

# Trade Sustainability Impact Assessment in support of FTA negotiations between the European Union and New Zealand

## **Draft Final Report**

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### **EXECUTIVE SUMMARY**

1. This draft final report for the Trade Sustainability Impact Assessment (SIA) in support of the free trade agreement (FTA) negotiations between the European Union (EU) and New Zealand presents findings of the potential economic, social, human rights and environmental impacts stemming from provisions in the FTA or being a consequence of removing or reducing barriers to bilateral trade and investment between the EU and New Zealand. The report also provides a number of recommendations, derived from the analysis, on issues to be incorporated into the FTA and mitigating measures.

2. The starting point for the SIA analysis was the simulation of the FTA's economic effects undertaken by the European Commission DG Trade in early 2019 using a Computable General Equilibrium (CGE) model, which simulates the effects of two alternative negotiation outcomes with different degrees of liberalisation: 1) a conservative scenario, which comprises elimination of tariffs on non-agricultural products (but not agricultural products), and some services trade liberalisation; and 2) an ambitious scenario, which comprises a full elimination of tariffs and quotas also on agricultural trade as well as a reduction of some non-tariff barriers on non-agricultural goods. It should be highlighted that this ambitious scenario is based on a theoretical assumption of a full elimination of tariffs and quotas in the agricultural sector. Such scenario has not been followed by the Commission in any trade negotiation.

3. It should be noted for clarification, that the CGE model considers the FTAs with Australia and New Zealand jointly. The model simulates the long term effects of the FTA by comparing the situation in 2030 with the FTA (in the conservative or the ambitious scenario) with the "baseline" situation of having no FTA in place. The expected economic effects of the FTA then constituted the basis for additional quantitative and qualitative analysis of the FTA impact on other economic issues, social indicators and gender equity, human rights, and climate change and the environment. Consultations with stakeholders in the EU and New Zealand were also undertaken through online surveys, requests for position papers, interviews, and meetings.

#### **Overall sustainability analysis**

4. From an **economic** perspective, the FTA is likely to have a small but positive *overall impact* on both the EU and New Zealand, based on an analysis also incorporating an FTA between the EU and Australia (Table 1). In the EU, welfare in 2030 is expected to increase by €4.1 billion and real GDP by €3.9 billion, compared to a situation without the FTA, and New Zealand welfare and real GDP are expected to increase by €567 million and 1.3 billion,

respectively (in the ambitious scenario). Bilateral exports are expected to increase by 32.5% and 23.4% respectively for the EU and New Zealand in the ambitious scenario. Gains of the FTA are balanced, with New Zealand benefiting more in terms of real GDP growth (in percentage terms) while the EU gains more in trade. Price effects are minimal, as are wage effects in the EU, while New Zealand is expected to see some real wage gains.

Table 1: Summary of macroeconomic effects

	EU27		New Zealand	
	Conservative	Ambitious	Conservative	Ambitious
<b>Major macroeconomic indicators</b>				
Welfare (€ million)	2,176	4,086	381	567
Real GDP (€ million)	1,755	3,917	680	1,333
<b>Trade effects</b>				
Bilateral exports (% change)	16.1	32.5	10.2	23.4
<b>Factor markets</b>				
Real wages unskilled labour (% change)	+0.0	+0.0	0.3	0.7
Real wages skilled labour (% change)	+0.0	+0.0	0.2	0.5

Source: Authors' calculations based on the CGE results provided by DG Trade

5. The *impact on sectors* in the EU in terms of output change is limited. The most positive effects (of up to 0.4% under the ambitious scenario) are predicted for the motor vehicles, machinery and gas sectors. Conversely, a number of sectors are expected to experience some contraction compared to a no-FTA situation, in particular beef and sheep meat (-1.4% in the ambitious scenario). Sectoral output effects in New Zealand are almost a mirror image of EU effects but slightly larger in scope, with increases in beef and sheep meat (+4.1% - but only in the ambitious scenario) and other agricultural sectors as well as utilities, and decreases of up to -2.8% in machinery and motor vehicles. Services sectors in New Zealand benefit across the board. Effects on EU services sectors are much smaller in relative terms but also positive.

6. The FTA is expected to have a positive *impact on small and medium-sized enterprises (SMEs)* in both the EU and New Zealand, as it would improve market access for SMEs through trade and investment liberalisation, global supply chains, and the overall reduction of administrative costs via lower entry and operating expenses. *Investment liberalisation* under the FTA could lead to an 87.2% increase in EU FDI flows to New Zealand and a 20.8% rise in inward FDI stock. *Preferential procurement* liberalisation is associated with a 50.4% increase in public imports.

7. The FTA's anticipated *effects on Turkey and the Least Developed Countries* are negligible, and on the *EU's Outermost Regions and Overseas Countries and Territories* expected to be small.

8. The **social impact** analysis shows that *employment* effects will be limited in most sectors. Keeping in mind that the economic model holds overall employment constant and is thus able only to show relative shifts across sectors, the simulations predict that employment in the EU will shift, again comparing the situation in 2030 with the FTAs in place against a situation without the FTAs, from some agricultural sectors (ruminant meat, rice, sugar, vegetables, fruits and nuts) and the coal sector to motor vehicles and transport equipment, and gas. In New Zealand, sectoral employment shifts are expected to be somewhat larger, with the highest job reductions (of up to 3.4%) in the machinery and motor vehicles and transport equipment sectors, and the largest job creation effects in the ruminant meat sector (up to 4.2%) as well as in vegetables, fruits and nuts (up to 2.8%). The FTA could also contribute (under the ambitious scenario) to an increase in employment opportunities for migrant workers in New Zealand, if facilitated.

9. The FTA is expected to have a positive but limited impact on *real wages* in New Zealand (increase of up to 0.7% for unskilled workers and 0.5% for skilled workers), and a marginally positive effect on wages in the EU. Even if wages for unskilled workers in New

Zealand rise marginally more than for skilled ones under both scenarios, the estimated differences are too small to bring about a reduction in inequality. Given that social impacts of the FTA for the EU are expected to be very limited to negligible, it is likely that impacts on job quality indicators at the EU level will also be negligible. In New Zealand, if positions of seasonal and migrant workers are protected and labour laws adhered to, the FTA effect on the quality of work in New Zealand could be positive. Regarding children's rights and the ratification by New Zealand of the fundamental ILO Minimum Age Convention No. 138, it is to note that the European Commission highlighted to New Zealand a need to ratify that convention.

10. The FTA impact on women in their roles as workers, entrepreneurs, traders and consumers, overall, is expected to be limited. Both in the EU and New Zealand, women tend to work more frequently than men in services sectors, which are not expected to see any major changes in employment levels as a result of the FTA. Regarding women as consumers, the FTA impact is anticipated to be negligible.

11. The **human rights effects** of the FTA are expected to be very small. Following screening and scoping, the in-depth analysis focussed on the right to work, and the right to health and access to essential medicines.

12. With regard to the *right to work*, increased trade flows between the EU and New Zealand triggered by the FTA are expected to promote economic growth as well as an increase in employment overall – this finding is a result of the predicted increases in wage levels at the overall level in the model which holds total employment constant. At the sectoral level, however, effects vary: The right to work is expected to be positively affected in the sectors that benefit (e.g. dairy in New Zealand; motor vehicles and machinery in the EU), but could come under pressure in those sectors that decline (e.g. ruminant meat in EU; machinery and motor vehicles in New Zealand). In some sectors gains and losses also lead to a broader impact on human rights: e.g. rights of indigenous peoples could be affected in those sectors that actively employ Māori and Pacific People in New Zealand. New Zealand did not ratify the ILO Conventions No.169, No. 138 and No. 087 and the International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families. Because of the reported existing sensitivities with respect to these vulnerable groups, stakeholders expressed concern that labour rights may not be adequately protected and impair implementation of the standards voiced in the textual proposal for the TSD Chapter of the FTA. Overall, inclusion of the TSD Chapter is expected to have a direct positive impact on labour rights in both EU and New Zealand, although protection of specific vulnerable groups (e.g. women, indigenous peoples) seems not to be addressed in detail, there is a commitment in the TSD Chapter to respect the Core labour standard of elimination of discrimination in respect of employment and occupation.

13. The *right to health* is only marginally affected by the FTA because factors determining the right to health tend to be more of a domestic nature. However, there are some links, e.g. via the right to a clean environment and the right to water. Access to medicines does not depend strongly on the FTA but rather on how New Zealand and EU Member States organise their healthcare systems. Whether IP systems are correlated with healthcare expenditures is not clear, but faster access to new drugs is mainly associated with regulatory approval processes. Finally, the right to a clean environment is to a limited degree affected by the FTA because the growth in trade in general and agricultural production in particular could lead to more emissions and could pose extra challenges for New Zealand to keep out invasive foreign species that could affect the delicate biodiversity balance, and the latter could lead to more emissions related to the beef and sheep meat sector as well as pressure on the environment via changes in land use.

14. From an **environmental perspective**, the most substantial expected impacts of the FTA are related to climate change, land use and biodiversity.

15. With regard to *climate change*, non-CO<sub>2</sub> greenhouse gasses (GHG) emissions are expected to increase in case of an ambitious scenario, resulting from increased production in New Zealand (e.g. in the beef and sheep meat sector) and in the EU. This increase is *partially* offset by decreasing emissions in other countries. Global non-CO<sub>2</sub> GHG emissions are expected to marginally increase as result of trade creation. It is expected that New Zealand and the EU will reaffirm their commitments to (implement) the Paris Agreement, their Nationally Determined Contributions (NDC) and other multilateral environmental agreements. Both parties are also expected to commit to promoting mutual supportiveness of trade in environmental goods, and climate policies and measures, which are in themselves positive provisions.

16. The FTA is expected to have a negative impact on *land use* in New Zealand. This is driven by the expected increase in production in the beef and sheep meat sector and the fruits and vegetables sector under an ambitious FTA, compared to the business as usual situation. The expected increases in agricultural production could increase pressure on biodiversity and water quality.

### **Sector analyses**

17. The SIA also provides more detailed assessments of the **FTA impact on five economic sectors** – ruminant meat, dairy, machinery, motor vehicles and transport equipment, and communication services – as well as four case studies – vegetables, fruits and nuts; children’s rights and poverty; ecosystems and biodiversity; and aluminium. The sector analysis findings can be summarised as follows.

18. *Ruminant meat*: In the EU, output of ruminant meat is estimated to decrease by 1.4% under the ambitious scenario (compared to a situation without the FTA), and increase by 4.1% in New Zealand (under the conservative scenario, since no liberalisation of the sector is assumed, the effects would be limited). This economic impact drives potential social and human rights effects: sector employment in the EU is expected to be lower than without the FTA but higher in New Zealand. The FTA could also contribute to an increase in employment opportunities for migrant workers in New Zealand, if recently identified staff shortages are not met by local workers. In terms of human rights effects, the FTA could in this scenario negatively affect the right to work and the right to an adequate standard of living for beef and sheep meat producers in the EU and affect these rights positively for New Zealand. Due to a high share of non-dairy farming in specific EU Member States, e.g. Ireland, Poland or Romania, liberalisation could be phased in or be partial to cushion the potential effects on workers. Based on the environmental analysis, the EU-NZ FTA is expected to increase to a marginal extent the pressure on the right to a clean environment. Methane and nitrous dioxide emissions in New Zealand are predicted to increase in the ambitious scenario, but fall in the EU. Secondly, the predicted increase in beef and sheep meat production in New Zealand (in the ambitious scenario) will also lead to increased pressure on water quality in New Zealand since the amount of nitrogen from urine and manure is expected to increase proportionally to the growth in the number of cattle in the ambitious scenario. Also, soil compaction will increase due to a higher number of cattle. Lastly, biodiversity can be harmed by land clearing, but this is likely minimal since increases in output in recent years have rather led to intensification of land use rather than more land clearing.

19. *Dairy*: In the EU, output of the dairy sector is estimated to rise by 0.1% in the conservative scenario and decline by 0.1% in the ambitious liberalisation scenario. For New Zealand, in contrast, the estimated percentage change in total dairy output is -0.8 percent and 0.5 percent, respectively, under the two scenarios. As for ruminant meat, the explanation for these results lies in the scenario definitions. In the conservative scenario there is no trade liberalisation in the dairy sector, which means that the dairy sector in New Zealand will not be benefitting from the FTA. In the ambitious scenario, increased market access for New Zealand dairy sector exports leads to a drop in production in the

EU, a rise in production in New Zealand and large increases in trade. Employment effects in the sector are expected in line with the estimated changes in output. Impacts on changes in wages and prices are negligible. Given the limited employment effects in the dairy sector, it is rather unlikely that the FTA will bring about noticeable changes in job quality indicators or respect for rights at work. The limited economic impact of the FTA on the sector is why also environmental and human rights effects are expected to be small, given the characteristics of the dairy industry. The effect on the right to work and right to health are negligible. The right to a clean environment is negatively affected by the FTA in the dairy sector due to the sector's environmental footprint, but only marginally so. The overall impact on climate change from FTA-induced sector effects can be considered to be small, also because dairy farming is conducted more intensely than beef and sheep meat farming. The predicted increase in dairy production in New Zealand could however lead to increased pressure on water quality in New Zealand. Since dairy farming is conducted more intensely than meat farming, the overall level of eutrophication is likely to be lower, but the localised impact on water in certain places higher (where farming output will be expanded). The impact of the FTA on biodiversity from dairy farming is likely to be minimal due to the relatively minor increase in output due to the FTA and the intensive way of production of dairy.

20. *Machinery*: Output of the EU machinery sector is expected to benefit marginally in the conservative scenario and increase by 0.1% in the ambitious scenario. Given the size of the sector, this small relative increase is still significant, making machinery one of the most important sectors for the EU in the FTA. For New Zealand, in contrast, the estimated change in machinery sector output is -0.6% and -2.8%, respectively, under the two scenarios. Bilateral sector exports are predicted to increase both-ways. Employment effects in the EU are in line with output effects, and slightly stronger in New Zealand, with sectoral employment estimated to be 3.4% lower for unskilled workers and 3.1% lower for skilled workers (in the ambitious scenario). If the trend of job loss in the sector observed until 2017 continues, then the estimated employment effects of the FTA could strengthen the negative effect on workforce in the sector. The economic and social results imply that there will be no impact on the right to work related to employment for the EU workers in this sector. For New Zealand, employment changes suggest a limited negative impact on the right to work under the ambitious scenario. In the context of the predicted reduction in employment and taking into account the high share of migrant workers employed in the sector, there is a risk that they may be treated disproportionately negatively. If agreed in negotiations, provisions on specific vulnerable groups under the TSD chapter could encourage the Parties to take further unilateral actions and pursue bilateral cooperation and dialogue in this area which may have a positive impact on labour rights of the workers. Environmental effects derived from the economic effects are expected to be negligible. An impact from the FTA could still be expected if regulatory cooperation between the EU and New Zealand foreseen in the FTA would lead to a further heightening of any environmental standards in either region, such as for example on the energy efficiency standards of those products, eco-design or waste legislation. However, given the FTA's principles of countries maintaining their full autonomy and right to regulate on domestic policies, no material impact is expected on this front.

21. *Motor vehicles and transport equipment*: In the EU, output of motor vehicle & transport equipment is estimated to increase by 0.3% under the ambitious liberalisation scenario, compared to a situation without the FTAs. In New Zealand, sectoral output is expected to decline by -2.7% in the ambitious one (albeit from a much lower baseline value). Employment effects are in line with the economic effects. Effects on the right to work, the right to an adequate standard of living, and the right to a clean environment are expected to be marginal in the EU. For New Zealand, employment changes suggest a modest negative impact on the right to work (and indirectly, right to an adequate standard of living) for both skilled and unskilled workers. From an environmental perspective, due to the higher level of fuel efficiency (measured in CO<sub>2</sub>/km) of EU cars, there is potential for the FTA to lower the climate change impact in the road transportation sector in New

Zealand in case car manufacturers in the EU sell the same cars in New Zealand as in the EU. An impact from the FTA could also be expected if regulatory cooperation between the EU and New Zealand foreseen in the FTA would lead to a further heightening of any environmental standards in both regions, such as for example on Euro, CO<sub>2</sub>, or ELV standards. However, given the FTA's principles of countries maintaining their full autonomy and right to regulate on domestic policies, no material impact is expected on this front.

22. *Communication and business services*: The analysis focuses on communication services, in particular telecommunication, and other business services, mainly professional services. A limitation in the analysis is that the economic model uses more aggregated sectors. In the EU, the FTA is expected to have only negligible impacts on output of "communication services" and "other services". In New Zealand, output of communication services is expected to be 0.2% and 0.5% higher, respectively, under the conservative and ambitious scenarios than without the FTA. For "other services" New Zealand's output is estimated to be 0.2% in the conservative scenario and 0.3% in the ambitious one. Based on the results of the economic modelling, no changes in employment levels in the EU in the sector are expected, and changes in New Zealand are roughly in line with the predicted output changes. Based on textual proposal tabled by the EU, the FTA has also potential to open the way to further mutual recognition of professional qualifications between the Parties and to facilitate in this way mobility of professionals and supply of services between the EU and New Zealand. Human rights impacts for the sector are not likely. Finally, environmental effects are expected to be marginal.

## **Recommendations**

23. For a concise overview of all **policy recommendations** as well as **recommended flanking measures**, we refer to the Chapter 6 in the main report, which provides a concise summary of the recommendations made throughout the study.