

Trade Policy Review Body

TRADE POLICY REVIEW

NEW ZEALAND

Report by the Secretariat

This report, prepared for the third Trade Policy Review of New Zealand, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from the Government of New Zealand on its trade policies and practices.

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Document WT/TPR/G/115 contains the policy statement submitted by the Government of New Zealand.

Note: This report is subject to restricted circulation and press embargo until the end of the meeting of the Trade Policy Review Body on New Zealand.

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SUMMARY OBSERVATIONS**(1) ECONOMIC ENVIRONMENT**

1. Radical macroeconomic and structural reform, including unilateral trade liberalization, commencing in the mid 1980s, have transformed New Zealand from a rather closed economy into one of the most open in the world. The outcome has been a substantial improvement in its economic performance. New Zealand's success in withstanding recent external shocks, namely the Asian crisis and the global slowdown in 2001, as well as adverse climatic conditions, is also undoubtedly due in large part to these reforms.

2. Following these reforms, economic growth slowed initially from an average of 2% annually during 1970-83, to 1.7% annually between 1983 and 1991, but it then accelerated to around 2.7% during 1991-02. Real GDP is expected to grow by 4% in 2002/03. Much of this growth was due to a rapid expansion of labour inputs, as labour markets were reformed; labour productivity improvements have been moderate. Total factor productivity growth since 1996/97 has averaged some 0.6% annually. Other macroeconomic indicators, including unemployment and inflation, have also improved markedly. Despite this substantial acceleration in growth, New Zealand's real GDP per capita continues to be below the OECD average.

3. There are several possible reasons why growth has not met expectations. One is New Zealand's reliance on agricultural exports, for which demand has grown relatively slowly, and which face highly protected, and thereby distorted, world markets. Also, distortions in New Zealand's own agriculture sector, including export monopolies granted to state-trading enterprises that are gradually being removed, could have hampered efforts to improve productivity. Further, New Zealand's traditional concentration on agriculture, owing to its obvious comparative advantage in

producing such goods, may have prevented diversification into more innovative manufacturing and service sectors. Other possible reasons for growth not meeting expectations include: New Zealand's small size and geographic isolation from major markets, limiting the ability of its firms to exploit economies of scale and thus to export; insufficient private involvement in innovative activity, including investment in R&D; and the high cost of capital, possibly due to inadequate national saving.

4. The Government, in the hope of raising GDP per capita to the top half of the OECD ranking and thereby making up ground lost during the past few decades, has been re-examining some of its previous reforms. For example, the continued unilateral tariff liberalization that had been envisaged up to 2006, was frozen in 2000; further privatization of state assets was also halted. Moreover, in contrast to the period 1984-99, when its economic policy was largely "passive", the Government has adopted a more "proactive" approach. In particular, the recently launched "Growth and Innovation Framework" seeks to encourage the economy into higher-value-added activities, in which the Government believes New Zealand has comparative advantage.

(2) TRADE AND INVESTMENT POLICY FRAMEWORK

5. By and large, New Zealand has maintained an open and highly transparent trade and investment regime, based on regular and widespread public consultations. In addition, any papers considered by Cabinet must demonstrate that effective consultation has occurred and a regulatory impact/business compliance cost statement must accompany any legislative proposals by Cabinet. Although there are no independent agencies to review government policy, reviews are conducted periodically by the authorities.

6. Trade policy is formulated and implemented by the Ministry of Foreign Affairs and Trade, in close cooperation with

other ministries. Major changes to this framework since the previous Review include the creation of Industry New Zealand, and the Ministry of Economic Development, which "facilitates, leads and implements the Government's vision on sustainable development" and is involved in trade-related issues such as the ongoing tariff review and tariff concessions.

7. All trade-related legislation must be enacted by Parliament to carry the force of law in New Zealand. Similarly, New Zealand's international obligations, such as the WTO Agreements, must be enacted by Parliament to be enforceable in a national court of law.

8. As an original Member of the WTO and a small open economy, New Zealand believes that a rules-based system is important for promoting and safeguarding its trade interests. It participates actively in the WTO, grants at least MFN treatment to all WTO Members, and has submitted several proposals in the Doha Development Agenda negotiations, concerning further liberalization of agriculture as well as non-agricultural goods, strengthening of trade rules, and better integration of WTO rules with other priorities, such as sustainable development. As a member of the Asia Pacific Economic Cooperation (APEC) forum, New Zealand aims to meet the 2010 deadline for removal of trade and investment barriers, on a reciprocal basis.

9. Australia remains New Zealand's main trading partner. In addition to its well established agreement with Australia, the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), New Zealand has stepped up bilateral trade negotiations with other neighbouring countries. Thus, it signed a Closer Economic Partnership (CEP) agreement with Singapore, which entered into force in January 2001, and is negotiating a bilateral agreement with Hong Kong, China and a trilateral "Pacific three" agreement with Chile and Singapore. The CEP aims to reduce barriers to trade in goods, services, and investment, including

technical and health related barriers. The ANZCERTA has also undergone further changes since 1996, including harmonization of food standards, revision of the government procurement agreement, and further integration of air services through an open skies air services agreement, which incorporates the single aviation market arrangements between the two countries. New Zealand also maintains trade preferences on some goods with Canada under the Trade and Economic Cooperation Agreement.

10. In general, foreign direct investment (FDI) is relatively unrestricted, although "national interest" considerations apply to foreign investment in land. Permission must be sought for investment in certain kinds of land and for the acquisition of 25% or more in business or property above \$NZ50 million in value. For investment in farmland, additional criteria include that the investment result in, or is likely to result in, "substantial and identifiable benefits" to New Zealand, and that the land be offered for sale on the open market to non-overseas persons unless the requirement is waived. Restrictions also apply in certain sectors. Overseas persons are prohibited from owning fishing quotas unless the Minister waives this restriction; foreign equity restrictions apply in certain services, notably on airlines qualifying as a New Zealand airline, and in the largest telecommunications service company, Telecom.

11. With national saving falling considerably short of domestic investment, New Zealand is heavily dependent on net inflows of foreign direct investment to bridge the gap; such inflows reached 8.4% of GDP in 2000/01, but have been sluggish since then – indeed, there was a small net outflow of FDI in the year to March 2002. In an effort to attract more FDI, New Zealand has introduced changes in its investment regime and is considering changes to tax policy. As a result of a recent review of foreign investment policy, the Investment Promotion Agency (IPA) was created within Industry New Zealand. The IPA will initially attempt to

attract more investment in certain sectors; it will also seek to target transactions that "provide a meaningful contribution to the growth and development of the New Zealand economy." Currently, New Zealand does not provide any specific tax incentives to attract FDI, although such measures are apparently being considered.

(3) TRADE AND TRADE-RELATED REFORMS

12. As an integral part of its package of comprehensive market-oriented reforms initiated in the mid 1980s, New Zealand greatly reduced barriers to trade, largely unilaterally; in particular, tariffs were cut considerably and non-tariff barriers in the form of quantitative restrictions (including those on textiles and clothing) were eliminated.

13. With the elimination of quantitative restrictions, the tariff has become New Zealand's main trade policy instrument. Tariffs have been reduced sharply, with the average applied MFN rate down to 4.1% in 2002. Although average applied MFN rates are low, tariff "peaks" apply to textiles, clothing and leather products; consequently, the average applied MFN rate for textiles and clothing, for example, is 9.5%. Clothing products are subject to alternative specific tariff rates, which may conceal tariff peaks, and tariff escalation; as importers pay whichever of the two rates is the highest (depending on the import price), the use of alternative-specific tariff rates in place of ad valorem rates for the same product imparts a degree of complexity (and therefore opacity) as well as unpredictability to the tariff. Under a phase-out programme, applied MFN tariffs were due to be reduced further, to an average of 3% by 2000 and removed between 2001 and 2006. However, in 2000, further unilateral tariff reductions were suspended until 2005, pending an ongoing review; official statements have suggested that any future tariff reductions are more likely to be on a multilateral, regional or bilateral basis than unilateral. The tariff review will also have

regard to the APEC goal of removing trade and investment barriers by 2010, on a reciprocal basis.

14. Tariff concessions (on an MFN basis) may also be offered in certain cases for imports related to humanitarian work, for customs facilitation, trade policy, and industry assistance purposes. Moreover, for imports subject to alternative specific tariffs, importers may apply for a concession if they feel that the specific rate of duty they are required to pay is unreasonably high; tariff concessions granted in such cases reduce the tariff payable to the ad valorem component of the alternative specific duty. While such concessions tend to reduce the tariff peaks considerably, they raise questions regarding the usefulness of specific duties in the context of the New Zealand tariff and also tend to compound its complexity and unpredictability.

15. Unilateral tariff preferences are offered to developing and least developed countries under the Generalized System of Preferences (GSP) and to the Forum Island countries under the regional agreement, SPARTECA. Developing countries are accorded tariff preferences of up to 80% for all goods, except those on a negative list consisting of apparel, footwear, and some motor-vehicle parts and accessories. As of 1 July 2001, New Zealand removed tariffs on all imports from least developed countries. Forum Island countries have tariff-free access to the New Zealand market.

16. New Zealand maintains some restrictions on imports and exports mainly for health, safety and sanitary and phytosanitary reasons. Tariff quotas were scheduled for some agricultural products but have not been applied because the tariff is zero for these products. Export monopolies granted to state trading enterprises for some agricultural products have gradually been removed during the period under Review.

17. Efforts to assist exporters have also been stepped up as part of the Government's proactive policy. The New Zealand Export

Credit Office (ECO) was established in March 2001 to provide assistance for insurance or guarantees to small and medium-sized exporters. The Government expects to create a new organization integrating the export and business development services currently provided by the main export promotion and industry assistance agencies, Trade New Zealand and Industry New Zealand; the agency is expected to begin operating in July 2003.

18. Concerns about New Zealand's OECD ranking of GDP per capita have led to a re-examination of policies. In contrast to the 1980s and 1990s, when there was a concerted policy to reduce state ownership, the policy since 1999 has been to halt further privatizations especially of assets considered to be strategic. Further, in recent years, the Government has re-nationalized the Accident Compensation Corporation (ACC), and purchased a majority (80%) stake in the previously privatized Air New Zealand; it has also helped establish Kiwibank, which is owned by the state-owned New Zealand Post. The Government also indicated that it will be more proactive in encouraging the development of high technology sectors, in which it believes New Zealand has a comparative advantage. Thus, in addition to creating a supportive environment for business, the Government has established a new institution, the Investment Promotion Agency, to encourage FDI.

19. Elements of the tax system are also being examined to, *inter alia*, attract skilled labour to New Zealand. New Zealand's tax to GDP ratio is below the OECD average but higher than some of its neighbours. Indirect taxes include a goods and services tax (GST) levied with few exemptions. The Government is currently re-examining principal exemptions, such as those for imported and financial services. The corporate tax rate, at 33%, is lower than it was in the late 1980s, but still higher than the rate in New Zealand's neighbours, including Australia. Few tax incentives are provided. While a tax review carried out recently determined that the tax

system was basically sound, it suggested changes aimed at re-aligning the top rate of personal income tax with the corporate tax rate and reducing taxation of offshore income of temporary residents, including skilled workers. The Government has indicated that the recommendations arising from the review regarding international taxation warrant further consideration, including perhaps reduced taxation of FDI.

20. New Zealand's competition law, the Commerce Act 1986 has been changed to respond to the evolving industrial structure and competition in the economy. Measures taken since the previous Review of New Zealand include the strengthening of key provisions relating to the use of dominant position, and the prohibition of anti-competitive mergers and acquisitions. While the Act applies to the economy as a whole, partial exemptions from parts of the law are allowed for some entities and sectors, notably PHARMAC, the Pharmaceutical Management Agency, some state-trading enterprises, and services such as international maritime and air transport services. Sector-specific legislation has become necessary in telecommunications services, electricity, and the dairy industry, where incumbents have significant market power that could be abused, perhaps suggesting weaknesses in New Zealand's generic competition law in dealing with such issues. In addition to the Commerce Act, the Fair Trading Act lays down consumer information and product safety standards for traders. Under the ANZCERTA, dumping between Australia and New Zealand falls within the purview of competition law rather than anti-dumping legislation.

21. Since 1996, changes have been made to intellectual property rights legislation including for patents, trade marks, industrial designs, and copyright. The Geographical Indications Act was enacted but is not yet in force. Legislation on further changes to the Trade Marks Act and Plant Variety Rights Act is currently before Parliament, while the Patents Act is being reviewed. New Zealand's

intellectual property rights legislation has been examined in the TRIPS Council.

(4) SECTORAL POLICIES

22. *Agriculture remains an important export sector, although its share of GDP is relatively small (5.4%). The authorities maintain that the economy's growth is hampered by tariff and non-tariff barriers in New Zealand's key agricultural export markets. The main exports are dairy and meat products and, to a lesser extent, cork and wood, and fruit and vegetables. The sector receives very little support in the form of subsidies or border protection. New Zealand's overall producer support estimate (PSE), at close to zero, has remained one of the lowest among OECD countries for several years, and agricultural imports face relatively low tariffs. Research and development by the industry tends to be funded through commodity levies under the Commodity Levies Act. For some products (most non-pasteurized cheese, fresh eggs, and poultry), there are currently no imports, perhaps indicating that the associated SPS measures might be unduly restrictive.*

23. *The main changes in agricultural policy relate to the restructuring of state-trading enterprises (STEs), including removing their statutory export monopoly rights, and in the case of the dairy industry, introducing new legislation to prevent the abuse by the main company of its dominant position. As a result, the only remaining STE that maintains a monopoly on exports is the Hop Marketing Board; legislation to remove this monopoly is currently before Parliament.*

24. *Food products account for around 31% of manufacturing. Other industries include textiles, clothing, footwear, and leather. In contrast to food products, which receive relatively little protection from tariffs, textiles, and especially clothing, imports face relatively high tariffs. They are also subject to relatively high tariff escalation. As part of its "Growth and Innovation Framework", New Zealand is targeting certain high technology sectors such as biotechnology,*

information and communications technology and creative industries, sectors in which the Government believes New Zealand has a comparative advantage.

25. *At around 67% of GDP in 2001/02, services is the largest sector in New Zealand. Its main exports include education, professional services, travel, and transport. Tourism and related services is one of the fastest growing service exports. State intervention in most services is minimal, although the Government retains control of some companies, including the three main electricity generators, and maintains significant state ownership in the transport sector. Competition issues in some services are now covered by sector-specific policies: in addition to the Commerce Act, sector-specific legislation was introduced to address issues relating to industry structure and market power in electricity and telecommunications.*

(5) PROSPECTS

26. *While New Zealand's economic performance during the past decade has been fairly strong, efforts are being made to accelerate growth. There appears to be a broad consensus that this can only be achieved through an improvement in the growth of productivity, particularly total factor productivity.*

The Government has responded by introducing a new proactive approach to economic policy in order to encourage innovation, including in high technology industries, such as biotechnology, information and communication technologies, and creative industries; efforts are also being made to attract skilled labour and foreign investment to New Zealand. In addition, policies to encourage New Zealand companies to become more export oriented are being implemented. However, while government policies do have a role in creating an environment that is conducive to innovation and improved productivity, it is not clear how a freeze in certain reforms, such as unilateral tariff

reductions and privatization, can improve productivity and growth and thereby help achieve the Government's objective of raising New Zealand's per capita income to the top

half of the OECD rankings. Moreover, as government intervention is seldom costless, care needs to be taken to ensure that the benefits of such intervention exceed its costs.