



February 2016

## Fonterra supports the proposed FTA

Fonterra strongly supports the proposed Free Trade Agreement between New Zealand and the EU. We believe that a high quality, comprehensive FTA that includes the elimination of all tariffs on dairy products and addresses non tariff barriers will be positive for both countries.

Fonterra is a farmer owned dairy co-operative owned by 10,500 farmers and their families. We are the largest processor of milk in New Zealand. Fonterra also has significant processing operations and partnerships in the European Union. A high quality FTA will enable Fonterra to optimise our production facilities in both the EU and New Zealand. It will lead to more dairy exports to the EU and imports from the EU. It will lead to more product innovation, higher profit margins and greater wealth creation in the dairy sectors in both New Zealand and the EU.

Fonterra's key defensive interest in dairy relates to Geographical Indications. A restrictive agreement in relation to Geographical Indications would have a negative impact on Fonterra's business in New Zealand. Any negotiated outcome on Geographical Indications will need to be assessed on its merits and considered in the context of the agreed market access outcomes for dairy.

The EU and New Zealand are both competitive producers of dairy products and both are net exporters of dairy. In 2015 New Zealand produced around 21.5 billion litres of milk. In comparison, the EU produces more than 150 billion litres annually with production growing rapidly following the abolition of the milk production quota system. Germany and France each produce more milk than New Zealand does. The EU produces around 7.5 times as much milk as New Zealand and the EU's milk supply is growing faster than New Zealand in percentage and absolute volume terms.

A comprehensive FTA between New Zealand and the EU that eliminates all dairy tariffs will unlock value and help the dairy industries in the EU and New Zealand to work together more for the benefit of consumers, shareholders and dairy farmers in the EU and New Zealand.

## Fonterra overview

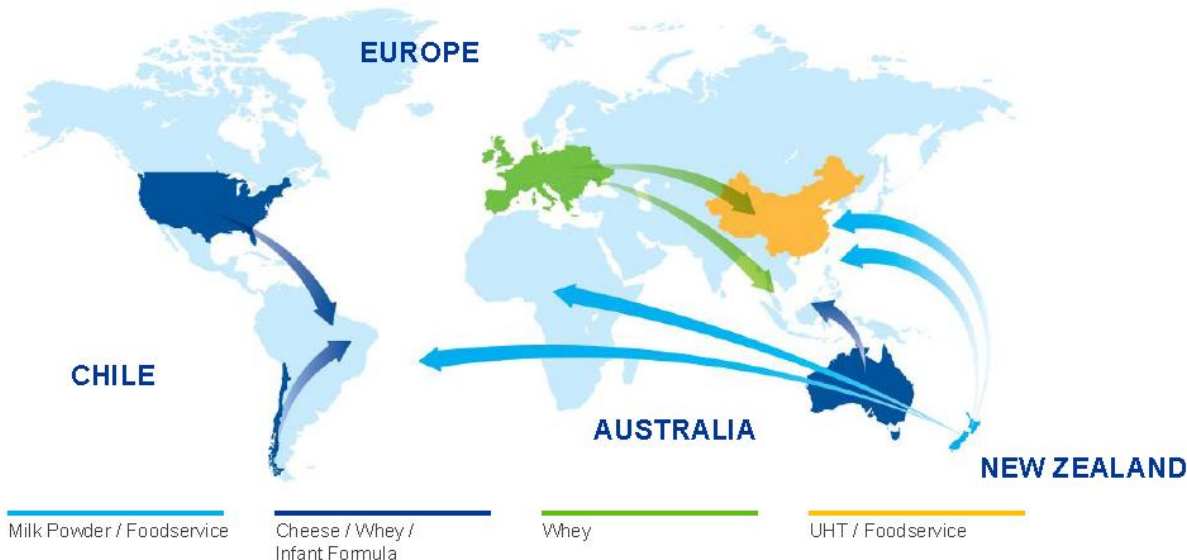
Fonterra is a global leader in dairy nutrition – the preferred supplier of dairy ingredients to many of the world's leading food companies. It is also a market leader with its own consumer dairy brands in New Zealand and Australia, Asia, Africa, the Middle East and Latin America. Fonterra is a farmer-owned co-operative. It is one of the world's largest investors in dairy research and innovation drawing on generations of dairy expertise to produce more than two million tonnes annually of dairy ingredients, value added dairy ingredients, specialty ingredients and consumer products for 140 markets.

Fonterra is New Zealand's largest exporter. Fonterra's economic impact on New Zealand is significant through the payout we deliver to our shareholders and the incomes received by Fonterra's 11,000 employees in New Zealand. Our sustainability and social responsibility programmes ensure that supporting the communities where we live, work and farm is part of who we are. We aim to improve livelihoods and support thriving communities by understanding their needs and expectations.

For decades Fonterra and its predecessors have exported dairy products to Europe. Today, however, Fonterra increasingly sees the EU as a source for high quality dairy ingredients.

Fonterra has developed a multi-hub strategy which aims to match global demand growth with the best sources of supply. In Europe Fonterra's strategy has focused on developing new sources of whey, which is a co-product of cheese. Fonterra has partnerships with Dairy Crest and First Milk in the UK and with Rokiškio in Lithuania for the manufacture of whey proteins. Fonterra uses its technical and sales expertise to add value to European milk.

## Global multi-hub strategy will match demand growth to our best source of supply



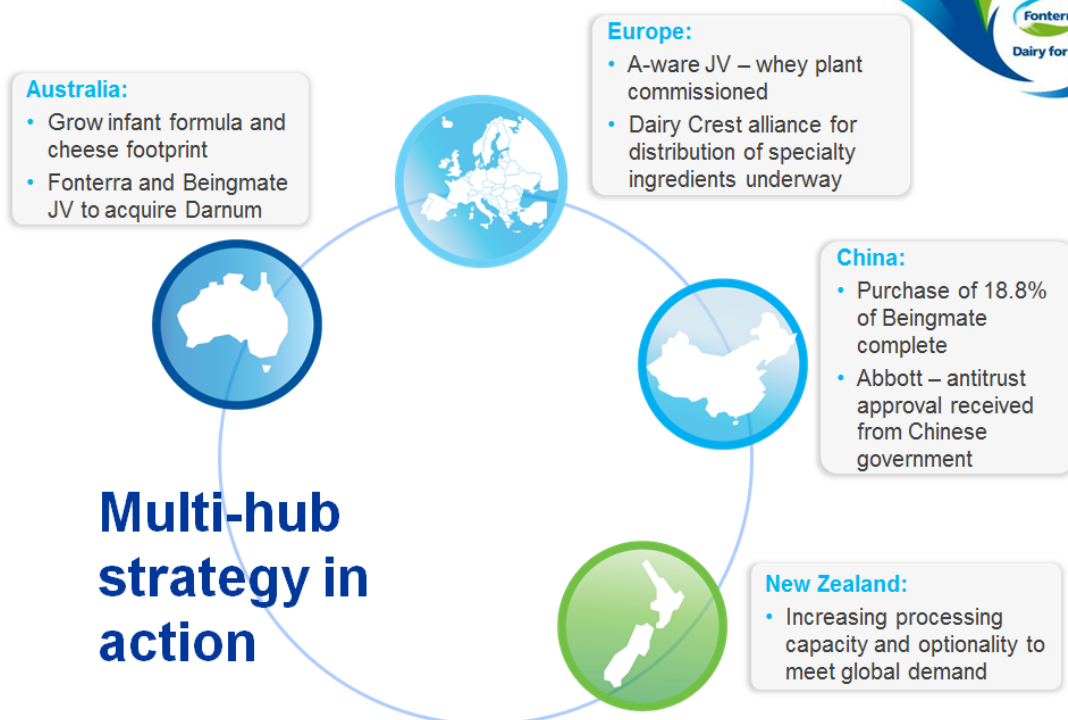
Fonterra also has a joint venture with the Dutch dairy co-operative Royal FrieslandCampina called DFE Pharma. This joint venture has production locations in the Netherlands, Germany, New Zealand and India. DFE Pharma specializes in manufacturing and marketing excipients for oral solid dose and dry powder inhalation formulations and in partnering with leading pharmaceutical companies to improve their own product performance.

Fonterra's first wholly-owned and operated dairy ingredients plant in Europe is its whey and lactose factory that has been built alongside A-ware Food Group's new cheese plant in Heerenveen, the Netherlands. The total investment across the A-ware and Fonterra plants is some €150 million. Fonterra's investment has directly created 50 new jobs. The annual production capacity of Fonterra's factory is 25,000 tonnes of lactose and 5,000 tonnes of whey. These ingredients are used by Fonterra and its customers to manufacture paediatric, maternal and sports nutrition products. Fonterra's exports to and exports from Europe are now relatively balanced.

### What impact could a comprehensive NZ-EU FTA have on Fonterra's business?

Fonterra already imports dairy ingredients from the EU to New Zealand for processing alongside New Zealand milk for the manufacture of highly specialised nutritional products. The two way flow of specialty ingredients, optimised across Fonterra's asset footprint in the EU and New Zealand, would grow in the presence of an FTA. An FTA would enable greater product specialisation to occur across Fonterra's asset footprint, which would drive greater production efficiencies.

Fonterra's multi-hub strategy has many components, all of which would benefit from increased market access to two way trade globally. Fonterra's global partnership with Beingmate Baby and Child Food Company, for example, integrates our global supply chain from the farm gate direct to China's consumers using Fonterra's milk pools and manufacturing sites in New Zealand, Australia and Europe.



Barriers to trade and tariffs prevent the deeper integration of supply chains and thus destroy value – barriers to trade benefit nobody. A comprehensive New Zealand-EU FTA will allow Fonterra and other dairy companies to develop supply chains linking dairy production in New Zealand and the EU with growing demand in emerging markets such as China. Products can be produced in New Zealand that can enter China under preference thanks to the China-New Zealand FTA.

Opportunities for EU dairy producers to import specialist dairy ingredients from New Zealand are at present limited because the EU’s dairy tariffs are generally prohibitive to trade. This potentially decreases the efficiency and competitiveness of EU dairy and food manufacturers.

**EU and New Zealand dairy tariffs and trade**

New Zealand’s tariffs on dairy products are generally low and in many cases there is no applied tariff and imports enter New Zealand duty free. This enhances consumer choice and increases the efficiency of the New Zealand dairy and food processing sectors.

Selected New Zealand Dairy Tariffs		
HS Tariff Code	Description	MFN Tariff
0401	Liquid milk and cream	Free
0402	Skim Milk Powder and Whole Milk Powder (SMP and WMP)	5% or Free depending on tariff line
0404	Whey	5% or Free depending on tariff line
0405	Butter and AMF	Free
0406	Cheese	Free
1702.11.00 & 1702.19.00	Lactose	5%
1901.10.09	Infant Formula	5%

In contrast, the EU's tariffs on dairy imports are in most instances very high and prohibitive to trade.

New Zealand butter and cheese may enter the EU through WTO country specific tariff rate quotas. The New Zealand country specific butter quota has an annual volume of 74,693 metric tonnes and an in-quota tariff of €70.00 per 100kg. Two New Zealand country specific tariff rate quotas exist for cheese, with a combined volume of 11,000 metric tonnes per annum and an in quota tariff rate of €17.06 per 100kg. These quotas are often not filled because of the high in quota tariffs.

The total EU butter market size is over 2 million tonnes and the cheese market size is over 9 million tonnes – the cheese market alone is far larger than New Zealand's total production of all dairy products.

Selected EU Dairy Tariffs		
HS Tariff Code	Description	MFN Tariff
0401	Liquid milk and cream	From 12.9 EUR / 100kg net up to 183.7 EUR / 100kg net depending on tariff line
0402	Skim Milk Powder and Whole Milk Powder (SMP and WMP)	From 1.19 EUR / kg + 21 EUR / 100kg up to 183.7 EUR / 100kg depending on tariff line
0404	Whey	From 7 EUR/ 100kg up to 167.2 EUR / 100kg depending on tariff line
0405	Butter	189.6 EUR / 100kg
0406	Cheese	From 140.9 EUR / 100kg up to 221.2 EUR / 100kg
1702	Lactose	14 EUR /100kg
1901.10	Infant Formula	7.6% + VC
3501.10	Casein	9%

In the year ending October 2015 New Zealand was an important dairy market for the EU. While the exact value of this trade depends upon which tariff lines are considered, with the tariff lines Fonterra has analysed **in the year ending October 2015 total EU dairy exports to New Zealand were valued at USD 134 million**. Key export items include whey, cheese and lactose. Indeed, in 2014 New Zealand was the EU's largest external lactose market.

Analysing the same tariff lines, **in the year ending October 2015 the EU imported dairy products valued at USD 293 million from New Zealand**. Key dairy products imported from New Zealand include casein and caseinates, AMF, butter and cheese.

However the trade data numbers are counted or analysed it is clear that there is already considerable two way trade in dairy products between the EU and New Zealand. Dairy is one of the few areas in which New Zealand has a positive trade balance relative to the EU, but the EU's dairy exports to New Zealand are by no means inconsequential. As European Union Agriculture Commissioner Phil Hogan stated in March 2015, Europe is "competitive enough to export some 11% of our milk production without any kind of subsidies".

The EU dairy sector is competitive – it is therefore hard to justify the maintenance of high and prohibitive tariffs. Furthermore, and while the elimination of tariffs is the top priority, the FTA presents an excellent opportunity to address a range of non tariff barriers to trade. The FTA could provide a framework for

discussing such issues and could help to ensure that decisions made bilaterally between the EU and NZ are effectively implemented in both jurisdictions.

## Conclusion

Fonterra looks forward to the launch of negotiations for a New Zealand-EU FTA. The evidence presented in this submission demonstrates that a high quality and comprehensive FTA that includes the elimination of all tariffs on dairy products will be positive for farmers and the dairy industries in both New Zealand and the EU. The EU produces far more milk and dairy products than New Zealand and the dairy trade balance between the EU and New Zealand is more evenly balanced than is generally supposed. The FTA will facilitate new opportunities for the EU and New Zealand dairy industries to work together collaboratively for the benefit of both.

We thank MFAT for this opportunity to make a submission and we welcome further engagement with MFAT about the New Zealand-European Union Free Trade Agreement as the negotiations progress.