

New Zealand-Russia FTA: Another BRIIC in the wall

Think about it this way....the gains from an FTA are strategic

The Prime Minister and Trade Minister have announced that New Zealand will be entering free trade agreement (FTA) negotiations with Russia, Belarus and Kazakhstan (RBK) with the aim of concluding talks in 2012. NZIER modelling indicates the FTA will deliver gains of around \$27 million to New Zealand. Dairy and meat exports to RBK will soar.

More importantly it will position New Zealand close to one of the world's emerging superpowers. It will ensure that we are never treated less favourably than Russia's other trading partners. It is part of ensuring New Zealand continues to be a world trader. This announcement is a good example of how New Zealand's trade policy is becoming increasingly strategic and long term in nature. It also emphasises the need to develop a new way of assessing the long term dynamic gains from trade agreements.

Developing a trade and economic relationship

On the face of it, RBK is not an obvious target for an FTA. Russia is New Zealand's 30th largest export market (\$187 million in CY2009), with Kazakhstan being 119th (\$1 million) and Belarus 184th (less than \$1 million). New Zealand's combined exports to RBK are concentrated in our traditional strengths: butter, cheese, lamb and beef, seafood and fruit. Services trade and the investment relationship are harder to measure.

Table 1 New Zealand's key exports to Russia

	\$ millions
Butter	104,737
Sheep meat	21,487
Cheese	14,351
Frozen fish	11,566
Coin	6,211
Apples	6,088
Malt extract	5,566
Meat offal	3,103
Molluscs	2,775
Frozen beef	1,411
Horse meat	1,127

Source: Statistics New Zealand

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An FTA will boost our exports

Using the GTAP general equilibrium model of the world economy, we estimate that a comprehensive FTA with RBK would have the following impacts on New Zealand:

- We would be \$27 million per year better off (measured by Equivalent Variation – a measure of welfare or living standards)
- Dairy exports to RBK would rise by 170%
- Meat exports would treble
- Fish exports would rise by 25%
- Returns to land would rise by 0.56%.

By themselves, these outcomes are worthwhile, and would make a small contribution to promoting a rebalancing of the New Zealand economy away from domestic consumption towards export-led growth. But this isn't the end of the FTA story – indeed, it's just the beginning.

We need to look beyond the immediate gains

Given the negotiating resources required to make it happen in a fiscally constrained environment, the question might be asked: is an FTA all really worth it for a measly \$27 million? The answer is “Absolutely”.

This is because an FTA with RBK is not really about the immediate gains that we would get from tariff removal. Harder to quantify and longer term benefits include:

- **Goodwill.** An FTA is a chance to cosy up with the world's 12th largest economy. This is useful in a political economy sense – it is good to have global superpowers well disposed towards New Zealand. Taking the opportunity to show a willingness to engage with RBK, when other countries are not, could well have significant pay-offs down the track.¹
- **Brand awareness.** The trade relationship will grow over time – RBK has a growing number of wealthy consumers looking to enjoy high quality food and beverage products. We want New Zealand products to be ‘top of mind’ when RBK consumers go to their supermarkets, and the publicity and goodwill that an FTA negotiation will deliver will help this.
- **Exporting expertise.** We have technology and knowledge in the agricultural sector that RBK needs to develop its own primary products. We can sell this intellectual property and know-how at a premium.
- **Future proofing.** An FTA now will ensure that New Zealand's exporters are never disadvantaged relative to our competitors who will also want to service this growing demand. And should RBK start to sign FTAs with other, bigger economies in Europe and elsewhere, there may be valuable opportunities for New Zealand to be tacked onto these agreements at relatively low cost
- **Peer pressure.** It increases the pressure on countries, such as Japan, to negotiate high quality FTAs, not just with New Zealand but countries with whom New Zealand has signed high quality FTAs.
- **Dynamic gains.** Our modelling results are from a scenario where all tariffs and on-tariff barriers between New Zealand and RBK are reduced to zero immediately. In this respect, it's over-optimistic. However, this estimate of benefits is from goods liberalisation only. It doesn't

¹ Remember that New Zealand's now flourishing relationship with China stemmed from a similar position. We showed considerable political adroitness by being the first country to recognise China as a market economy and then supporting its WTO aspirations. These gestures played a significant part in New Zealand being the first developed country to sign a highly lucrative FTA with China.

take into account the gains from services liberalisation, investment liberalisation and other dynamic gains from trade.

New Zealand's trade policy is highly strategic

These points all highlight why the Trade Minister has not wanted to place a single value on the potential benefits from an FTA with RBK – focusing on the \$27 million gain from tariff and no-tariff barrier removal alone would substantially underestimate the value to New Zealand from this agreement. Rather the FTA is another example of how New Zealand's trade policy is changing over time. Instead of focusing on tariff reduction, our FTAs are increasingly about building long term political and economic relationships, future-proofing market access and creating the conditions for enhanced services and investment trade.

It has long been forecast that the BRIICS countries (Brazil, Russia, India, Indonesia, China and South Africa) will be the group that drives global economic growth in coming decades. It is no coincidence that New Zealand now has, or is negotiating, FTAs with four out of the six (Russia, India, Indonesia and China). A betting man would probably get short odds on New Zealand announcing developments with Brazil and South Africa in coming years as well.

So analysing the gains from FTAs requires a strategic way of thinking

In order to persuade stakeholders – including other agencies who need to commit resources to the negotiating process – of the importance of FTAs that are as much strategic as economic in nature, ministers and trade officials need to be able to outline the potential gains from closer economic relationships in a much broader way. This suggests that there may be value in developing a set of explicit assessment criteria against which FTA targets could be 'scored'.

In addition to the traditional measures of potential goods trade expansion such as those presented above, the criteria might include, for example:

- Future size and growth of middle- and upper-income populations that will present sales opportunities for New Zealand exporters
- Potential gains from services trade liberalisation
- Prospects for improved investment opportunities and investor protection
- Areas where New Zealand might exploit its technological know-how and IP
- Potential benefits from retaining preferential (or at least no less favourable) market access over competitors
- Possibilities of the FTA target signing FTAs with other economies that we could latch onto
- Areas of potential cooperation in multilateral fora (e.g. United Nations, climate change negotiations, etc) in which New Zealand and the potential FTA partner both participate, and where New Zealand might want to call in some favours.

By their nature, these aspects of potential gains from FTAs are difficult to estimate with any degree of accuracy. However, if they are to be the major sources of benefits to New Zealand, then any FTA assessment should be clear on how important they might be. This would help officials to explain to New Zealand firms and other stakeholders why future FTAs are a sensible use of scarce negotiating resources.

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