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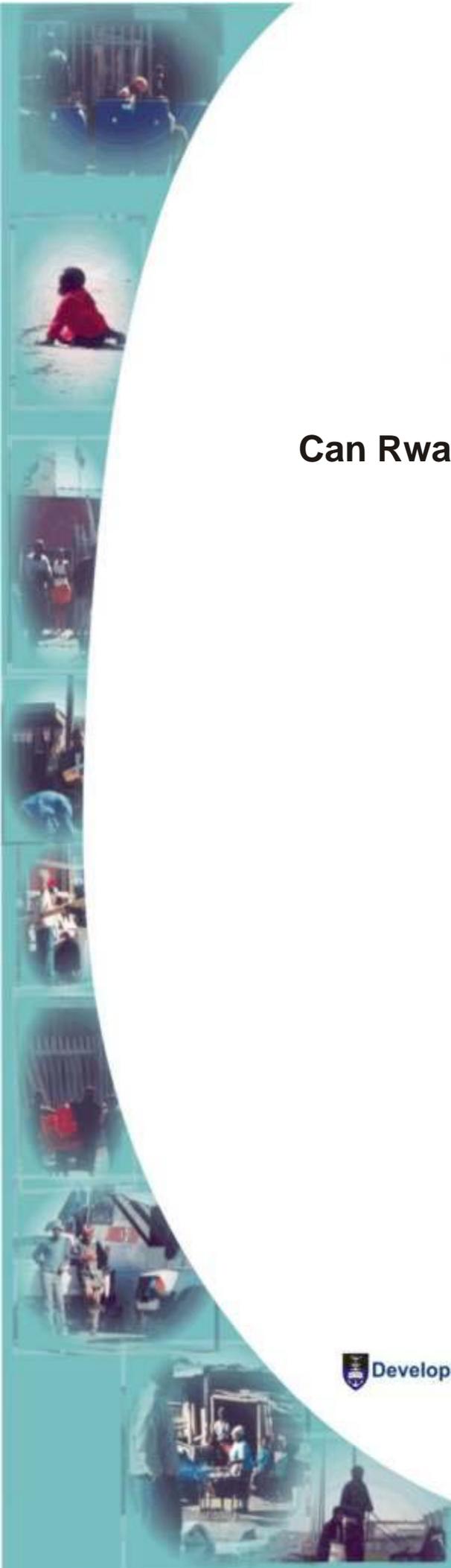Development Policy Research Unit   Trade and Industrial Policy Strategies
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Key Points

This study finds that export trade widened rather than deepened as a result of the CER trade agreement with Australia. Trade has expanded in those products that were not heavily traded prior to the agreement as opposed to an expansion of "traditional" exports that were traded at the start of the agreement.

This finding is therefore consistent with other recent empirical research undertaken on this new aspect of trade expansion, and gives weight to the suggestion that these agreements are beneficial not just in the short or "static' term, but in the longer or "dynamic" term. While often cited as a benefit of bilateral liberalisation, this widening feature of a trade agreement is not generally forecast in traditional computer modelling exercises.

Importantly, the analysis of the trade expansion to the 'rest of the world' indicated that much of the result may be directly attributable to CER and not a change in worldwide trade patterns. Moreover, this widening was most pronounced in manufacturing lines, reinforcing the value of CER in that it had not merely diverted our traditional (and supply constrained) exports away from third markets. This was underlined by a similar analysis of the "mirror" imports of manufactured products from New Zealand into Australia. This showed an increase post-CER and confirms the trade widening hypothesis.

As New Zealand prepares to begin negotiating an FTA with China, this study adds weight to the general conclusion that comprehensive bilateral agreements are likely to produce more welfare benefits than may be forecast by traditional means (ie computer models). It also supports the broad assumption that trade agreements are likely to significantly contribute to a growth and innovation export-oriented drive.

Introduction

While multilateral liberalisation remains the cornerstone of New Zealand's trade policy, in recent years the bilateral relationship has become an increasingly important component as well. These bilateral Free Trade Agreements (FTAs) – sometimes referred to as Closer Economic Partnerships (CEPs) - have, however, been criticised on the basis that indications from modelling suggest limited economic welfare gains. While this may be true in the traditional and narrow economic sense, benefits, including business-to-business relationships and investment effects, are more extensive than just the tariff elimination effects and over the longer term may prove to be more valuable.

Another potential and usually overlooked benefit is that of trade widening. This takes place when new trade is created as a result of the CEP. It is defined as an expansion of trade in new areas that did not take place prior to the CEP. It is distinct from trade deepening, defined as an expansion of trade in the sectors as they were at the inception of the CEP. Trade widening is a feature of CEPs that will be difficult to capture by traditional computer general equilibrium (CGE) models. These CGE models operate at the margin, with output predicated upon existing production and trade relationships. Although these models can conceivably allow for the development of new trade, or trade expansion based upon pre-existing but limited trade, such analysis does extrapolate further than a marginal analysis, and model results must be treated with caution once they move outside of the realm of marginal analysis. At the same time one must exercise caution in that trade patterns change over time for a variety of reasons such as taste and preference changes and developments in technology. In short, change cannot be attributed to tariff liberalisation alone.

For New Zealand, the logical place to examine the extent to which trade widening may have occurred following a CEP is to analyse the trans-Tasman Closer Economic Relationship (CER) agreement between New Zealand and Australia. Long considered one of (if not the) most comprehensive agreements in the world, the original CER Agreement was signed in 1983. It was negotiated against a backdrop of dissatisfaction with the managed incremental approach of NAFTA (New Zealand Australia Free Trade Agreement) and a view that the greatest possible liberalisation of trans-Tasman trade would bring significant benefits to both the Australian and New Zealand economies. It has become integral to New Zealand's economic structural adjustment process and our drive for increased international competitiveness.

The provisions of the original treaty were substantially accelerated, deepened, and widened by a general review undertaken in 1988. The agreement was further refined and consolidated by a second review, completed in October 1992. Full free trade in goods was achieved in July 1990, five years earlier than originally planned, with the removal of all remaining tariffs, quantitative restrictions and export incentives on trade in goods between the two countries. Trans-Tasman anti-dumping provisions were removed from 1 July 1990, with trade now subject only to the disciplines imposed by domestic competition laws, and the application of countervailing duty in respect of Government subsidies. Thus, while increasingly comprehensive (and still evolving),

CER had an incremental rather than a "big-bang" start. This makes it harder to define a definitive point at which it is possible to nominate the birth of CER as we know it. An arbitrary decision was made to define 1988 as this auspicious date on the pragmatic grounds that only the statistical data series from 1988 onwards is fully compatible.

Another related but equally crucial issue associated with CEPs is whether they create new trade or divert trade away from the benchmark world least-cost suppliers. The former is welfare enhancing, while the latter is not. Recent research (the Australian Productivity Commission, 2003[1], for example) has cast doubts on many CEPs in this respect.

There is little question that trade between New Zealand and Australia increased following CER. Bano and Sandrey[2] examined these trade flows in detail using the entire suite of traditional tools available to trade economists. First, an historical analysis of New Zealand's changing patterns of trade was presented. Second, intra-industry trade development was examined. This looks at whether the establishment of CER resulted in increasing exchange of similar products (intra-industry trade), or whether international trade is still playing the role of filling the gap of products not produced within the country (inter-industry trade). In recent decades there has been a major shift in the trading habits of developed nations. The old style trade where, for example, New Zealand exported primary products in exchange for manufactured goods (inter-industry trade) has increasingly given way to the exchange of goods which are differentiated products and very close substitutes. New Zealand and Australia, for example, import each other's beer and wine, and this is intra-industry trade.

Third, Bano and Sandrey examined the strength of trade relations between New Zealand-Australia and other selected countries. For this purpose, the estimates of the trade intensity index were reported and discussed. A more sophisticated approach is to use a gravity model of trade to estimate the extent to which New Zealand-Australia and the other countries trade can be explained in terms of "natural factors" such as population, GDP, culture, productivity and distance. An analysis of selected literature on this aspect of trade was then presented. Finally, some research modelling of New Zealand's trade was considered, along with the relative market share of Elaborately Transformed Manufactures (ETMs) in the partner's imports of each country.

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[1] Adams, R., Dee, P., Gali, J. and McGuire, G. 2003, "The Trade and Investment Effects of Preferential Trading Arrangements – Old and New Evidence", Productivity Commission Staff Working Paper, Canberra, May. Note that this analysis examines the econometric results of both the trade and investment flows post-liberalisation, but makes no judgements on the implications of these for economic welfare.

[2] "Bilateral Trade Relations between New Zealand and Australia", by Sayeeda Bano, Waikato University and Ron Sandrey, MFAT. On the MFAT website at: www.mfat.govt.nz.

They concluded: *"The results suggest that the removal of trade and non-trade barriers through bilateral and multilateral negotiations has positive impacts on New Zealand's foreign trade. The removal of trade barriers through bilateral and multilateral negotiations has positive impacts on intra-industry trade and the intensity of trade of these economies. In particular, CER has been beneficial to both New Zealand and Australia."*

The important question therefore becomes: "is more trade better trade?" If that trade is merely trade diversion away from least-cost suppliers, the answer may well be no. For exports this is not an issue, unless of course one feels a loss of utility knowing that a trading partner is sourcing goods from New Zealand rather than the world's least-cost supplier; although that said, in many important agricultural exports New Zealand sets the world benchmark price.

The objective of this paper is to examine that trade growth, and assess whether CER lead to enhanced trade in existing lines (deepening) or in new lines (widening). The analysis follows the format developed by Kehoe and Ruhl (2002)[3]. They found that in their examination of European and North American trade agreements (the EU and NAFTA) the goods that were traded the least before liberalisation accounted for a disproportionate share in trade following the reduction of trade barriers[4].

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[3] How Important is the New Goods Margin in International Trade?" Timothy Kehoe and Kim Ruhl, University of Minnesota and Federal Reserve Bank of Minneapolis, October 2002.

[4] The methodology used by Kehoe and Ruhl is to examine trade at the time of liberalisation trade at the detailed line-by-line level. This examination is done by using the Standard Industry Trade Classification (SITC) for the simple and pragmatic reason that changes to the more standard Harmonised System (HS) over recent years make a comparison over time using HS codes impractical. Detailed SITC trade lines are initially sorted from lowest to highest values of exports in the first year. These lines are then split into exactly ten groups (segments) of equal value[4]. The key group of interest is the group containing the 10 percent least traded SITC lines in 1998. To judge the trade widening effect this group's 10 percent contribution was assessed against the share at the most recent 2003 year. If trade had widened we would expect that this original 10 percent share would have grown significantly, whereas if trade had deepened the relative growth would have taken place in trade lines that were making a more substantive contribution in 1998.

The results found a strong relationship between the initial trade composition and its post-liberalisation growth. The set of goods that accounted for the lowest 10 percent of trade (segment) following liberalisation accounted for as much as 40 percent subsequently. This finding applied to all 26-country pairs associated with the EU Single Market and the North American Free Trade Agreement (NAFTA) countries. The average increase was from the initial 10 percent to 16 percent, with the extreme of 41.5 percent being exports from Canada to Mexico.

CER Results

(a)   Exports to Australia

Data was obtained from Statistics New Zealand at the very detailed SITC 5 level (Kehoe and Ruhl used the SITC 4 level) for the December years 1988 to 2003 inclusive for trade with both the world and Australia. The same ranking procedure was carried out; the 10 percent splits were applied to the 1988 data. Given the incremental nature of the goods liberalisation, both during the early years of CER and during its parent NAFTA phase, the 1988 starting point is somewhat arbitrary. It is influenced by the problems of getting a detailed data series prior to 1988.

A total of 3,070 SITC codes were provided from Statistics New Zealand. Of these, there were no global exports in 47 (leaving 3023) and no exports to Australia in a further 151. This left 2,872 export lines applicable lines, and of these some 2,478 were in the lowest 10 percent group. The group size reduced progressively from there, with a further 182 lines in the second set and only 2 (newsprint and horses[5]) in the final set.

The results, shown in Table 1, are consistent with Kehoe and Ruhl's findings that trade widened. The second column in Table 1 shows the percentage share of the lowest 10 percent of exports to Australia through time. By the first three years of the 21st century these had stabilised at 30 percent after rising to 20 percent within 6 years.

New Zealand exports to the rest of the world (RoW) have also been scrutinised and shown in column 4. This is needed (but not undertaken by Kehoe and Ruhl) given the importance of exports to Australia in the total mix, as in many sectors this could and does dominate changes to overall global exports. Isolating out RoW exports shows a consistent and stable pattern; quickly rising to 25 percent from the initial 23 percent the share and briefly nudging 30 percent before retreating slightly. This is an important finding, as it enables the Australian results to be seen in context of the CER agreement and not New Zealand's global export trade patterns.

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[5] Note that live horses are somewhat of an anomaly in trans-Tasman trade as the same horses can be counted more than once as they may frequently cross the Tasman during the racing season. Normally these "goods" would be counted as re-imports. The value of these animals is large enough to slightly distort trans-Tasman trade data.

Table 1: Export Share of Bottom 10% Segment to Australia

Year	Aust	World	Rest of World
1988	10.00%	18.87%	22.93%
1989	14.86%	19.55%	22.64%
1990	15.05%	21.81%	25.15%
1991	17.62%	23.07%	26.05%
1992	19.22%	24.03%	27.06%
1993	19.69%	26.68%	29.97%
1994	21.58%	25.04%	27.96%
1995	21.98%	24.95%	28.03%
1996	22.10%	25.36%	28.24%
1997	24.38%	25.36%	27.61%
1998	24.51%	25.84%	27.73%
1999	26.35%	24.71%	25.80%
2000	26.15%	25.58%	27.17%
2001	29.91%	24.78%	24.96%
2002	30.45%	25.67%	25.93%
2003	29.50%	26.60%	27.18%
Average	23.66%	24.67%	26.67%

Source: Statistics New Zealand

Which of the 10 segments is the segment 1 growth being "poached" from? If all 10 segments were consistent through time then Graph 1 would reflect that in a constant level of the boxes. Instead, segment 1 is shown at the 30 percent share (shown as 0.3), and no other segment rises above 12 percent (segment 2). Segments 5 and 10 both fall below 5 percent over the period.

Graph 1: Relative Shares of the 10 NZ Export Segments to Australia at 2003
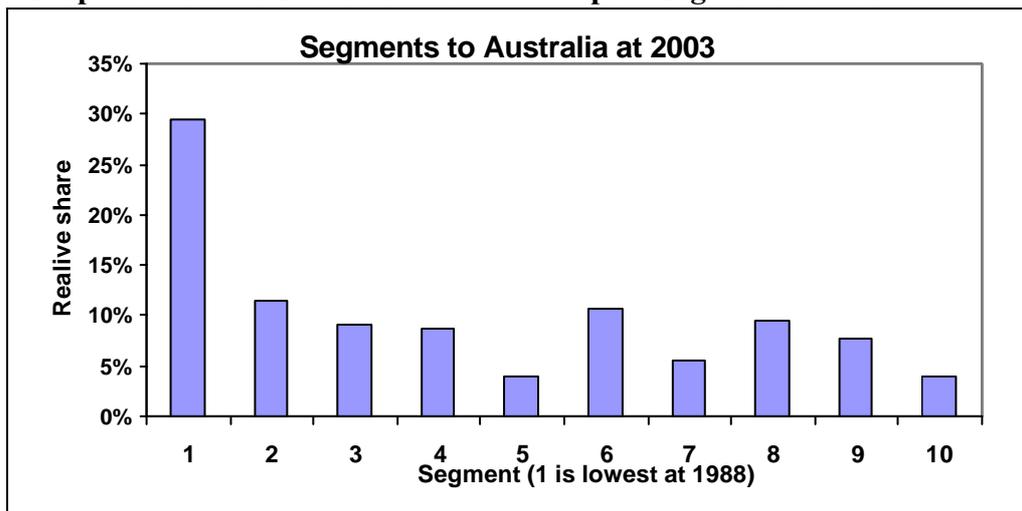
Source: Ministry of Foreign Affairs and Trade calculations

What are the specific SITC growth areas? The data was examined to see where the big growth was coming from. A quick insight into the major growth sectors in the lowest

segment (segment 1) is provided in Table 2. This shows the SITC lines where trade increased by over $20 million from 1988 to 2003 along with the associated MFN tariff rates at 1991 and 2001. The latter is given to provide an insight into the extent of the early tariff preference that is likely to have driven the increased trade. The year 1991 is the earliest (easily available) tariff, while 2001 is similarly available and likely to be current. There were likely to have been MFN tariff reduction between the implementation of CER and the 1991 rates, and this would accentuate the early advantages to New Zealand. This tariff reconciliation is neither a straightforward exercise nor an exact science, as one must make a tedious translation back from the SITC codes to HS in order to assess the relevant tariff line.

An interesting point is the extent to which the trade widening itself is actually a "narrow widening" in the sense that is driven by a relatively small number of the of the 2,478 SITC codes in segment 1. Table 2 shows this is indeed the case. The 17 SITC lines represented in the table accounted for a mere 0.11 percent of the total exports in 1988. By 2003 these exports had grown to $535 million and represented 7.81 percent of the total exports to Australia at that time and 26.5 percent of the exports to Australia in segment 1.

Table 2: The "Big Movers" in Segment One

		av MFN Duties (%)		Exports to Australia ($)		
SITC5	Description	1991	2001	1988	2003 $m	Incr $m
55422	Cleaning preparations	15	5	24,871	65.58	65.56
11102	Sweetened drinks	12	5	59,978	55.32	55.26
79329	Other vessels	19	5	2,000	51.91	51.91
64243	Toilet paper	15	5	0	40.20	40.20
09849	Other sauces etc	0	0	349,434	31.99	31.65
09850	Soups and preparations	5	4	503,187	31.73	31.23
64294	Paper tissues etc	15	5	52,776	27.91	27.86
77314	Other electric conductors	12	5	120,125	25.16	25.04
69241	Steel tanks, casks etc	12	5	439,836	25.01	24.57
72491	Washing machines	19	5	106,632	24.37	24.27
08195	Dog or cat food	0	0	283,690	24.32	24.04
71491	Parts for turbo-jets	0	0	21,105	23.76	23.74
67312	Steel coils	5	5	0	23.67	23.67
64177	Paper & paperboard	15	5	35,336	22.51	22.47
58299	Other plastic sheets	15	0	639,181	21.52	20.89
67411	Steel plates	10	5	0	20.18	20.18
09891	Pasta	10	5	65,670	20.18	20.11
	Sub Total	**11.6**	**4.2**	**2,705,809**	**535.35**	**532.64**

Source: Ministry of Foreign Affairs and Trade calculations

Most of the SITC lines shown had an early tariff advantage of between 10 and 19 percentage points, but there are three examples where there were zero duties at 1991.

Table 3 expands on this and examines the "big gainers" in segment 1 by the more aggregated SITC 2 lines.

Table 3: SITC 2 (aggregated) "Big Gainers" to Australia in Segment One

		Exports to Australia ($mill)	
SITC 2	Definition	1988	2003
84	Clothing accessories	13.22	176.85
67	Iron and steel	6.19	124.48
64	Paper, paperboard & pulp	4.84	120.30
09	Miscellaneous food products	2.63	106.29
77	Electrical goods	13.25	113.10
74	General machinery etc	23.45	104.88
55	Toiletries	3.44	79.71
79	Other transport equipment	1.81	73.52
11	Beverages	1.30	71.92
89	Miscellaneous manufacturing	16.04	73.62
71	Power generating gear	4.92	60.33
78	Vehicles	5.48	60.37
65	Textiles etc	16.46	69.63
87	Instruments	7.10	54.46
69	Other metal manufacturing	12.36	59.55
72	Specialised machinery	12.37	59.17

Source: Ministry of Foreign Affairs and Trade calculations

It is important to note that most of these "big gainers" are (a) off a low base, and (b) the non-agricultural goods dominate.

The Australian "Mirror"

Bano and Sandrey examined the relative performance of elaborately transformed manufactures (ETMs) from New Zealand into Australia over the period 1988 to 1999. This analysis is a sub-set of the total trade examined above, but nonetheless important as (a) Australia is the destination of around 50 percent of New Zealand's total ETM exports and (b) around 50 percent of New Zealand's exports to Australia are comprised of ETMs. Only Fiji, of important trading partners, comes close to emulating this second point given the commodity-focus of New Zealand's general export mix.

While total ETM imports from New Zealand into Australia only held a 2.5 percent market share in 1999, the data showed that this percentage had increased over the 12-year study period before retreating at the end of it. Over the period (comparing both the first two years and the last two years combined to even annual fluctuations) New Zealand's imports increased by 107 percent by value. This increase was ahead of the overall growth in Australian ETM imports of 99 percent by value and ahead of the developed major sources of the EU, the US and Japan. The increased competition came from the "newer" Asian economies of East Asia, and China in particular.

That New Zealand is very much a niche exporter in even the relatively (by international standards) small Australian market was confirmed by detailed analysis. At the more aggregated SITC 2 digit lines, 84 Apparel is the big mover in both dollar values and market share. This is not surprising, as the Industry Commission calculated the Effective Rate of Assistance for the Australian textile, clothing and footwear sector to be 39 percent in 1996-97. Large percentage increases also took place for plastics, vehicles, rubber, and other transport. Conversely, there are several product lines where the market share (and even the imports in dollar terms) decreased over the period. Wood products are where New Zealand had the largest market share, and this market share increased by two percentage points over the decade. Other double-digit market shares are in perfumes, paper and paperboard, and Non-ferrous metals, although the latter was declining over the decade in both market share and actual dollar values. Fibreboard and carpets both have a high market share and significant trade. Specialised cleaning materials, vehicle parts and tyres all increased in value and market share.

This paper now extends the Bano and Sandrey analysis by applying the Kehoe and Ruhl methodology to that same ETM data set. This time the data was supplied by DFAT, and is at the SITC 4 level. While the latter is more aggregated than the SITC 5 digit level used above, it still has 559 individual lines to give enough of a sample size for serious analysis. Some 404 of these lines were in segment 1, the lowest 10 percent of trade items by value at 1989. Table 4 shows the results of the analysis, with the 1989 segments adjusted to fit exactly 10 percent as in the export analysis above.

Table 4: Analysis of NZ ETM imports into Australia, 10 Segments 1989 v 1999

Segment	Segments NZ 1999 %	NZ share of total world imports 1989 %	1999 %	No. of SITC lines
1	19.0	0.39	0.86	404
2	15.9	2.39	3.99	53
3	13.3	2.51	3.46	32
4	7.4	6.3	3.21	20
5	6.7	6.55	4.39	15
6	8.7	4.41	2.98	12
7	8.3	5.84	5.46	8
8	10.3	11.73	15.13	7
9	6.2	14.19	8.57	5
10	4.7	22.56	10.92	3
Average		**2.344**	**2.513**	**559**

Source: Ministry of Foreign Affairs and Trade calculations

The results presented in Table 4 are consistent with the Kehoe and Ruhl hypothesis that New Zealand's imports into Australia post-CER were trade widening, with segment 1 showing the largest increase and the segments 2 and 3 showing the second and third largest increases respectively. This latter feature is at variance with the data shown in Graph 1 for all New Zealand exports to Australia in that in Graph 1 no other segment rose above 12 percent over the period. Note however that (a) this data is Australian import data and (b) it is ETMs only.

Trade_Widening_Sandrey.DOC

Also shown in Table 4 are the percentages related to imports from New Zealand *vis-à-vis* total Australian imports over the same period. Excepting for segments 7 and 8 there is a very strong correlation between the increase in the segment share and the increase in New Zealand's total market share. Note also that only in the segments 8, 9 and 10, segments where New Zealand's exports were concentrated in 1989, did New Zealand have a significant market share in 1989.

(b)   Imports from Australia

Often, in a mercantilist view of trade analysis, imports are overlooked. This is sub-optimal, as the welfare-enhancing effects of a greater selection at lower prices for consumers is an important component of trade liberalisation. There are, of course, the dangers of trade diversion discussed above, and this is likely to be more acute in the CER case as Australia is not the world's benchmark cost supplier of many consumer goods. Subsequent analysis ignores the possible trade diversion effects and just examines the extent to which imports into New Zealand from Australia have been trade widening or deepening. The same methodology as employed for exports to Australia is used to assess imports from Australia over the same period. Like Australia, New Zealand was also implementing a unilateral tariff reduction programme over this period, so the same caveats apply to the results.

Table 5 sets out the results for imports from Australia that is analogous to Table 1's analysis of exports to Australia.

Table 5: Imports from Australia – the Analysis of Segment 1 (lowest by value at 1988)

| Year	Aust Share Segment 1	World Share	RoW Share
1988	0.10	0.361	0.433
1989	0.126	0.358	0.419
1990	0.156	0.356	0.407
1991	0.161	0.439	0.403
1992	0.174	0.386	0.442
1993	0.171	0.365	0.417
1994	0.176	0.368	0.420
1995	0.185	0.364	0.413
1996	0.197	0.343	0.390
1997	0.29 (0.18)	0.377	0.408
1998	0.206	0.364	0.409
1999	0.28 (0.18)	0.360	0.387
2000	0.20	0.328	0.364
2001	0.215	0.329	0.362
2002	0.217	0.335	0.369
2003	0.219	0.339	0.375
Average	**0.203**	**0.352**	**0.395**

Source: Ministry of Foreign Affairs and Trade calculations

The table shows an increase from the initial 10 percent (0.10) in 1988 through to around 20 percent (0.20) at 1996. From there, the data stabilises except for two large jumps in 1997 and 1999 where the figure rises to 0.286 and 0.276 respectively. Analysis of the data shows that these latter outliers in the data are caused by imports of in SITC 79329, "Other vessels, including warships", of $563.4 million and $632.0 million for the 1997 and 1999 years respectively. Deleting these two entries from the analysis reduces the share of imports in the lowest segment to 0.184 (from 0.286) and 0.180 (from 0.276) for 1997 and 1999 respectively. Substituting these data into Table 1 gives a very stable but generally slightly rising pattern over the years 1994 to 2003. Notable also is that few agricultural product feature in the "big gainers".

Overall, increases in imports from Australia in segment 1 are not as large as those calculated for exports to Australia over the period. The other feature of table 4 is that imports from the world in these Segment 1 SITC categories do not increase to the extent that exports to the world in Segment 1 increased (as shown in Table 1). This implies that there is less new trade being generated through trade with Australia on the import side. Similarly, there appears to be little trade displacement from the rest of the world as well, as shown in the final column of Table 4.

The "displacement" effect for imports from Australia by segment is shown in Graph 2.

Graph 2: Imports from Australia: Relative Segment Shares at 2003.
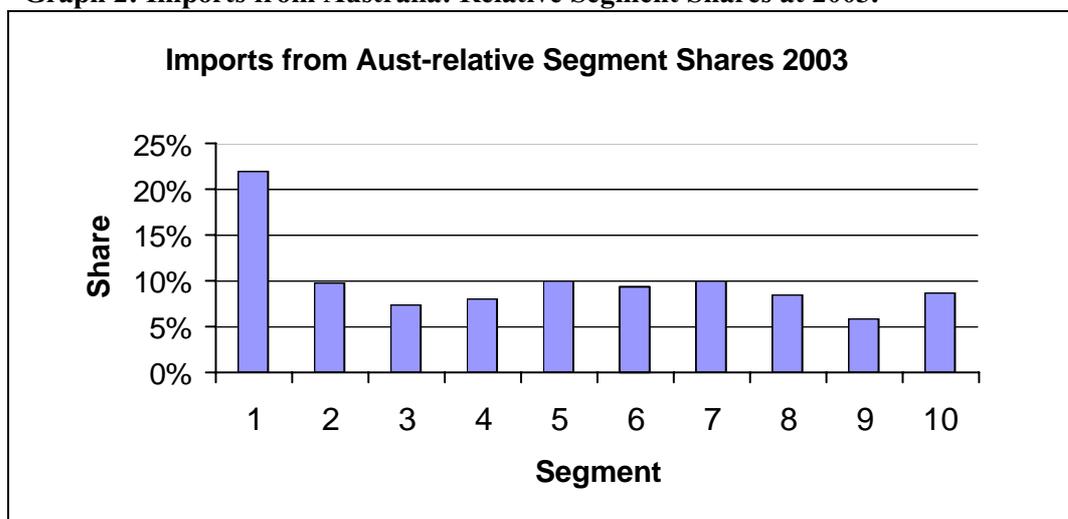
Source: Ministry of Foreign Affairs and Trade calculations

This displacement between segments on imports from Australia is not as large as that demonstrated on exports to Australia. The notable feature is that only segment 1 increases, while the others are all stable or declining. Segment 9 shows the largest decline (magazines/newspapers, wheat and petroleum products), followed by segment 3.

As in the first section of exports to Australia, the data was examined to assess where the growth was coming from. Over the full period the big gainers were the Navy frigates, fuel and oils and assorted paper products. The first two of these groups would not have been motivated by tariff preferences, although paper products may have been. It is interesting to note that paper products (and, in particular, SITC 64243, toilet paper), appears in Table 2 of the "Big Gainers" in exports to Australia as well as in this current list. This is an example of intra-industry trade at work, as discussed by Bano and Sandrey.

Again, as for the export sector, Bano and Sandrey examined New Zealand's ETM imports from Australia into New Zealand over the period from June years 1989 to 2002. Analysis showed there was an upward trend in the Australian market share of both total imports and ETMs through to about 1998, although the ETM increase was below that of Australian total imports. Also, Australian imports were comprised of 61 percent ETMs at June 2002, compared to global imports that were 76 percent ETM. By the end of the period studied, Australia's ETM market share was close to that at the start of the period. The major competitor to Australia in the New Zealand market has been China, while Japan in particular lost market share.

In both east and westbound trade the increasing market share of the ETM market in both countries of their respective CER partner over the first part of the post-1988 CER period followed by a decline at the end of the period. This is consistent with the hypothesis that trading behind the tariff preferences helped exporters in both countries initially but that advantage was eroded as the preferences similarly eroded over time as both countries opened their borders more widely.

The CER preference had the big advantage of helping the domestic adjustment process but not to the extent that it led to a longer term trade diversion cost to either economy. The more interesting long-term question is whether this has led to durable competitiveness and business patterns that will be sustained as the preferences erode over time. Bano and Sandrey show that there was a degree of erosion of New Zealand's import share into Australia over the 1990s, and suggest that tariff erosion may have been one factor in this.

In **summary**, while imports into New Zealand lend support to the trade widening hypothesis, this support is not as strong as that demonstrated in the export sector for two reasons. The first is that the percentage increase in segment 1, while consistent in that it dominates the trade increases over the period, is not as large as is the case in the export sector. The second reason is that analysis of the big-ticket items shows these to be products that would have to be considered as not being influenced by tariff preferences.

It is encouraging from an economic perspective to see that there is limited suggestion of trade diversion, although this has not been examined in detail.

Implications of the Results

This study underlines the point that a CEP does more than expand trade in traditional sectors. It provides empirical evidence that CER has benefited New Zealand by widening the export base to Australia over the period under examination. Importantly, this widening has been much greater than that of trade to the rest of the world, dampening the argument that it may well taken place in the absence of CER. An estimate of the outer limit of this increased trade over the period of $8.4 billion can be derived by calculating the annual cumulative value of trade in Segment 1 that is greater than the 10 percent initial share. Obviously attributing all of the increase to CER is extreme and we would make no such claim, but the figure serves as a useful starting point as to the potential trade widening effect of a bilateral trade agreement.

It is likely that the trade widening effects may be more dramatic if an earlier time period was used, or if CER had been introduced as a "big bang" rather than incrementally. These findings support New Zealand's current emphasis on engaging bilateral partners in CEP negotiations as well as being a strong supporter of the multilateral process. In particular, it lends analytical support to the desirability of negotiating an FTA with China, one of the world's fastest growing economies.

While a similar pattern is demonstrated for imports into New Zealand from Australia, the results are muted. While not explored, this may raise the possibility that the effects may be asymmetric between large and small countries in an FTA, with more of the benefits accruing to the smaller partner through access to the larger market.

The more in-depth analysis of New Zealand's increasing market share of ETMs highlights that CER was an important contributor to the feature of trans-Tasman trade in this category of exports. This represents an extension to the New Zealand trade mix, as most of these exports do not face the supply constraints that most of our more traditional agricultural and fisheries exports do (meaning that most of the ETM trade is therefore trade creation and not merely export diversion away from other markets). This has implications for the Growth and Innovation Framework (GIF) that is currently a focus of the government's export policy, ie the generation of new trade opportunities is important, and an FTA with, for example, China is likely to be a contributor to this.