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Introduction

Fonterra Co-operative Group welcomes the opportunity to provide its views to the New Zealand Government on a future potential free trade agreement (FTA) with the United Kingdom (UK). Fonterra and the New Zealand dairy sector have a long history of trade with the UK, and Fonterra has a number of important relationships in place with dairy partners in the UK that operate for our mutual benefit.

We strongly support a comprehensive, high-quality NZ-UK FTA.

We have also had the opportunity to formally submit to the UK Government on a potential future NZ-UK FTA, as well as the opportunity to participate in a UK Select Committee hearing on a future trade agreement. At each turn, we have registered the clear view that a NZ-UK FTA will form the blueprint for the ongoing trade and economic relations between New Zealand and the UK. A NZ-UK FTA is a critical opportunity to secure an ambitious, modern and commercially-meaningful framework that works to the advantage of both countries. We also consider a bilateral FTA to be an important stepping stone for the UK, in moving toward potential membership of the Comprehensive and Progressive Trans-Pacific Partnership Agreement (CPTPP).

A NZ-UK FTA that includes the elimination of all tariffs on dairy products, addresses non-tariff barriers and drives cooperation on issues of mutual interest would support a further deepening of commercial ties between UK and New Zealand companies, including Fonterra. Such an agreement would allow existing partnerships to thrive and new commercial partnership opportunities to be identified. As such, an FTA will not only be important for growing dairy trade flows in both directions, but also in driving enhanced participation in global value chains (GVCs) and increasing competitiveness for exports to third country markets, including in the Asia-Pacific region. This, in turn, will lead to greater product innovation, maximise consumer choice and drive wealth creation in the dairy sectors in both New Zealand and the UK.

In addition, a high-quality agreement between the UK and New Zealand will deepen economic ties and provide certainty to business in both countries about the trade rules that apply. The importance of such certainty and predictability is critical for business in the current turbulent trade environment (which, of course, includes Brexit).

Fonterra

Fonterra is a dairy co-operative owned by 10,000 farmers and their families. We are the largest processor of milk in New Zealand and a global leader in dairy nutrition – the preferred supplier of dairy ingredients to many of the world's leading food companies. Fonterra is a market leader with its own consumer dairy brands in New Zealand and Australia, Asia, Africa, the Middle East, and Latin America. We are also 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 value-added advanced dairy ingredients, foodservice and consumer products for over 140 markets.

Fonterra's business in the UK

Until the entry of the UK into the European Economic Community, the UK was New Zealand's single largest dairy market. Today, however, dairy exports from New Zealand to the UK market are limited: only 0.14% of New Zealand's dairy exports by value went to the UK in 2018, valued at approximately £13.5 million.

This is despite the overall significance and size of the UK dairy market. The UK is the world's fourth largest dairy importer by value, with imports totalling £5.9 billion in 2017, and the largest net importer of cheese, with

annual UK cheese imports exceeding New Zealand's annual cheese exports to all markets. Currently, around 93% of dairy imports into the UK are of EU origin.

The UK does however remain an important market for Fonterra for other reasons. Europe is an increasingly important part of Fonterra's global dairy sourcing strategy, which aims to match global demand growth with the best sources of supply. Our current UK partnerships, with Dairy Crest and First Milk, are an important part of this wider strategy. These partnerships are for the production of whey derivatives, which are key ingredients in sports and infant nutrition products. Fonterra sells the products from these partnerships in the UK, across a number of EU markets, and in markets outside the EU.

Galacto-oligosaccharide (GOS) is a key example of how Fonterra is already working with our UK partners to leverage global value chains for the benefit of both industries. Here lactose produced by Fonterra in the Netherlands is exported to Dairy Crest (a Fonterra partner) in the UK, where it is converted to GOS. The GOS is then exported to a Fonterra plant in Australia, where it is further blended with NZ ingredients, to make infant formula. The infant formula is then exported to markets, including China and South East Asia. In sum, we are leveraging our intellectual property for the manufacture of whey proteins, and then using our technical and sales expertise to add value to UK milk.

The Dairy Opportunity in a NZ-UK FTA

As noted, the UK has historically been a significant market for the New Zealand dairy industry, however, dairy exports are far more limited today. This is despite the overall size of the UK dairy market. Of the £13.5 million of exports to the UK in 2018, key traded products included butter, infant formula and milk powders.

The limited amount of dairy exports from New Zealand is primarily due to the significant tariff disadvantage that New Zealand dairy exporters face relative to the highly competitive EU dairy sector, as well as increased demand for dairy product from more open emerging markets.

The EU tariff rates applied to many dairy products are often prohibitive for dairy exporters into the EU-28 market. While New Zealand butter and cheese may enter the EU and UK through WTO country specific tariff quotas, these quotas are very rarely utilised due to high in-quota tariffs (for example, the butter quota for New Zealand with an annual volume of 74,693 metric tonnes, has an in-quota tariff rate of €70.00 per 100kg), as well as complicated tariff quota administration arrangements. The New Zealand Government is, of course, well-versed in these complicated arrangements.

The removal of these market access restrictions in the UK market, and the ability to compete on a level playing field with the EU (or better, depending on how Brexit lands), is a key opportunity for New Zealand dairy exporters.

While there are often sensitivities registered in respect of dairy liberalisation, the reality is that the UK already has an open market for major global dairy exporters (the EU is the number one global dairy exporter). In addition, New Zealand and the UK have counter-seasonal production systems, as well as a shared interest in ensuring global dairy demand growth is met by the supply of high quality, nutritious dairy products. We consider there are significant *mutual* advantages to be gained from both safeguarding existing access and deepening the trading relationship between New Zealand and the UK.

Safeguarding existing access

This is a key priority for Fonterra in the context of Brexit, in particular in regards to the EU's WTO tariff rate quotas (TRQs).

We are deeply concerned at the proposals put forward by both the EU and UK to split these quotas (both country-specific quotas and the WTO dairy MFN quotas) into two parts, based on historical trade flows. There are a number of reasons why such a proposal is unacceptable, not least of which the complete disregard for bilateral access arrangements that have been bought and paid for in previous negotiating contexts.

We continue to provide detailed views to the New Zealand Government on this issue. We appreciate the work that is being done by New Zealand, including MFAT and MPI officials, to safeguard the New Zealand's dairy interests.

Deepening the trading relationship

A high quality, comprehensive FTA between the UK and New Zealand would provide benefits to dairy customers and consumers in both countries by providing additional supply choices. It would also reduce compliance costs, making it easier for both sides to do business.

As well as being a major global importer of dairy products, the UK is also a significant dairy exporter – the 5th largest dairy exporter globally behind the EU (excluding the UK), NZ, USA and Australia – and any FTA would also provide export advantages for the UK dairy industry. For example, given dairy products are often traded as intermediate goods for further processing, the development of complex value chains for food and dairy processing is impeded by the application of tariffs. The removal of these tariff barriers would provide the opportunity for specialised dairy ingredients from the UK and New Zealand to be traded in both directions, for further processing and re-export under our respective FTAs. Currently such opportunities are limited, due to the EU's dairy tariffs being generally prohibitive – which potentially decreases the efficiency and competitiveness of UK dairy and food manufacturers.

For Fonterra, these kinds of opportunities would allow current and future partnerships to grow and reach their full potential under free trade conditions. A genuinely ambitious FTA would enable Fonterra to develop deeper partnerships in the UK, for the benefit of both the European and New Zealand dairy industries.

The UK Dairy Sector: Key Facts (based on 2018 data)

- The UK is the world's fourth largest dairy importer by value, behind the EU-27, China & USA.
 - The UK represents 5% of global dairy imports.
 - On a volume basis, the UK is world's seventh largest importer. This is because of the large volume of liquid milk that moves across borders within the continental EU into Germany, Italy, Belgium, the Netherlands and France, whereas the UK's dairy imports are dominated by cheese, which has lower volume and higher value than liquid milk.
- The UK imported USD 7,405 million of dairy products in 2017, 93% of which was EU origin.
 - USD 1,636 million was from Ireland, followed by Germany (USD 1.064 million), and France (USD 990 million).
 - Cheese was the UK's single largest dairy import item (24% of the total value of UK dairy imports), followed by ice-cream.
- The UK is the second largest *net* importer (imports minus exports) of dairy behind China.
 - The UK is the largest net importer of dairy in the EU, or the largest "dairy deficit" market.
 - The UK had a net dairy trade deficit in 2018 of USD 3,066 million (or 518,500 MT in volume terms).
- The UK is the largest net cheese importer in the world by value (USD 1,213 million) and volume (332,134 MT).
 - Annual UK cheese imports exceed New Zealand or US annual cheese exports to all markets
 - The UK is the world's third largest cheese importer by both volume (493,826 MT - behind Germany & Italy) and second by value (USD 2,011 million) – behind Germany.
 - Ireland supplies 25% of UK cheese imports by volume, followed by France (15%) and Italy (12%). Cheese imports are dominated by Cheddar (USD 1,085 million) and Fresh Cheese (USD 516 million)
- The UK is the fifth largest butter importer globally (USD 408m / 76,802 MT).
 - More than half of UK butter imports come from Ireland (41,350 MT). Historically New Zealand was a major supplier of butter to the UK market, but volumes imported from New Zealand have declined sharply in recent years with 326 MT imported in 2017. This is due to the price gap between the EU internal market and the globally traded market narrowing and the tariff barriers faced by New Zealand product entering the EU.

- The UK is the fifth largest dairy exporter behind the EU-27, NZ, USA and Singapore.
 - The UK was the 11th largest exporter of dairy products globally in 2017, with USD 4,460 million of exports.
 - The UK's dairy exports were primarily cheese (USD 676 million), liquid milk (USD 294 million), specialist milk powders (USD 203 million) and ice-cream (USD 138 million). 70% of UK dairy exports went to other EU countries.

Country	UK Imports	UK Exports	Net Imports
Ireland	1 st 1,636	1 st 1,056	580
Germany	2 nd 1,064	3 rd 437	608
France	3 rd 990	4 th 307	683
Netherlands	4 th 744	2 nd 456	288
USA	9 th 236	7 th 186	50
New Zealand	29 th 17	48 th 11	6
World	7,405	4,392	3,013
Cheese	1 st 1,963	2 nd 780	1,183
Food Preparations	2 nd 1,736	1 st 1,285	451
Cocoa Preparations	3 rd 999	3 rd 509	490
Butter	4 th 388	6 th 169	219
In USD million (2017)			

Other key FTA issues

Exports globally are facing an increasing number of non-tariff barriers at, or behind, the border. Such barriers often add significant, unjustified, cost to trade. While it is difficult to quantify the precise impact of such measures, a recent study by the New Zealand Institute for Economic Research (NZIER) has estimated the overall cost of non-tariff measures (NTMs) on New Zealand's primary sector exports in the Asia-Pacific region to be US\$5.9 billion (based on 2011 data), with dairy bearing the brunt of these costs at US\$2.9 billion (*Quantifying the costs of non-tariff measures in the Asia-Pacific region, NZIER working paper 2016/4, November 2016*).

We consider that there is a real opportunity for New Zealand and the UK to not only develop a gold-standard FTA that puts in place WTO-plus provisions in areas such as sanitary and phytosanitary rules (SPS) and technical barriers to trade (TBT), but also to work collaboratively to ensure there are high benchmarks for progressive approaches to tackling NTBs in third-country markets. Fonterra is highly supportive of the approach taken by New Zealand in its FTAs, which seeks to drive regulatory coherence outcomes, as well as standards and regulation that are science-based, best-practice and outcomes-based. We also support chapters that ensure liberalising Rules of Origin (ROO) and trade-facilitating customs administration procedures.

New Zealand and the UK also both care about a number of wider issues of high relevance to the dairy sector such as sustainability and high environmental standards. Sustainability is a core strategic priority for Fonterra and our farmers, and we recognise that strong, healthy local environments and communities are of central importance to all New Zealanders. Sustainability is also significant to our customers and consumers who are placing increasing importance on knowing their food is produced this way.

Dairy farmers have already invested over \$1bn in on-farm environmental improvements and will be doing more. Fonterra and our farmers are continuing to make improvements to our farm management systems, manufacturing sites, and supply chain in order to reduce our environmental footprint. On climate change, Fonterra fully supports the Paris Agreement and is committed to playing our part in helping the country meet its climate ambitions. We are proud of our leadership towards becoming a sustainable co-operative. We believe it is important to consider the types of provisions that could be agreed within the context of trade agreements that support the achievement of New Zealand's (and the UK's) environmental and sustainable development objectives. There is also an opportunity to consider how any potential bilateral FTA could contribute to the implementation of the UN Sustainable Development Goals, including the goal to end global hunger.

Conclusion

A NZ-UK FTA provides a unique value proposition for both the New Zealand and UK dairy sectors. UK agriculture, including dairy, is well positioned to continue to be an important global exporter of dairy products and Brexit provides a unique opportunity for the UK sector to take advantage of global value chains in wider regions, including the Asia Pacific, through the establishment of high-quality FTAs with partners such as New Zealand. A UK-NZ FTA also provides a coherent framework for deeper bilateral engagement between New Zealand and the UK on a range of agriculture issues, to the benefit of all.

In New Zealand, the dairy sector provides direct jobs and incomes to approximately 40,000 workers (26,500 on farm and a further 12,000 in dairy processing), supports regional economic development across New Zealand and bolsters the livelihoods of many small and medium enterprises (SMEs) that support the dairy sectors' farming, processing, and sales operations. In 2017, the dairy sector delivered around \$2.6bn in wages to dairy farmers and processing workers. This is particularly significant in regional New Zealand, given approximately 80% of all dairy sector wages are earned in rural areas. High quality FTAs are a key factor in ensuring the continued vibrancy of the sector and the contribution we make to the New Zealand rural economy.

We thank MFAT for the opportunity to make this submission. We welcome the opportunity to answer any further questions and to be involved in more detailed and specific discussions, once negotiations with the UK are launched.

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