, although this seems like a distant prospect.
[27] MFAT (1993, p.22).
[28] As the APC (2022, p.49) puts it: "while it might be possible to estimate the value of increased market access for Australian exporters, it would be difficult to determine the contribution that tariffs, used as leverage, might make to the negotiation. The contribution of tariffs to negotiations will decrease as the focus of new PTAs shifts towards behind the border issues".

For example, the modelled gains to the UK its FTA with New Zealand, including the impacts of tariffs, NTMs, services liberalisation and trade facilitation, are tiny at 0.01% of GDP by 2040.[29] The UK had strong political economy reasons for concluding an FTA with New Zealand, to get a quick post-Brexit win and promote their accession to CPTPP.

Similarly, the gains to the EU were modelled at less than 0.01% of GDP by 2035.[30] The EU's motivations for concluding an FTA with New Zealand were primarily strategic, rather than economic, and its sales pitch to stakeholders has focused on the climate change and sustainability aspects of the agreement, not market access.

Retaining tariffs comes at a macroeconomic cost…

New Zealand's increasingly 'patchwork quilt' of a tariff regime imposes some non-trivial costs on the economy.

Tariffs introduce allocative inefficiencies that result in resources not being directed to their most valuable use. They also push up the price of imported consumer and capital items, which can reduce households' and firms' purchasing power.

These distortions are unlikely to be huge, however, given the low levels of tariffs in place. Ballingall et al (2009) estimated that eliminating tariffs would lead to real GDP being around 0.2% above baseline after 15 years.

Given effective tariffs have fallen some 60% since that study (Figure 3), it would be reasonable to expect the macroeconomic benefits from their removal would have fallen commensurably. If real GDP in 15 years' time is around $400b, a back-of-the-envelope estimate is that the macroeconomic benefits from tariff removal might be in the order of $320m.[31]

…and impose compliance and administrative costs

Removing New Zealand's remaining tariffs would be expected to reduce businesses' compliance costs

As APC (pp.33-34) notes, "[tariffs] also impose compliance costs, part of which are paid by Australian importers and part of which are paid by foreign exporters to Australia. Compliance costs fall on those accessing preferences and concessions from the statutory rate, as those businesses devote time and resources to become eligible for them (if not already eligible) and to demonstrate their eligibility. Most of these costs are passed on along the supply chain to Australian consumers in the form of increased prices, at least in the short run".

[29] ImpactECON (2022a, p.17).
[30] ImpactECON (2022b, p.17).
[31] Based on average real GDP growth of 2% per year from today's real production GDP of $280b, and pro-rated GDP impacts of (1-0.6)*0.2%. Updating the estimates of the economic impacts of unilateral tariff removal using a dynamic computable general equilibrium model is on the Sense Partners work programme for the coming year.

The more FTAs New Zealand implements, especially overlapping ones[32], and the more other tariff concessions become available, the more New Zealand's tariff system starts to look like a complex patchwork quilt of rules and regulations.

Or as the APC (2022, p.5) puts it, "[a] complex tariff system with many exemptions is more costly to manage than one with few exemptions and generates compliance costs for businesses as they must determine what rate applies to their imports and whether they qualify for a preferential or concessional rate of customs duty".

As far as we are aware, there are no New Zealand-specific estimates available of the compliance burden on businesses regarding adherence to the current tariff regime. However, the APC (2022, p.45) has estimated these compliance costs to be between $0.49 and $1.45 per dollar of tariff revenue. Given Australia's tariff regime is similarly 'patchwork-y' to New Zealand's, it seems reasonable to apply these figures in a New Zealand context to get a rough indication of compliance costs.

Based on $178m tariff revenue in 2022, the compliance costs of retaining New Zealand's tariff regime would be $87.7m to $258.1m.

And deliver small administrative savings

Maintaining a tariff system that has a degree of complexity in terms of multiple options for businesses to seek concessions for imports comes at a cost.

In 2021/22, Customs New Zealand processed over 20 million import transactions. While most of these transactions are low risk items for which processing occurs electronically and almost instantaneously, there will be non-trivial administrative costs associated with retaining New Zealand's tariff system.

The APC (2022, p.30) estimates the administrative costs of maintaining Australia's tariff system to be between $0.007 and $0.013 per dollar of tariff revenue collected. A fair chunk of these costs (28% to 53%) stem from administering preferences under PTAs. APC highlights the challenges of separating out the costs of administering the tariff system from other border processes and believes its estimates are likely conversative.

In lieu of any New Zealand specific estimates, and on the basis that it seems reasonable that Australia and New Zealand would have similar administrative costs for maintaining their respective tariff regimes, we use the APC estimates. On tariff revenue of $178m, this equates to $1.2m to $2.3m for New Zealand.

Is the cake worth the candle?

Based on the indicative estimates above, retaining New Zealand's tariffs imposes efficiency, compliance and administrative costs of between $410m to $580m per year.

[32] For example, New Zealand's imports from Malaysia are covered by a bilateral PTA, the AANZFTA regional agreement and the CPTPP regional agreement, all of which have different rules of origin determining preferences.

One would need to attribute relatively high probabilities to the US and India agreeing to negotiate an FTA with New Zealand and New Zealand's tariffs being a material factor in their decisions in order to justify these costs.

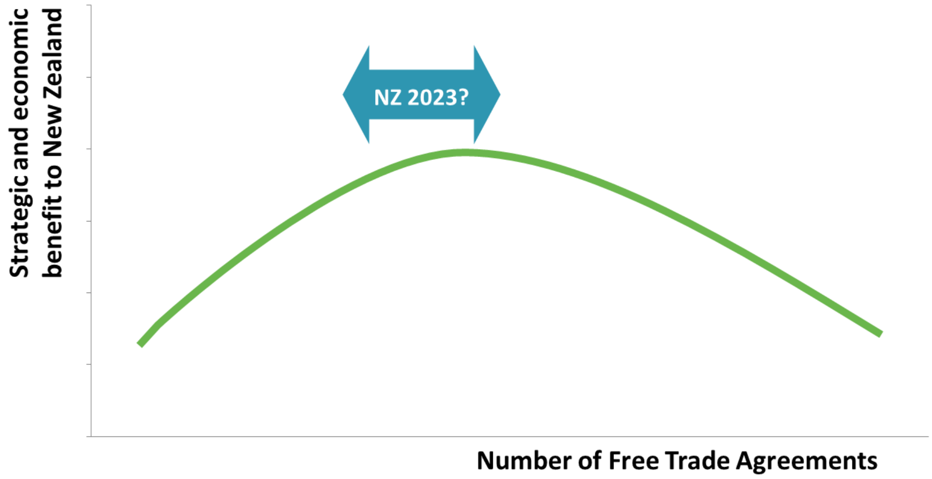
Knowing these probabilities is of course almost impossible in practice, but in our view the time has come to test the negotiating coin logic very closely.

4. Bilateral FTAs – who's next?

Recommendation 4: Aside from the US, India and GCC economies, consider saying "no" to bilateral FTAs unless they offer a comprehensive commercial opportunity and can be negotiated rapidly.

Business needs to prepare for a post-bilateral FTA world...

FIGURE 4 DIMINISHING MARGINAL RETURNS OF FUTURE FTAS



SOURCE: ADAPTED FROM VITALIS (2016, P.201)

Our view is that we have reached (or are rapidly reaching) 'peak FTA' – the natural limit of what bilateral FTAs can do for New Zealand businesses and households.[33]

In addition to the fact that FTAs can only ever be one part of the solution to reducing businesses' transaction costs, there simply aren't many big FTA prizes left for New Zealand. And the EU FTA has set an unhelpful precedent in terms of the market access we might realistically be able to expect from now on.

As such, the marginal return from additional FTAs is likely to diminish (Figure 4).

...as we are running out of potential partners...

As noted earlier, over 80% of New Zealand's goods trade is with markets with whom we have an FTA. The US (9.8%), GCC (2.4%) and India (1.2%) account for the bulk of the remaining trade.

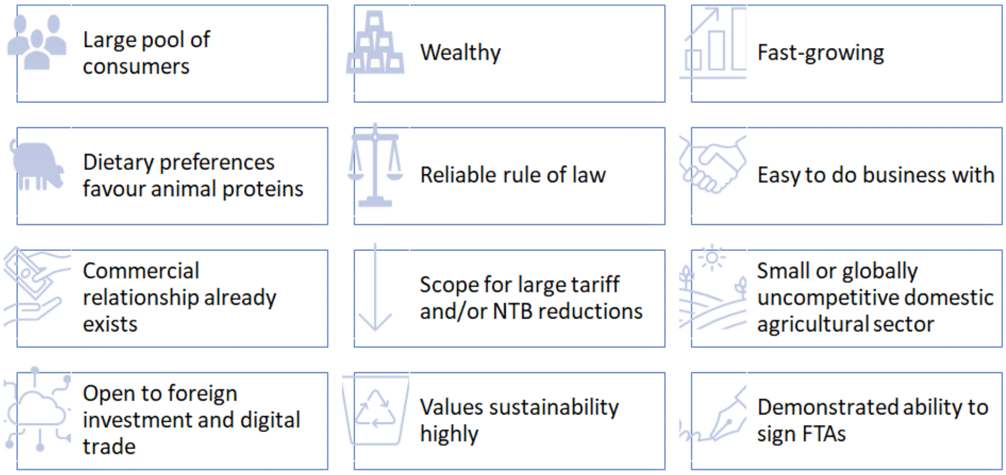
Besides these longstanding FTA targets "it is hard to identify potential FTA partners that would excite New Zealand firms across all industries... Commercial gains from many future FTAs are likely to be highly concentrated for certain firms or sectors".[34] This is because not many

[33] AIG (2022, p.10) concurs. Referring to issues such as geopolitics and protectionism, digital transformation and carbon pricing, they conclude "These trends demand a fundamental reappraisal of Australia's trade strategy. For policymakers, it will mean **moving beyond the market access strategy** that has defined past trade successes" (emphasis added).
[34] Ballingall (2021, p.i).

potential partners tick enough boxes in terms of their suitability for a comprehensive and commercially beneficial FTA.[35] Figure 5 outlines these boxes.

While individual companies may be able to point to potential benefits from future FTAs in developing economies in Asia, Africa or Central and Latin America, it is questionable whether the economy-wide benefits would outweigh the negotiating costs involved.

FIGURE 5 FEATURES OF AN IDEAL FTA PARTNER



SOURCE: BALLINGALL (2021).

…and future FTA negotiations are only going to get more costly and less beneficial

There are at least three key reasons why we expect future FTAs to become more challenging in terms of their benefit-cost ratios.

CPTPP and the EU FTA have set a precedent for less than comprehensive FTAs

New Zealand has always sought high quality, comprehensive outcomes for agricultural exporters in its FTA negotiations, as around 2/3 of our goods export revenue comes from the primary sector. Our negotiating partners have tended to use long periods for tariff reduction phase-outs, plus safeguard measures, to incorporate market access improvements in particularly sensitive areas (often dairy and meat).

As a result, New Zealand officials and politicians have always been able to say that an FTA has delivered meaningful market access for New Zealand exporters, even if they sometimes forget the caveat "over time".

The EU FTA sets a precedent for New Zealand considering less than comprehensive FTAs in the future.

[35] Ballingall (2021) develops an FTA Partner Suitability Index that can be used to rank potential FTA targets. Outside of existing FTA priorities (US, India, etc.), the Index suggests Switzerland, Norway, Morocco, Isarel and Turkey are the top five ranked targets.

While the EU FTA was very welcome for most industries, and valuable from a geopolitical perspective, it was nonetheless a watershed moment for New Zealand's trade negotiating history: it became the first bilateral agreement New Zealand has signed that delivered such limited market access outcomes for many of its traditional agricultural exports.[36] The CPTPP outcomes for some dairy and meat products were also relatively limited, which will have influenced EU negotiators' positions.

This precedent matters. Almost the first thing an Indian or US agricultural trade negotiator will do if FTA negotiations with New Zealand were to be announced would be to check out what market access the EU offered New Zealand.

Their logic would be:

(i) Like the EU, our meat and dairy farmers and processors aren't terribly thrilled about the prospect of additional competition from New Zealand exporters.

(ii) If New Zealand can conclude an FTA with the EU with limited market access outcomes for dairy and beef, then they can probably agree to the same with us.

The parameters of the EU FTA will shape their negotiating starting point, which would likely be welcomed by US and Indian agricultural industry bodies concerned about additional competition from New Zealand exporters. Australia's decision to agree to an FTA with India that completely excludes dairy isn't helpful for New Zealand's cause either.

Overall, future FTA partners now have a stronger case to make meagre concessions in their sensitive agricultural industries in any market access offer to New Zealand. This might make an FTA easier to sign but would materially reduce its economic value.

Furthermore, other potential future FTA partners in the developing world (e.g. Africa) may well also seek to exclude sensitive agricultural sectors if we were to explore bilateral FTA negotiations with them. Without (say) key dairy and beef lines included, any such FTA with a developing country might struggle to cover 'substantially all the trade', as required by WTO Article XXIV.

Polluters need not apply?

The EU FTA contains legally binding commitments on climate change. Both sides have agreed to "refrain from any action or omission which materially defeats the object and purpose of the Paris Agreement".[37]

Breaches of this commitment are subject to dispute settlement and potentially trade sanctions. If this is the new benchmark for climate and trade issues in New Zealand's FTAs, it could be very difficult to get new FTA partners (e.g. US, India, high-emitting developing countries) to the negotiating table.

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[36] This is no criticism of New Zealand's negotiators, who had almost nothing of economic value to the EU to negotiate with. We appreciate politics played a big role in the decision to conclude negotiations. The fact that we concluded a deal at all was a significant achievement.
[37] Article 19.6.3.

This is not to say that including ambitious climate change and sustainability commitments inside FTAs is a 'bad' thing. Indeed it was probably essential for getting the EU FTA across the line.

However, potential FTA partners who are less progressive on climate change may be less inclined to agree and see it as one more reason *not* to engage in FTA negotiations with a very small, very distant economy with offensive interests in likely sensitive sectors.

Balancing external ambition with domestic sensitivities

Internal economic change alters trade policy priorities and agendas. Which is the chicken and which is the egg can be debated[38].

FTAs have become more complicated to negotiate for New Zealand due to changes in domestic stakeholder interests and political pressure to make trade more inclusive and sustainable. This is part of a global trend away from FTAs being primarily about improving efficiency towards them also being used to address existing distributional challenges.

New Zealand's Trade For All (TFA) agenda was developed in response to concerns from some parts of New Zealand society over TPP. Its goals are laudable and its development necessary to push back against an emerging tide of anti-trade sentiment.

But it has complicated New Zealand's commercial negotiating position vis-à-vis FTA partners.

The range of New Zealand's negotiating 'asks' has expanded, while we don't have much more to offer FTA partners in return. The likely outcome is that New Zealand needs to compromise more on commercial objectives.[39]

Again, this is not a criticism of TFA. Trade policy needs to take into account the domestic and global political economy of the day, and New Zealand is far from alone in seeking to avoid trade policy worsening social challenges.[40] But we shouldn't pretend there are no trade-offs involved.

It's only by saying "no" that you can concentrate on the things that are really important in trade policy[41]

Putting aside FTAs with the GCC economies (either collectively or individually), the US and India, which officials will continue to push for in some shape or form (see next section), serious consideration may need to be given to just saying "no" to other potential FTA suitors.

In our view, unless a potential FTA partner is clearly ready and incentivised to sign a comprehensive bilateral FTA with New Zealand, then we should diplomatically decline their

[38] MFAT (1993, p.24).
[39] However, it can also be argued that the inclusion of high-ambition climate and sustainability provisions in the UK and EU FTAs was a positive outcome that allowed all parties to 'sell' the agreements to a wider range of interest groups.
[40] There are valid questions about whether trade policy is being asked to do too much and whether the tax and transfer system might be better suited to addressing distributional issues.
[41] With apologies to Steve Jobs.

advances. A full set of bilateral FTA negotiations from scratch with a partner seeking to carve out big chunks of New Zealand's offensive negotiating interests is unlikely to be net beneficial.

There will always be exceptions to this rule of thumb, not least broader foreign policy considerations. But the obligation should be on officials and/or industry to clearly demonstrate the likely benefits will be greater than the negotiating costs.

This could free up resources to focus on other trade policy priorities. For example, more effort could be directed into upgrading existing FTAs that leave a bit to desire in terms of their economic opportunities for New Zealand.

5. Regional agreements: strength in numbers

Recommendation 5: Use RCEP and CPTPP as the primary vehicles to engage with new potential FTA partners.

Recommendation 6: Seek to upgrade existing FTAs rather than seeking new bilateral FTA partners.

Recommendation 7: Engage with IPEF provided greater clarity emerges on potential benefits and resourcing challenges can be managed.

Recommendation 8: Consider some 'grand gestures' to deepen the bilateral relationship with India; rely on RCEP instead of seeking a bilateral FTA.

Seek agreements with the US, India and others via mega-regionals

New Zealand participates in the world's three largest FTAs:[42]

- RCEP covers 15 economies, over 2.2 billion people and a combined GDP of US$27.4 trillion.
- After the UK's accession, CPTPP covers 12 economies, over 580 million people and a combined GDP of around US$15 trillion. China, Chinese Taipei, Ecuador, Costa Rica and Uruguay have formally applied to accede to CPTPP. South Korea, Colombia, Indonesia, the Philippines, and Thailand have all publicly expressed interest in acceding.
- AANZFTA covers 12 economies, over 650 million people and a combined GDP of US$4.5 trillion.

CPTPP and RCEP have accession clauses. These 'mega-regionals' could form the basis of our approach to India, the US and others.

Given the challenges outlined above regarding the costs and benefits of negotiating new bilateral FTAs, we could instead take the position that New Zealand should primarily seek additional market access gains through expansions or upgrades of existing FTAs.[43]

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[42] Largest in terms of population. The EU has a combined GDP of around US$18.3 trillion for a population of 446 million. USMCA has a combined GDP of US$26 trillion and a population of 500 million.

[43] New Zealand is also seeking to become an Associate member of the Pacific Alliance, comprising Colombia, Mexico, Chile and Peru. Should New Zealand accede, this agreement may present further expansion opportunities in Latin America. New Zealand is also party to the PACER Plus agreement but given its role – for New Zealand at least – as a vehicle to promote Pacific economic development rather than to expand New Zealand's market access, we do not explore it further here.

Safety in numbers for expansion negotiations; more efficient processes for upgrades…

Focusing our scarce negotiating resources on expanding membership of existing FTAs or upgrading existing agreements rather than seeking new bilateral FTA partners could provide several benefits for New Zealand:

(i) Negotiations with any potential new member should be less resource intensive because existing texts and processes are in place for accession.

(ii) The more these agreements expand – especially CPTPP – the larger the economic and geopolitical incentives for non-members to accede. These incentives are larger than anything New Zealand could offer bilaterally.

(iii) The US is very familiar with the CPTPP text and will know it covers most of their offensive interests, provided other members are willing to engage on some aspects that were put on ice when the Trump administration withdrew from TPP.

(iv) India is very familiar with the shape of RCEP and its level of ambition. It was close to signing in 2020 and the door remains open to it re-joining. It will have already done its analysis of economic costs and benefits, so wouldn't need to start from scratch should the domestic political calculus shift over time.

(v) When challenging negotiating issues arise, New Zealand would not be taking on the might of the US and India by itself. Other, larger economies may share the same concerns and be prepared to do the heavy lifting, with New Zealand playing a supporting rather than leading role.

(vi) When upgrading existing FTAs, the negotiations will be tightly focused on products and issues of interest that both parties will already be well aware of. These discussions should therefore be relatively resource efficient compared to a full-blown set of new FTA negotiations with a new partner.

…but with some additional challenges

There would be trade-offs involved with this approach too, which would need to be considered before committing to it:

- Regional negotiations are subject to a different set of economic and geopolitical constraints than bilateral negotiations and are certainly not simple exercises.
- New Zealand might not be able to push the tempo as much as it might wish, so a longer term perspective may be required.
- Some aspects of CPTPP and RCEP, for example, are in need of updating and upgrading to align with Trade for All principles and changes in business practices since they were originally agreed.
- There may be foreign policy niggles associated with rebuffing potential bilateral FTA suitors' approaches in favour of regional FTA expansion.

However, on balance, in our view it is an approach which merits some attention from officials.

We need to be open to, not dismissive of, different approaches

The Indo-Pacific Economic Framework (IPEF) has been met with a lukewarm reception from New Zealand businesses. This perhaps isn't surprising because the natural comparator for most businesses is a bilateral FTA with the US, or the US re-joining CPTPP. Both of those would come with the glittering prize of improved market access, whereas lower US tariffs or expanded quotas are off the table in IPEF.[44]

Yet neither a bilateral FTA nor the US re-joining CPTPP is realistic *at this point in time*. It's just not going to happen given the anti-trade sentiment that pervades US Congress, regardless of who is in the Whitehouse.

An engaged US is better than an isolated one…

So an FTA is the wrong counterfactual. A better one is the US *not* being engaged in the Indo-Pacific and *not* being interested in improving the resilience and efficiency of regional supply chains, as we saw under the Trump administration. IPEF is an improvement on this.

It represents a different way of engaging in plurilateral discussions aimed at reducing some of the costs of doing business in our region. Without the need for Congressional approval on tariff reductions, there may be more scope for officials to cooperate creatively to reduce other forms of transaction costs in the Indo-Pacific that hurt New Zealand businesses' competitiveness and margins.

IPEF could – if we're being optimistic – also push officials and businesses to shift their thinking away from allocative efficiency gains (the direct effects of reducing tariffs) to dynamic efficiency gains (reducing transaction costs and promoting investment through greater technology transfer and innovation). Dynamic efficiency gains are arguably more important for promoting productivity growth and improvements in living standards/wellbeing (Nordås *et al*, 2006; OECD, 2007).

…but IPEF could end up a resource sink with uncertain commercial returns

However, given its very broad scope, unclear enforcement mechanisms, a wide range of IPEF member perspectives on negotiating topics, and uncertain outcomes given the absence of market access incentives, there is a non-trivial risk that IPEF soaks up a huge amount of New Zealand's scarce negotiating and diplomatic resource for little commercial return.[45]

And we are acutely aware of the risks the US sees IPEF as a chance to impose its own regulatory preferences on others, rather than make any significant changes to its own systems that might benefits New Zealand firms and households.

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[44] Though see earlier caveat regarding the EU FTA setting a precedent for less than comprehensive deals. US asks in any FTA could also be highly problematic for New Zealand – biologics, ISDS, copyright extensions, IP, etc.

[45] The recently released text for Pillar II of IPEF on supply chain resilience (US Department of Commerce, 2023) provides some hints here. It establishes a an IPEF Supply Chain Council, an IPEF Supply Chain Crisis Network and an IPEF Labor Rights Advisory Board, all of which will require devoted resources from New Zealand to service. It is heavy on intentions (the word "intend" is used 39 times in the 25-page document) and light on readily apparent commercial benefits.

As a small country, we can't afford not to be at the IPEF table… for now

On balance, we suggest it is worth continuing to engage with IPEF. But as the shape of the negotiations emerges and estimates of potential commercial benefits can be generated, care will need to be taken to calibrate the resourcing directed towards negotiating and implementing it.

More broadly, the key point is that New Zealand needs to remain open to different approaches to engagement on trade issues, while being mindful of resource constraints.

India: rely on RCEP? Or invest bilaterally?

The sheer potential of India as a growing market which wants to advance its role in regional and global affairs cannot be ignored. As the India-New Zealand Business Council recently noted (2023, p.5), "New Zealand has some catching up to do - as a country with a lot to offer India, we are at risk of being further marginalised as the centre of economic and geopolitical gravity shifts towards India over the next generation. New Zealand must get serious about India and invest in this relationship now - we cannot afford to be left behind".

Above all, to achieve our important goals requires patience and persistence[46]

In our view, India needs to be seen as a longer term investment opportunity, and New Zealand needs to be ready to jump should political, economic or geostrategic forces shift sufficiently to present a window for some form of formal agreement.

This may not be in the next 3 years, 10 years, or even 20 years, but as we saw with China in the mid-2000s sometimes circumstances change, and small countries can strike it lucky.

We can't influence Indian domestic politics…

A bilateral FTA with India seems unlikely in next few years. It's been tried for at least 20 years and India shows little inclination of being willing to move on market access in the areas of New Zealand's comparative advantage.

There is little value – in our view – in continuing to bang the bilateral FTA drum in vain.

Domestic politics in a country of over 1.4 billion people is always going to be more important to Indian politicians than the interests of 5 million Kiwis. There is little we can do to influence that.

…we need to control the controllable

We have two central options regarding India.

The first is a more passive choice: relying on RCEP, which might be the best chance of securing some form of deal with India for New Zealand. India participated in 16 RCEP negotiating rounds between 2013 and 2019 before withdrawing, citing concerns over potential impacts on its sensitive agricultural sector and its bilateral trade balance with China.

[46] MFAT (1993 p.7).

The door remains open for India to re-join should circumstances change and Indian politicians have a change in heart. New Zealand should continue to support such a move.

The prospects of India remaining interested in RCEP would be enhanced by RCEP members proving over time that the agreement has delivered significant benefits to members. New Zealand can have a role in working from the inside to ensure it is implemented to deliver the maximum benefits possible, and promoting evaluation activities that demonstrate RCEP's (hopeful) success.

Should RCEP negotiations re-open to India, New Zealand might want to consider addressing India's concerns around dairy and meat by proposing the use of time-bound, phased-down special safeguards to limit the expansion of bilateral exports. While this would reduce the benefits to New Zealand of India's accession, we would at least have a foot in the door.

The second is a more active approach: New Zealand investing in the wider economic relationship and perhaps making a 'grand gesture' towards India to demonstrate the importance we place on it.

During his 2022 visit, a focus of India's External Affairs minister was Indian student visas. Why couldn't New Zealand consider providing Indian students with better access to the New Zealand labour market after their studies in certain in-demand occupations?

Doing so would almost certainly be beneficial for New Zealand given ongoing skills shortages and would be a powerful demonstration that we've listened to India's concerns and are prepared to be proactive about addressing them.

The current political environment is not conducive to such a move, but this too shall pass, and future governments may be more open to New Zealand attracting overseas workers.[47]

Would it lead to demands from other sources of students for similar arrangements? Probably. But that could give us leverage for FTA upgrades or other bilateral priorities.

Another area could be around agricultural supply chains. India has a strong interest in lifting its agricultural productivity and reducing food waste along its supply chains. New Zealand has huge expertise in both areas. Might a 'Sustainable agricultural supply chain cooperation' contestable fund be set up into which Indian businesses could bid for funding to buy New Zealand agri-services or agri-tech?

The aim would be to gradually change the (unrealistic, but still pervasive) narrative around the risks of New Zealand agriculture flooding the India market if trade barriers are reduced. Instead, we try to emphasise our interests are more in exporting our technology and expertise to help Indian agricultural productivity rather than displacing Indian farm products.

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[47] As Sense Partners (2023, p.1) notes, the "core working age population (15-64) will shrink over coming decades. But the total population will still grow and demand for workers will increase".

6. Plurilaterals: Do something new, New Zealand

Recommendation 9: Increase resources devoted to using open plurilateral approaches to address emerging trade issues with like-minded economies.

As the trade environment shifts, so too must New Zealand's approach

The world of trade policy is becoming ever more complex, reflecting rapid shifts in technology, and pressing environmental problems. This is occurring at the same time as a marked return to inward-looking policy settings by major global powers.

There is a high degree of unpredictability involved in a situation where trade tensions rise, both sides have sharply differing perceptions of where the balance of fault lies, and there is no effective umpire in the form of a functional multilateral dispute settlement process[48]

This poses challenges for a small, distant economy such as New Zealand. We can't afford to be left outside looking in the world changes around us. But we lack the economic clout to demand a seat at the table as larger economies set new norms and approaches to trade policy.

There is no limit to human ingenuity[49]

What we *do* have is a demonstrated ability to be "interested and interesting; creative and constructive".[50] New Zealand has often been at the forefront of innovative approaches to emerging trade issues in recent years, such as:

- the Digital Economic Partnership Agreement (DEPA)
- the Agreement on Climate Change and Sustainability (ACCTS)
- the Indigenous Peoples Economic and Trade Cooperation Arrangement (IPETCA).
- various initiatives to keep essential goods and services flowing during through the COVID-19 pandemic.

And we should not forget that CPTPP (completed in 2018) was built on the foundation of the P4 agreement, a New Zealand-led initiative signed in 2005.

'Concerted open plurilaterism'[51] has become, and will likely remain, increasingly important for New Zealand's trade policy ambitions.

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[48] MFAT (1993 p.57).
[49] MFAT (1993, p.6).
[50] Vitalis (2016, p.193).
[51] Defined as "This involves identifying pathfinder opportunities to work with groups of like-minded economies to develop new ideas and norms in trade policy areas which respond to business needs and global priorities. High quality trade instruments are then developed that build on and support existing

Concerted open plurilaterism allows for creative thinking on modern trade issues

These recent initiatives share several common features:

- They all focus on emerging trade issues (climate change, digital trade, etc.) for which existing global or regional rules may not be appropriate.
- They are all 'open' plurilaterals – other economies are welcome to join provided they meet the required standards.
- They are geography- and scale-agnostic – the door to membership is open regardless of an economy's location or size.
- Initial membership tends to be smaller economies from multiple continents with a particular interest in the issue at stake.[52]
- They are less focused on 'traditional' market access issues such as tariffs and quotas and more focused on matters that bilateral and regional FTAs struggle to incorporate effectively.
- They take a long-term 'modular' perspective, recognising that success could take many years or even decades, and that economies move at different speeds on different issues.

Given the statis in multilateral trade liberalisation at the WTO (see next section), the possibility New Zealand is close to peak FTA (see section 4), and New Zealand's participation in various mega-regional agreements (section 5), it seems likely that much progress on trade initiatives that matter to New Zealand is likely to occur through open plurilaterals for the foreseeable future.

The following are some suggestions – and perhaps they are 'moonshots' – for consideration when New Zealand thinks about its next open plurilateral initiative.

Explore comprehensive negative list-style Mutual Recognition Agreements

Under the Trans-Tasman Mutual Recognition Agreement (TTMRA):

- A product produced in, or imported into, New Zealand and then legally sold, may be sold in Australia, and vice versa.

WTO rules, and are open to other WTO members to join if they can meet the high standards" (WTO, 2022, p.9).

[52] ACCTS' current members are New Zealand, Costa Rica, Fiji, Iceland, Norway and Switzerland. DEPA's current members are New Zealand, Chile and Singapore. Accession negotiations with Korea were concluded in June 2023. Canada, China, Costa Rica and Peru have formally requested accession.

- A person who is registered to practise an occupation in Australia is entitled to practise an equivalent occupation in New Zealand after notifying the local registration authority, and vice versa.

While there are limited exemptions, TTMRA aims to eliminate the regulatory burden and transaction costs that exporters, importers and workers would otherwise face working in the trans-Tasman market.

Clearly, the TTMRA was made more feasible because of the intertwined nature of the New Zealand and Australian economies, but we wonder whether such MRAs could be explored with a small group of other developed trade partners (e.g. EU, US, UK, Japan, Chile, Singapore).[53] New Zealand's regulatory system is generally well-regarded, and our goods are recognised as being high quality and safe. Our vocational and professional training standards are also likely to meet muster in most overseas labour markets.[54]

Under these MRAs, the presumption would be one of regulatory equivalence: that all rules and regulations related to the movement of goods, services and people would be mutually recognised.[55]

Limited exceptions could be negotiated for tightly-defined legitimate public policy purposes, using a negative list approach whereby only listed products or occupations are exempt and any new products or occupations are recognised as meeting the required standards.

Promote an 'Agreement on Reducing Business Costs' plurilateral on non-tariff measures

Consistent with a transaction costs-reducing objective for New Zealand's future trade policy, there may be opportunities to work with like-minded economies on an open plurilateral 'Agreement on Reducing Business Costs', focused on non-tariff measures (NTMs).

NTMs "are policy measures other than tariffs that can potentially have an economic effect on international trade in goods. They are increasingly shaping trade, influencing who trades what and how much".[56] Examples include Sanitary and Phytosanitary (SPS) Measures, Technical Barriers to Trade (TBT), quotas, rules of origin, pre-shipment inspections, etc.[57]

Some NTMs deliver benefits to consumers and businesses. For example, if a TBT reassures consumers that a product is safe, it can be trade-creating; and if an SPS measure prevents a biological pest entering a country and devastating its crops, that too has value.

[53] In an example of cross-continent trade in knowledge-intensive intermediate services, this idea fell out of a Twitter exchange with David Henig of ECIPE. See Henig (2023, p.11) for a discussion of what a 'mature' trade policy might look like for the UK, including MRAs.
[54] There is some precedent for MRAs in specific services sectors, with the UK recently announcing an MRA on architects with several US states (see https://www.gov.uk/government/news/trade-minister-in-us-to-sign-fourth-trade-pact-with-a-us-state).
[55] There may be challenges with triggering the services MFN provisions of New Zealand's existing FTAs through implementing these MRAs. This would need to be explored carefully.
[56] UNCTAD website.
[57] See UNCTAD (2019) for the full list of recognised NTMs.

But all NTMs impose transaction costs on businesses. Meeting regulations and filling out paperwork (even electronically) all takes time and resources. NTMs can even halt trade completely.

According to a recent paper,[58] NTMs increased trade costs by 12% on average globally in 2019. That amounts to a NZ$2.4 *trillion* increase in trade costs. That same paper estimated that:

- NTMs cover at least 83% of New Zealand goods exports.
- They impose an annual compliance cost of over $12 billion on New Zealand exporters.
- Beverage products (especially wine) are subject to the most expensive NTMs internationally. The costs of NTMs on wine are estimated to be 1.5 times total export value – around NZ$3.3 billion.
- New Zealand meat exports typically face 28 NTMs, dairy 24, and fish 20, across the markets to which they are exported.

While some of New Zealand's FTAs genuinely extend WTO SPS and TBT commitments (e.g. the UK FTA), this is the exception rather than the rule. It is questionable how effective FTAs are at reducing NTMs already in place.

Once in place, NTMs can be 'sticky' and foreign agencies do not face incentives to either remove them or improve the efficiency with which they are applied.

Proactive trade policy for New Zealand…is frequently a matter of encouraging other countries to look at an issue involving trade with New Zealand from a somewhat different perspective[59]

We wonder if there is scope for New Zealand to champion an open plurilateral agreement that seeks to actively reduce the transaction costs of the stock of NTMs on trade between participants. This could involve:

- Assessing NTMs against APEC's 'Cross Cutting Principles on Non-Tariff Measures' or a modification thereof.
- Removing redundant 'legacy' NTMs that no longer serve their stated purpose.
- Identifying ways to improve the efficiency with which necessary NTMs are applied (e.g. through digitisation of processes).

Negotiating such an agreement would no doubt be challenging. Many NTMs – including New Zealand's – are in place for legitimate public policy purposes and may not be suited for removal or amendment.[60] Legitimacy is also in the eye of the beholder. And since NTMs are often multilateral in nature rather than country-specific, there may be concerns about free-riding by non-participants.

[58] Stephenson (2022).
[59] MFAT (1993, p.8).
[60] But even these 'valid' NTMs could potentially be applied more efficiently without threatening their objectives.

But if designed carefully, an agreement to remove unnecessary NTMs and improve the efficiency of remaining NTMs should deliver economic gains to all participants – both the country imposing them (through lower implementation costs) and the countries facing them (less red tape, more streamlined processes, etc.).

As with New Zealand's other plurilateral agreements, the countries initially involved might be the smaller and more innovative trading partners (e.g. Chile, Singapore, etc.), with the hope that more economies could join over time as the agreement's effectiveness in reducing business transaction costs was demonstrated.

A chance to push DEPA further?

As recently outlined by leading trade economist Richard Baldwin, globalisation has entered a new phase.[61] Trade in goods as a share of global output has stabilised as the early century wave of outsourcing and unbundling of tasks from developed economies to developing economies plateaued. But trade in services – and especially commercial services used as intermediate inputs to supply chains – has continued to grow rapidly.

Digital trade is at the core of the trend towards increased cross-border exchanges of intermediate services.

Traditionally, New Zealand's trade policy has been shaped around our primary sector, and rightly so given our comparative advantage and the presence of high trade barriers for primary products. The question for the next decade or more is whether this approach still makes sense.

The rapid growth of the export of services is influencing our trade policy[62]

Perhaps the time has come to rebalance – at the margin– our trade policy in the direction of digital.[63] Initiatives such as DEPA and the inclusion of digital chapters in FTAs are helpful, but can more be done to push New Zealand to the forefront of removing barriers to digital trade and implementing the greater digitisation of border processes?

Doing so will need considerable leadership from the private sector. There is perhaps a tendency for officials to treat "digital" as a homogenous sector, when the reality is there are thousands of heterogenous digital technologies and processes already being traded either directly or embedded in other goods and services. Legal, regulatory and technological barriers will be imposing transaction costs on all these businesses.

It could be useful for a group of digital businesses to put together a prioritised list of challenges they face when exporting or investing offshore and identifying areas where government has a distinctive or unique ability to assist. This could then be the basis for a focused discussion with officials on how these barriers might best be addressed, perhaps using DEPA as the starting point for engagement with New Zealand's trading partners.

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[61] Baldwin (2022).
[62] MFAT (1993. p.21).
[63] Continued efforts to reduce trade barriers on New Zealand's agricultural exports must remain a priority of course, be that through upgrades of existing FTAs or through new agreements with major players.

Squaring the climate change and trade circle

New Zealand has long been a champion of using trade policy to deliver environmental benefits. It has been prominent in international discussions around liberalising trade in environmental goods and services, reducing fossil fuel subsidies and imposing disciplines on fishing subsidies, for example.

One area where it has been less prominent is Border Carbon Adjustment Mechanisms (CBAMs). CBAMs are being introduced or considered by many countries around the world as a way to limit emissions leakage to economies that don't regulate emissions as stringently.[64] Many observers suggest CBAMs are being introduced at least partly for protectionist purposes too.

New Zealand does not have any CBAM in place, although has explored the possibility of designing one for cement imports.[65]

Given New Zealand's distance from key markets, limited constraints on agricultural emissions, and protectionist tendencies towards agricultural products internationally, the emergence of CBAMs could present a headache for New Zealand exporters over time.[66] At a minimum, CBAMs will impose potentially painful compliance costs on exporters, especially those trading in several markets, all of whom might conceivably implement different CBAM variants.

The introduction of CBAMs also highlights several important issues that are at the core of climate change and trade policy:

- How will the emissions intensities of traded products be measured, and by whom?
- How far up and down a product's supply chain should embodied emissions be counted? How are multi-country supply chains to be accounted for, and how might this interplay with Rules of Origin provisions of trade agreements?
- What are the prospects for mutual recognition of climate policies, pricing schemes and concessions for trade exposed sectors (such as free emissions allowances)? How might this occur?
- Special and Differential Treatment is an integral part of the global trade policy landscape, giving developing countries more flexibility around implementing (say) WTO agreements. A corollary (albeit imperfect) is Common But Differentiated Responsibilities in multilateral climate discussions. How will CBAMs incorporate these principles to ensure that developing countries – including our neighbours in the Pacific – are not disproportionately burdened?

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[64] See Cosbey and Baršauskaitė (2023) for a useful overview of the key CBAM design choices.
[65] See Cabinet paper.
[66] Presently, direct agricultural emissions do not feature in any of the emissions pricing schemes around the world. This reduces the immediate competitiveness risks to New Zealand, but this situation may not last. In the EU, farmers face compliance costs associated with climate policy and that could provoke interest in CBAMs on agricultural products. And in any case, processed agricultural products could be targeted for their embodied energy emissions even if countries don't have meaningful constraints on farm-level biological emissions.

- If a government provides subsidies to support its exporters to meet the emissions standards demanded in CBAM markets and hence avoid border tariffs, how worried should we be? How might such subsidies need to be disciplined at the WTO, if at all?

These are all thorny, multi-disciplinary questions, which researchers and policy-makers are already thinking hard about, including at the WTO, OECD, APEC and G20.

We wonder whether New Zealand might seek to bring together a group of like-minded countries with scientific, trade policy, climate change and development expertise to start exploring these, and no doubt many other, CBAM and trade issues.

More broadly, the emergence of CBAMs (and other measures such as green industry policies) points to the need for New Zealand's trade and climate change negotiators to work much more closely together.

Trade negotiators will need to deepen their understanding of sustainability and climate policy. They will need to give sustainability outcomes greater weight in developing their negotiating positions and be more aware of the climate and development implications of their trade policy approaches.

And climate change policymakers and negotiators will need to be more attuned to the important role that trade can play in addressing global emissions reduction, and the trade implications of setting ambitious domestic and international emissions targets.

7. Multilateral channels

Recommendation 10: Retain the current level of engagement with the WTO, recognising its value as arbiter of disputes and promoter of transparency of policy measures. Maintain existing approach to APEC and the OECD.

The WTO remains critical to safeguard New Zealand's interests

The WTO has delivered several important outcomes for New Zealand over the past decade, such as the Trade Facilitation Agreement of 2013, the elimination of agricultural export subsidies announced in 2015, and the 2022 Agreement on Fisheries Subsidies. Ongoing negotiations on e-commerce are also important.

As the only institution that can develop global, binding commitments, the WTO remains "the first best option" for addressing many of New Zealand's trade negotiating priorities – not least agricultural subsidies.[67]

It is a vital part of the rules-based order that New Zealand benefits from and warrants our ongoing support, not least for its role as an arbiter of disputes and repository for notifications about new trade policy measures.

Ultimately, respect for [the WTO] is held in place by a delicate pattern of political compromises based on everyone's common interest in preserving the overall system. From time to time, that system is put under severe pressure…[68]

However, the prospects of the WTO delivering further meaningful improvements in global market access, services liberalisation or multilateral reductions in trade-distorting subsidies appear slim in the current global environment.[69]

The global trade system is currently under one of the periods of "severe pressure" that our previous trade strategy foresaw. Any WTO negotiation featuring the US, China, India and EU that includes market access is going to be very difficult to land.

…success rests ultimately on whether key governments show sufficient political rationality concerning their country's long term interests in a stable system of multilateral rules governing world trade[70]

Perhaps the best we can hope for is that "sufficient political rationality" emerges from the major powers over time to reinvigorate multilateral negotiations. This is likely to be a long-term play, but the potential benefits from multilateral trade negotiations for New Zealand warrant our ongoing investment, even if the probability of success is low.

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[67] Vitalis (2022, p.284).
[68] MFAT (1993, p.36).
[69] One commentator notes: "If you are expecting [the WTO] to perform the function it did in the past, which was to facilitate large multilateral negotiations and the delivery of notable progress in respect of trade liberalisation, it is going to fall short at the moment" (Lowe, 2023).
[70] MFAT (1993, p.46).

In the interim, the WTO will continue to play an important role in protecting existing market access that New Zealand has secured in previous negotiating rounds.

Overall, there does not appear to be a compelling reason to adjust the way New Zealand approaches its engagement at the WTO, nor the resources devoted to it.[71]

OECD and APEC are important fora for exploring creative solutions to modern trade challenges

While the OECD and APEC are not vehicles for negotiating trade agreements, they play a very useful role in building norms and facilitating forward-looking discussions between their members.

As New Zealand's reliance on traditional FTAs to open up new export opportunities declines over time, these fora will become increasingly important as incubators to test novel ideas on non-traditional trade challenges (digital, climate change, indigenous trade, NTMs, etc.) and identify coalitions of the willing wishing to enter open plurilaterals. As such the resources directed to OECD and APEC initiatives and meetings might usefully be lifted.

[71] There are just five full time staff members at New Zealand's Permanent Mission to the WTO in Geneva. Additional support comes from Wellington-based officials, but it seems fair to say that we are not over-investing our scarce negotiating resources in multilateral engagement.

8. Summary and next steps

It has been 30 years since New Zealand developed its “first and only”[72] comprehensive and long-standing trade policy strategy.

It is time for a new one.

We've done well over the past 40 years

New Zealand has been successful in pursuing a range of bilateral, regional and multilateral agreements to boost the competitiveness of New Zealand businesses and improve the variety and value for money of imports for households.

And in recent years it has proven innovative in promoting open plurilateral initiatives on newer trade issues related to digital trade, climate change and sustainability, and indigenous trade.

But the outlook is quite different

This paper finds New Zealand is at a trade policy crossroads:

- Aside from the US, India and the GCC economies, there are few obvious candidates for further FTAs. If we have not reached ‘peak FTA', we are on the summit track.
- Regardless of its overall high quality and strategic value, our FTA with the EU has set a precedent that New Zealand is now prepared to conclude bilateral agreements that offer limited improvements in market access for key export sectors.
- This major departure from previous practice makes getting a comprehensive deal with the US and India that much more difficult (and it was already exceedingly difficult).
- Other potential future FTA partners in the developing world would also likely seek to significantly limit market access opportunities in their sensitive agricultural sectors if we were to initiate bilateral FTA negotiations with them, based on the EU FTA precedent. This would materially reduce their economic value to New Zealand.
- If we are unlikely to sign more bilateral FTAs, it is doubtful whether there is economic value in retaining unilateral tariffs and operating an administratively costly patchwork quilt of preferential tariff regimes. The ‘negotiating coin' argument for keeping some tariffs in place has significantly weakened since the last tariff review in 2017.
- New Zealand is participating in several mega-regionals, such as CPTPP, RCEP and AANZFTA. The Pacific Alliance, while not quite as ‘mega', is another potential vehicle for regional integration. Expanding membership of these agreements might be a more resource-efficient approach to seeking new market access opportunities for New Zealand businesses, and one which is much less dependent on New Zealand retaining its MFN tariffs as negotiating leverage.

[72] Vitalis (2016, p.199), referring to MFAT (1993).

- There would be long odds on the WTO achieving further multilateral market access commitments or material agricultural subsidy reforms.
- Modern trade issues which offer 'offensive' opportunities or pose 'defensive' risks for Kiwi businesses are increasingly being addressed in open plurilateral agreements such as DEPA and ACCTS. Whether these initiatives gain sufficient critical mass over time to influence global rules in these areas is yet to be seen, but they demonstrate the value in working with like-minded, progressive partners to promote rules and norms in areas where we have shared ambitions.

These significant shifts in New Zealand's approach to negotiations, along with a global trading environment characterised by greater nationalism and less regard by the big players for existing trade rules, point to the need for a different approach for the next 30 years.

More of the same? Or something different?

The key question is: as we look forward to 2050 and beyond, where might New Zealand's scarce negotiating resources best be directed?

This paper has proposed 10 recommendations to hopefully prompt a broader discussion on this question between agencies, businesses, trade organisations, researchers and other interested stakeholders. We look forward to participating in these discussions.

TABLE 4 SUMMARY OF RECOMMENDATIONS

	Track	Recommendation
1	All	Reposition New Zealand's trade policy objectives in terms of reducing businesses' transaction costs and improving New Zealanders' wellbeing.
2	All	Recognise that with a limited pool of trade negotiations and diplomatic resources, agencies need to be clear-eyed in their resource allocation decisions and explicitly consider the trade-offs involved.
3	Unilateral	Revisit the 'negotiating coin' logic for retaining New Zealand's remaining tariffs considering the non-trivial costs they impose on households and businesses.
4	Bilateral	Aside from the US, India and GCC, consider saying "no" to bilateral FTAs unless they offer a comprehensive commercial opportunity & can be negotiated rapidly.
5	Regional	Use RCEP & CPTPP as the main vehicles to engage with new FTA partners.
6	Bilateral & regional	Seek to upgrade existing FTAs rather than seeking new bilateral FTA partners.
7	Regional	Engage with IPEF provided greater clarity emerges on potential benefits and resourcing challenges can be managed.
8	Bilateral	Consider some 'grand gestures' to deepen the bilateral relationship with India.
9	Plurilateral	Increase resources devoted to using open plurilateral approaches to address emerging trade issues with like-minded economies.
10	Multilateral	Retain the current level of engagement with the WTO, recognising its value as arbiter of disputes and promoter of transparency of policy measures. Lift engagement with APEC and the OECD.

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