

Chair,
Cabinet Economic Growth and Infrastructure Committee (EGI)

Pacific Alliance: Mandate to launch trade negotiations

Proposal

1 This paper seeks approval to launch negotiations on a free trade agreement (FTA) with the Pacific Alliance.

Executive summary

2 The Pacific Alliance is a regional integration initiative established in 2011 by Chile, Colombia, Peru and Mexico. The Pacific Alliance has already established its own high-quality trade agreement and is now looking to engage with countries of the Asia Pacific.

3 New Zealand is expected to be invited to launch formal trade negotiations with the Pacific Alliance, potentially at the Pacific Alliance Summit in Colombia 28-30 June. Successful completion of a trade negotiation would then see New Zealand become an Associate Member of the Pacific Alliance.

4 Securing a free trade agreement with the Pacific Alliance has strategic and commercial value. It would make New Zealand a part of a dynamic regional integration initiative which is looking to expand into the Asia-Pacific. Conversely, it would bring an integrated regional trading bloc more directly into the Asia-Pacific in a way that may help spur further integration across the region. It would provide an anchor to New Zealand's broader political and foreign policy relations with Latin America and deliver on the strategic economic goal of diversifying and growing export markets. Current trade levels with the Pacific Alliance are modest but with strong growth potential across goods, services (education and tourism in particular) and investment. The cost of tariff duties on current exports to the Pacific Alliance is around \$69.5 million.

5 With respect to the objectives of Trade Agenda 2030, an agreement with the Pacific Alliance would, based on current trade levels, make a 1.4% contribution toward the target of ensuring 90% of exports are covered by FTAs by 2030. However, given that trade generally increases once a trade agreement is in force, that percentage is expected to increase, s9(2)(j) Potential growth opportunities in services and investment in the Pacific Alliance countries suggest that the increased focus in those areas as envisaged under Trade Agenda 2030 could pay dividends. Non-tariff barriers could be targeted for resolution, either as part of the FTA negotiation or subsequently through any framework established under the Agreement.

6 This paper seeks a mandate to launch FTA negotiations with the Pacific Alliance, which would in turn lead to New Zealand becoming an Associate Member of the group.

Background

7 The Pacific Alliance is a regional integration initiative established in 2011 by Chile, Colombia, Peru and Mexico. These countries are known as the "Pacific Pumas" for their consistent economic growth, outward looking perspective and commitment to open markets.

8 The Pacific Alliance consists of two core elements. The first is a Framework Agreement which sets deep regional integration objectives including opening of labour markets and integration of aspects of financial systems. Secondly, Pacific Alliance members agreed an 'Additional Protocol' in February 2014 which addressed more traditional trade and investment issues and is akin to an FTA in content.

9 New Zealand has been exploring options for deepening economic ties with the Pacific Alliance since 2014. s6(a)

11 In March this year the Pacific Alliance took a significant step in its external engagement by creating a category of "Associate Member" of the Pacific Alliance. Following that announcement, the Minister of Trade wrote to Chile, as President pro-Tempore of the Pacific Alliance, expressing New Zealand's interest in launching free trade negotiations and becoming an Associate Member of the Pacific Alliance. On 2 June, Pacific Alliance Ministers agreed a set of guidelines for countries interested in becoming Associate Members (outlined in paragraph 30 below), which includes as a necessary step negotiating a free trade agreement. This clears the way for an announcement on the launch at the Pacific Alliance Summit in Colombia 28-30 June 2017.

12 The purpose of this paper is for New Zealand to be prepared to formally launch negotiations at the Summit, and to approve a high-level mandate for the initial rounds.

Comment

13 The case for embarking on an FTA negotiation with the Pacific Alliance rests on a combination of strategic and commercial benefits. Securing a formal trade agreement with the Pacific Alliance would make New Zealand a part of a dynamic regional integration initiative, provide an anchor to New Zealand's broader political and foreign policy relations with Latin America and deliver on the strategic economic goal of diversifying export markets.

The strategic benefits

14 The Pacific Alliance ^{s6(a)}

has a stated objective "to become a platform for economic and commercial integration and projection to the world, with emphasis on the Asia-Pacific region". The Pacific Alliance has achieved a lot internally in its relatively short existence, and the next phase of its development is likely to be focused on engagement with external partners. The expected announcement at the Pacific Alliance Summit will put New Zealand at the forefront of that process.

15 The Pacific Alliance's trade protocol is relatively high quality, involving tariff elimination on all products of interest to New Zealand as well as services and investment chapters of an acceptable standard. A trade agreement between us that delivers comprehensive tariff elimination, including for agricultural goods, would show that high-quality market access outcomes can be reached, even in the current global climate.

16 With the Pacific Alliance now looking to the Asia Pacific, the time is right for New Zealand to leverage its position to act as a bridge between Latin America and Asia. Supporting the Pacific Alliance to make this transition would help to secure New Zealand as a strategic partner in the Asia-Pacific.

17 New Zealand has had a long-standing Latin America Strategy aimed at broadening and strengthening relationships with key countries in the region including Chile, Mexico and Peru. ^{s6(a)}

The Government's decision in 2015 to open an embassy in Colombia reflects its commitment to growing New Zealand's influence in Latin America and is recognition of Colombia's geo-strategic importance as a bridge between Central and South America. It is an important potential market for New Zealand exports but is not covered by other trade initiatives. The countries of the Pacific Alliance are also key partners for New Zealand in a range of international fora such as the UN, World Trade Organisation and the Asia Pacific Economic Cooperation.

18 A commitment to engage seriously with the Pacific Alliance, including through a formal trade agreement, should have positive benefits for New Zealand relations with the broader Latin American region. While our engagement to date has had a trade focus, these discussions have given us the avenue to start to build much broader relationships with key Latin American countries. The Pacific Alliance is also the focus of others in the region; both Costa Rica and Panama have indicated an interest in becoming full members of the Pacific Alliance, which could potentially broaden the scope of our future agreement with the group into Central America. New Zealand is also currently in discussions about a trade agreement with the other major Latin regional bloc Mercosur¹. ^{s6(a)}

19 Both the Business Growth Agenda and the new trade strategy (Trade Agenda 2030) have identified the need to diversify New Zealand's export market base. Securing

¹ The Southern Common Market comprising Brazil, Argentina, Uruguay and Paraguay.

high-quality access to a range of markets gives exporters options and helps to provide insulation to shocks that may affect any one market or region.

20 s6(a)

Adding a new model to the regional trade mix (provided it is high quality and comprehensive) should add value not just in terms of commercial benefits but also as a signal of continued political commitment to regional economic integration. This would be a good way to s6(a)

prevent a vacuum in rules making in the region from developing.

The commercial benefits

21 The Pacific Alliance represents a strong potential market for New Zealand goods and services exports. The four Pacific Alliance countries have a combined GDP of US\$3.85 trillion, which makes it the sixth largest economy globally when taken as a bloc². They have experienced generally consistent GDP growth since 2005, and over last two years alone the Chilean economy expanded 6.3%, Colombia and Mexico each about 7.5% and Peru almost 10%. Projected annual economic growth to 2021 varies from 4.5% in Mexico to 5.9% in Peru.

22 The Pacific Alliance group is home to 221 million people, around 35% of the total regional population. Per capita incomes vary from \$25,000 per annum in Chile to \$16,000 in Peru. Projected per capita income growth through to 2021 is 3.3% on average across the four countries. Evidence from Asia suggests that demand for many New Zealand food and beverage exports tends to expand at or about the GDP per capita levels currently seen in the Pacific Alliance.

23 Current trade levels with the Pacific Alliance are relatively modest. New Zealand exported \$722 million worth of goods and services to Pacific Alliance countries in 2016. The Pacific Alliance combined would rank as our 20th largest trading partner and accounts for 1.4% of New Zealand's global exports. More than half of current exports are dairy products. Butter fat exports to Mexico have grown rapidly, jumping from NZ\$57 million in 2014 to NZ\$251 million in 2016. Total imports from Pacific Alliance were \$455 million in 2016.

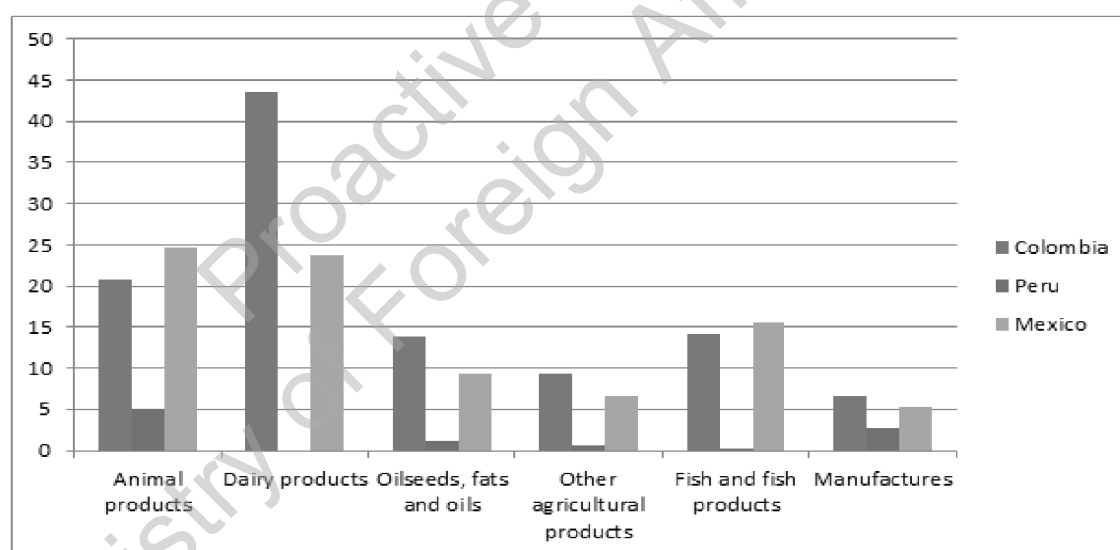
² GDP measured in Purchasing Power Parity terms.

Trade with the Pacific Alliance

New Zealand key exports			New Zealand key imports		
Exports	NZ\$ mil	% exports	Imports	NZ\$ mil	% exports
Butter fats	281	39%	Electric equip	64	14%
WMP SMP	87	12%	Wood & woodpulp	63	14%
Casein etc	69	10%	Medical equip etc	43	9%
Cheese	49	7%	Beer wine etc	42	9%
Ag machines	15	2%	Fruit	31	7%
Sheep meat	14	2%	Vehicles	29	6%
Tourism ³	12	2%	Plywood	17	4%
Yachts etc	12	2%	Coffee	14	3%
Education ³	7	1%	Tourism ³	9	2%
Totals ³	557	77%	Totals ³	312	69%

24 The cost of tariff duties on current goods exports to the Pacific Alliance is around \$69.5 million⁴ annually. New Zealand's top export product (dairy) faces some of the highest tariff barriers in the Pacific Alliance with an average tariff rate of 23.8% into Mexico and 43.5% into Colombia.

Average Tariff rates in Peru, Colombia and Mexico⁵



³ Of the Pacific Alliance countries, Statistics New Zealand only collects services trade data for Mexico. These figures refer to New Zealand services exports to Mexico only and therefore will underrepresent actual trade levels.

⁴ Based on aggregate values of trade for 5 product groups and associated aggregate tariff rates

⁵ Average Most-favoured Nation applied rates. Source: World Trade Organisation tariff profiles 2016

25 New Zealand currently has an existing trade agreement with Chile (the P4 agreement), which has seen tariffs eliminated on all goods trade; however the P4 agreement does not contain provisions on investment or financial services. Chile, Peru and Mexico are TPP signatories. Should TPP come into force in its current form, the benefits of a Pacific Alliance agreement on top of that would be in gaining access to the Colombian market and on any specific improvements possible beyond P4 and TPP. s6(a), s9(2)(j)

26 Given our similar production bases with the Pacific Alliance countries, we also see real opportunities for trade in technology and services that support those productive sectors. For example, exports of agriculture sorting and harvesting technology are higher to the Pacific Alliance compared to our normal trade profile with the world.

27 The current level of services trade with the Pacific Alliance is difficult to measure because data is only collected for Mexico. Trade in the two main services sectors, education and tourism, is around \$7 million and \$12 million respectively for Mexico alone. However, visitor numbers show that eight times more students from Chile and Colombia combined study in New Zealand than from Mexico (although the latter is a priority target for many New Zealand tertiary institutions). Therefore the total education export figure for the Pacific Alliance could be closer to \$56 million. Education New Zealand has identified Colombia as a market with growth potential and already has a market development manager based in Bogota.

28 Similar productive sectors can also lead to opportunities in investment. An existing example is Manuka Farms in Chile, a dairy farm established by a syndicate of New Zealand families together with Chilean shareholders. Manuka Farms employs 400 people, produces 120 million litres of milk per year and has become Chile's largest pasture based dairy producer.

29 In terms of the objectives of Trade Agenda 2030, an agreement with the Pacific Alliance would, based on current trade levels, make a 1.4 percent contribution toward the target of ensuring 90 percent of exports are covered by FTAs by 2030. However, given that trade generally increases once a trade agreement is in force, that percentage is expected to increase, s9(2)(g)(i) Potential growth opportunities in services and investment in the Pacific Alliance countries suggest that the increased focus in those areas as envisaged under Trade Agenda 2030 could pay dividends. An FTA with the Pacific Alliance would also provide a framework under which Parties can seek to address non-tariff barrier issues. s9(2)(j)

s9(2)(j)

Associate Membership

30 On 2 June Pacific Alliance ministers agreed a set of guidelines that set out the process toward becoming an Associate Members as follows:

- An interested country sends a formal request to the Pacific Alliance indicating their desire to become an associate member. The Alliance must accept the request to move to the next step.
- The Alliance agrees a Terms of Reference with the interested Party to guide a trade negotiation. The Terms of Reference should take into account high standards in trade and economic issues which favour the opening and integration of markets, including but not limited to trade in goods, trade in services and investment.
- The subsequent negotiation would be between the Alliance on one side and the interested Party on the other and is expected to be realised in the short term.
- Once the negotiation is successfully concluded, the interested Party would then be considered an Associate Member of the Pacific Alliance.

31 The Pacific Alliance has indicated that New Zealand has already completed the first step above. Chile has written to the Minister of Trade on behalf of the Pacific Alliance advising that an announcement to formally launch negotiations will be made by Pacific Alliance leaders at the Pacific Alliance Summit in Colombia 29-30 June 2017. s6(a)

32 The third bullet point of the guidelines above indicates that any negotiation would take place between the Pacific Alliance as a bloc and New Zealand. In previous discussions with the Pacific Alliance, New Zealand had suggested that we could simply accede to the existing Pacific Alliance trade protocol, as a way of reaching a high-quality agreement in quick time. s6(a)

the negotiation is likely to take the form of a more traditional FTA negotiation.

33 Regardless of the form of any agreement, officials' assessment is that a high-quality outcome should be possible with the Pacific Alliance, based on P4 and TPP experiences with Chile, Peru and Mexico. s6(a)

s9(2)(g)(i)

34 While a number of other countries have shown interest in starting negotiations with the Pacific Alliance, at this stage only Australia is in the same position as New Zealand and on track for announcement of the upcoming Summit.

Initial Mandate

35 Given the uncertainty to date around the form of any agreement with the Pacific Alliance, this paper does not seek a detailed negotiating mandate. However, to guide officials in initial negotiating rounds, this paper recommends that officials seek a comprehensive, high-quality agreement that meets New Zealand's key trade interests across goods, services and investment, s9(2)(j)

37 A more detailed negotiating mandate will be sought at a later date. s9(2)(j)

Consultation

38 The following departments have been consulted in the preparation of this paper and concur with its recommendations: Treasury, Ministry of Business Innovation and Employment, Ministry for Primary Industries, Customs, Education NZ, Ministry for the Environment and New Zealand Trade and Enterprise.

Financial implications

39 Committing to FTA negotiations with the Pacific Alliance will have fiscal implications. The costs of negotiating an agreement will be met from departmental

s9(2)(j)

baselines. The Ministry of Foreign Affairs & Trade received additional resource through Budget 2017 to progress these negotiations and strengthen the relationship with Latin American partners. There may be future implications for departmental resources relating to the content of the negotiations. Ministers would have the opportunity to consider any residual funding requirements through the Budget process. Potential costs include:

- The costs associated with the negotiations including preparatory work, research, travel, public engagement and the cost of hosting rounds;
- Any cooperation programmes agreed;
- Any reduction in New Zealand's existing tariff levels as part of an FTA would result in reduced Crown revenue. Current tariff revenue on imports from Pacific Alliance countries is around \$21 million per annum;
- Depending on the outcomes of any FTA, there may be costs associated with the implementation of the agreement.

40 Officials will provide more information to Cabinet on these costs as they become clearer throughout the course of the negotiations.

Human rights

41 There are no inconsistencies with the Human Rights Act 1993 and New Zealand Bill of Rights Act 1990.

Legislative implications

42 There are no legislative implications at this stage; however legislative amendments would be required to enable any completed FTA with the Pacific Alliance to enter into force.

Regulatory impact analysis

43 Not required at this stage. Should an FTA be successfully concluded, an extended National Interest Analysis (incorporating a Regulatory Impact Analysis) will be presented to Cabinet.

Gender implications

44 A gender implications statement is not required.

Disability perspective

45 A disability perspective statement is not required.

Publicity

46 The possibility of moving to deepen trade relations with the Pacific Alliance was flagged in Trade Agenda 2030. It is proposed that the Minister of Trade release a statement at the time of the launch of negotiations, which would also call for submissions

to allow business and the public to provide their views on the negotiation. A plan for ongoing public engagement will be developed to run for the duration of the negotiation.

Recommendations

47 The Minister of Trade recommends that the Committee:

1. Note that the Pacific Alliance is a regional integration initiative established by Chile, Colombia, Peru and Mexico that has already concluded a high-quality trade agreement among themselves and is looking to engage with countries of the Asia Pacific;
2. Note that New Zealand has been looking to deepen economic ties with the Pacific Alliance since 2014 and that the Minister of Trade wrote to the Pacific Alliance in May this year expressing New Zealand's interest in launching free trade negotiations and becoming an Associate Member of the Pacific Alliance;
3. Note that the Pacific Alliance is now in a position to formally launch FTA negotiations at the Pacific Alliance Summit in Colombia 28-30 June 2017;
4. Note that the case for embarking on negotiations with the Pacific Alliance rests on a combination of strategic and commercial benefits;
5. Note that securing a free trade agreement with the Pacific Alliance would:
 - 5.1. make New Zealand a part of a dynamic regional integration initiative;
 - 5.2. provide an anchor to New Zealand's broader political and foreign policy relations with Latin America; and
 - 5.3. deliver on a strategic economic goal of diversifying export markets and help to reinforce New Zealand's objective of achieving comprehensive tariff elimination in trade agreements, particularly for agriculture;
 - 5.4. bring a new model to the Asia-Pacific regional trade mix, which would provide a useful signal of continued political commitment to regional economic integration;
6. Note that current trade levels with the Pacific Alliance are relatively modest but with strong growth potential across goods, services (education and tourism in particular) and investment;
7. Note that the Pacific Alliance has developed guidelines for becoming an Associate Member that involve agreement on a Terms of Reference followed by a free trade agreement negotiation;

8. Agree that New Zealand can accept an invitation to formally launch trade negotiations with the Pacific Alliance, which if successfully concluded would see New Zealand become an Associate Member of the Pacific Alliance;
9. Agree that negotiators should seek a comprehensive, high-quality agreement that meets New Zealand's key trade interests across the core areas of goods, services and investment, s9(2)(j)
10. Note that a detailed negotiating mandate will be sought at a later date.
11. Note that the costs of negotiating the agreement will be met from departmental baselines, and that Ministers will have the opportunity to consider at a later date any additional costs that may arise from the content of any agreement.

Hon Todd McClay

Minister of Trade