



# The International Trade Environment

## CFO SUMMIT - AUCKLAND

**PHILIP TURNER** Director, Global Stakeholder Affairs, Fonterra

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The international trading environment is at a critical moment for New Zealand. This is not just my view. The Governor of the Reserve Bank has recently said that the international trading environment represents the biggest single threat to the NZ economy. I want to talk today about what is going on, and how New Zealand should be responding. While there is a lot of understandable anxiety out there, my short summary is that change always brings opportunity.

What we need to do is to keep our heads and our ambition, resource ourselves up, and be nimble and alert to the opportunities that will come our way.

### Trade has always really mattered to NZ. No more so than now.

Over the last twenty-five years New Zealand has achieved a great deal in trade strategy. Improved market access and connectedness has been one important factor in our economic success over that period.

The Uruguay Round, completed in the mid-1990s, was a massive breakthrough.

It gave us the WTO, and it brought agricultural tariffs under disciplined trade rules for the first time.

New Zealand built on that multilateral success with a number of highly successful bilateral deals – China in particular – and plurilateral ones – such as the original P4 agreement between NZ, Singapore, Chile and Brunei.

A bunch of small and relatively low influence countries got together to create a model FTA that would demonstrate to others what high quality really is.

It was a smart move and it worked.

The TPP grew out of that – and New Zealand can take a good deal of credit for its invention.

### Progress on trade liberalisation

New Zealand now has FTAs with markets that take 52% of our exports.

This would rise to 72% if TPP were implemented in full, and 90% if all current negotiations and an agreement with the EU enter into force.

All of this progress has occurred in a context of New Zealand bipartisan political support – with Labour governments if anything even more active on this front than National ones.



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### The retreat of globalisation?

In the last ten years however things have been going the wrong way. The appetite for further globalisation in the Western world has virtually dried up. The WTO Doha Round, intended as a step-up from the Uruguay Round, collapsed. Protectionism has been growing steadily.

### Protectionism has been growing

The OECD tells us that the number of restrictive measures on trade from G20 countries has grown by 80 new measures a year.

This increase in protectionism is one factor in the generally poor performance of the world economy over the last decade – which ironically is feeding the anti-globalisation politics.

In 2015, global trade grew by only 2 percent. Trade growth has been at that level or lower in only 5 of the last 50 years.

The need for more market liberalisation is most glaring in relation to food and agriculture.

In my industry of dairy, only 13% of global consumption is really open to New Zealand exporters. I want to stress that all of this has been going on for some time – at least the last decade. But last year certainly brought it all into the spotlight.

### The year of populism

In the Western world, the year 2016 could be defined as the year of populism.

The Brexit vote, the US election, and now critically important elections coming up in France, Germany and the Netherlands suggest that globalisation is in retreat.

Even relatively limited trade deals seem to be in trouble.

The US has withdrawn from TPP.

Talks between the US and EU have collapsed. The EU is still struggling to implement its FTA with Canada, despite 7 years of negotiation and it already being signed by both parties.

When ordinary Europeans worry about a threat from Canada you know the world is in an odd place.

This populism reflects a widespread feeling in the Western world that globalisation has failed everyday people.

The impulse to focus on 'my country first', and on jobs at home, risks ramping up trade tensions and potentially full-blown trade wars.

Even apparently moderate changes – such as the mooted border adjustment tax proposal from the US – have the ability to disrupt and displace hundreds of billions of dollars of trade and to dampen global growth.

### Shag on a rock

Against this background New Zealand sometimes feels like a shag on a rock – cushioned by a healthy local economy and continuing to argue strongly for trade liberalisation, and, but with apparently few other friends out there prepared to listen.

There is no doubt these risks are real.



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But New Zealand has been in difficult places before.

We tend to forget that New Zealand has not always been a strong supporter of free trade.

For much of the twentieth century, we were a contented member of a highly protected economic zone – the British Empire, then Commonwealth.

In the 1930s this was formalised in the imperial preference system, which guaranteed us access to the UK and discriminated against non-members of the old Empire. No WTO, no MFN rules in those days.

This worked fine for us. New Zealand's economy was almost entirely dependent on Britain – New Zealand was Britain's farm.

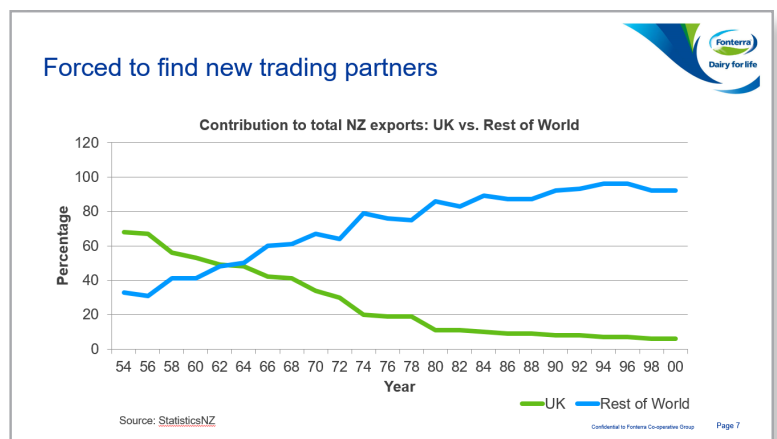
When our relative wealth was at its peak, in the 1950s, this was not due to free trade. It was due to trading with our family.

This all came crashing down when the UK joined the European Economic Community in 1973 and our market access crumbled.

### Forced to find new trading partners

New Zealand was forced to look for new markets. We were also forced to drastically deregulate and open up our economy.

The result? For the last forty years New Zealand has developed strong economic ties with other parts of the world, particularly the Asia Pacific region.



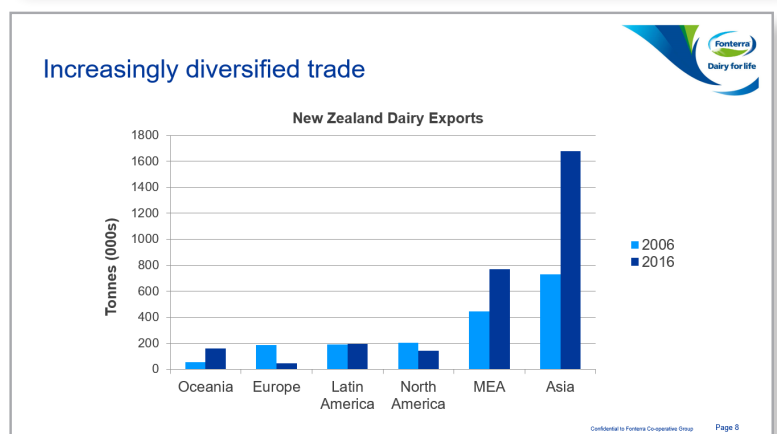
### Increasingly diversified trade

Asia is now our largest export destination, worth four times more than New Zealand exports to Europe. This is no coincidence.

It is also a great benefit to us right now.

While we are fixated with the rise of populism in the West, the picture in most of Asia and the rest of the world is different.

Countries as varied as Malaysia, Vietnam, Chile and Japan are strong supporters of TPP and casting around for ways to shore up the trade agenda.



Brazil and Argentina are seeking to return to more open economic settings after years of wandering off course.

And President Xi told the World Economic Forum at Davos in January that China strongly supports globalization. The message to the Western world is clear – if they are going to take a step backward then Asia will step up.

While we need to wait and see if that admirable rhetoric will actually be translated into reality, it is striking that China has for a decade or more already been the most open large market for our food exports in the world.

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Most markets in Asia have relatively low tariff barriers in food and agriculture compared to the US, Japan and Europe. Most of them are also prepared to negotiate trade agreements that achieve full tariff liberalization. This relative openness, combined with the boom of economic growth in the region has allowed New Zealand to pivot successfully to Asia – and massively shift our trade in that direction. So it's ironic that despite the strong and consistent pull to Asia, it's the other side of the world that's been grabbing the trade world's attention of late - the US and UK in particular.

### Brexit: opportunity or threat?

Following the Brexit vote, the UK now has to decide how to balance their desire to control trade and immigration against their need to preserve access to the EU single market.

This is not an easy balance to achieve - the EU is the largest economy in the world and for many products there are high external tariffs.

Losing the flexibility of free trade between these markets could significantly impact global trade flows in some products and services.

If we look at the implications for dairy trade alone, it becomes clear how much is at stake.

### UK dairy market second only to China

The UK is the world's second largest net dairy importer, behind only China – or in numbers terms, approximately \$2.3billion USD of net dairy imports annually.

Most people don't realise quite how large the UK dairy market is, since 98% of its imports currently come from the EU.

A messy Brexit could be highly damaging to global dairy markets – or it could be a major opportunity.

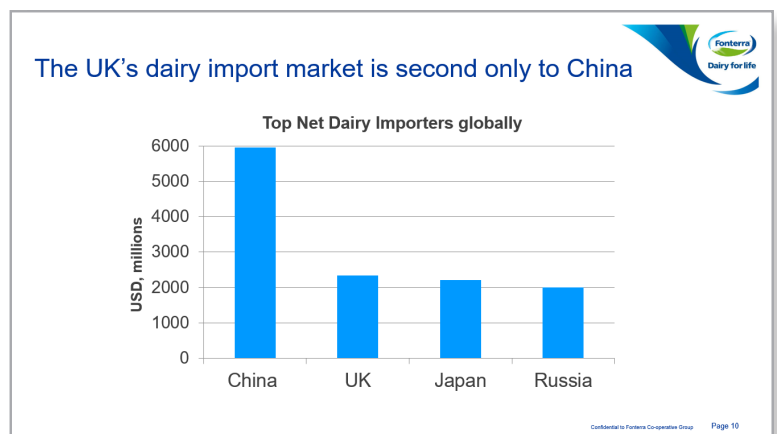
This is a highly complex issue and how it will work out is not clear to anyone.

But is profoundly important, to both British consumers and New Zealand businesses, that Brexit should result in the removal of trade barriers rather than the imposition of new ones.

This is because global trade is increasingly occurring through global value chains.

Production of many goods has become geographically fragmented, with different actors adding value in each market and deeply intertwining their economies.

Fonterra's business today is an example of this.

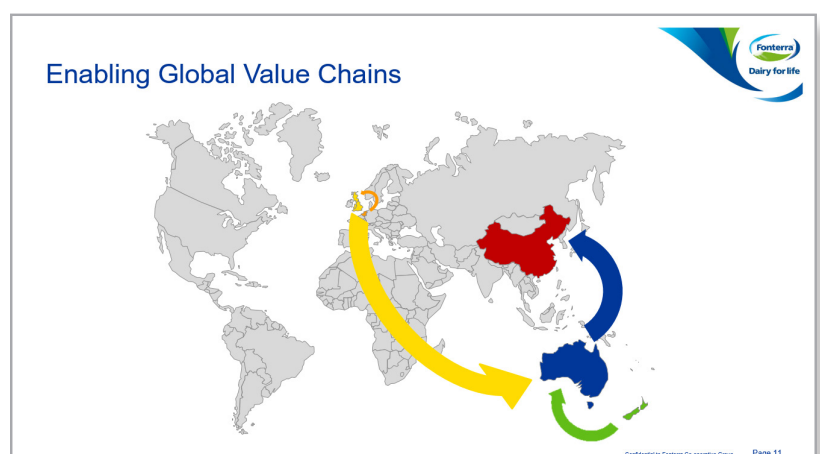


### Enabling global value chains

Take galacto-oligosaccharide (or GOS) by way of example: we produce lactose in the Netherlands.

It's then exported to the UK where it's converted into GOS, exported to Australia where Fonterra blends it with NZ ingredients to make infant formula – and finally exported to China and elsewhere in Asia.

I hardly need to lecture a group of CFOs on the benefits of open markets: they allow companies and entrepreneurs to invest, innovate and



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create a value chain from multiple geographies, to the benefit of consumers around the world. The risk is that Brexit will weaken these global value chains; the opportunity is that it will strengthen them.

In the US as well, in my view we are going to see opportunities as well as risks.

### A changing world

The Trump administration has walked away from TPP, committed to renegotiating NAFTA, and indicated it will take a more aggressive attitude to key relationships like China and Mexico.

There are clear risks here. But the simple response from New Zealand and others should be: don't panic. In a fast-changing environment it is simply not clear where things will end up. There are some areas where New Zealand and the US can and should work together.

Together we won an important WTO case against Indonesia on beef last year.

We have the opportunity to work together again to force Canada to back off its deeply egregious manipulation of the market for dairy products.

So how should New Zealand be reacting to this in terms of our trade strategy overall?

First, it seems very clear that if the West is losing enthusiasm for open trade, then that is all the more reason to reinforce our focus on the Asia-Pacific – and other regions further afield such as Latin America, the Middle East and Africa.

Fonterra already sells more product by value to Africa than the NZ seafood or wine industry sell globally – and we believe that continent is poised for substantial growth.

Second, we need to work very hard on making existing rules work better: both through dispute settlement under the WTO for example, and through attacking non-tariff barriers – insidious bureaucratic red-tape and regulatory barriers that restrict or even prevent trade.

The WTO remains critical to our interests as small nation. Not just in upholding the rules, but also as the only means we have for addressing the distortionary effect of domestic subsidies on global markets.

Third, we need to hold on to our confidence and our ambition.

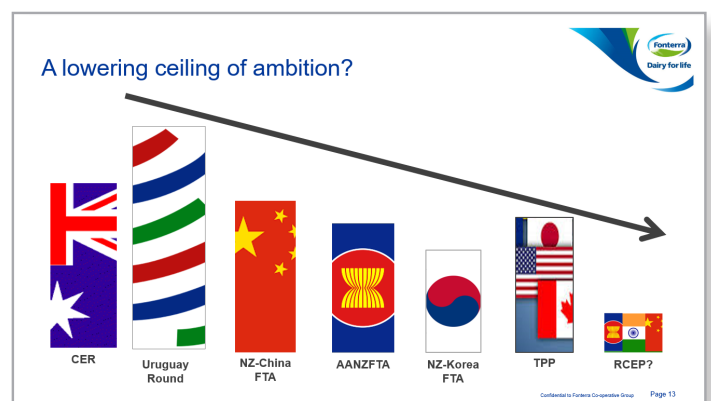
The biggest single risk I see is that New Zealand and other countries succumb to a steady debilitating erosion of aspiration.

### A lowering of ambition?

This chart highlights some of the big trade policy wins for New Zealand over the last 40 years, from CER, through the WTO Uruguay Round, to the China, ASEAN and FTAs. These have all contributed greatly to our economic success today.

Now the political temptation is to lower the bar:

- big multilateral rounds under the WTO haven't worked; so let's settle for plurilateral deals
- But TPP isn't working as planned. So let's settle for TPP minus.



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- Or small bilateral deals
- Or RCEP – a potentially interesting group of countries (including India, China and Japan) but one that has so far failed woefully to address market access in a serious way.

New Zealand has a well-deserved and hard-fought reputation for leading the cause of trade liberalisation and an open economy worldwide.

While we may feel sometimes like a shag on a rock, others watch and take note.

Now is not the time to reduce our ambition and settle for third best – but to continue to speak out and advocate for liberal trade.

There is always opportunity in change.

While it is not clear just where these opportunities will lie, there is no doubt that those opportunities will exist. Let me give you some examples:

- The UK, post-Brexit, has a golden opportunity to resume its traditional championship of free trade, using its weight as the world's 6th largest economy to catalyse new groupings that could involve NZ
- The EU has the chance to show it is still a force for good in trade by concluding high quality FTAs with New Zealand and others.
- China has the chance to follow through on President' Xi's speech and demonstrate real leadership on globalisation. An upgraded FTA with New Zealand would be one early example of that. Its One Belt One Road concept may be another innovative way forward that New Zealand should engage with actively.
- New Zealand itself has opportunity to continue to explore new bilateral FTAs with countries that are prepared to sign on to our high standards: that must always mean a commitment in time to go to zero tariffs for all products.

So in this highly dynamic situation, New Zealand needs to maintain our ambition, and be nimble, agile and open to opportunities wherever they may arise.

To achieve this we also need the right resources and people in the key agencies – MFAT and MPI – who do this stuff.

We have some terrifically capable people in our trade negotiating teams – but not enough of them.

If we are to deal effectively with the challenges I have outlined, we believe it is critical that the Government reinforce resources in trade strategy quickly and substantially in the next budget.

Finally a suggestion for all of you. Trade matters to all of us.

Governments are struggling to persuade ordinary people why this is.

We cannot simply leave it to politicians and officials to make the case.

Business also needs to make a stand and tell our stakeholders – our investors, shareholders – why trade is important.

Quite simply, there won't be new trade deals if civil society does not believe in or understand the benefits of trade.

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**So to sum up:** the world is certainly looking riskier and scarier, particularly for a trading nation like us.

But protectionism is not new.

Trade patterns continually evolve to changing market access environments.

And change always brings opportunity.

The last thing we should do is to allow our ambitions to sag, and settle for lowest-common denominator outcomes in the name of political reality.

New Zealand needs to keep a cool head, build our resources, and be ready for the inevitable opportunities that will arise from the current chaos.

We have a well-deserved reputation, and considerable economic success, from our role as a leader in promoting an open and fair trading environment. We need to stick to it now of all times.