

## **The Trans-Pacific Partnership Agreement: Should New Zealand Dairy Trade Be Excluded?**

Dairy imports from New Zealand are shaping up to be a major issue as the United States proceeds with negotiations with a Pacific basin free trade agreement with Singapore, Chile, Brunei, Vietnam, Peru, Australia and New Zealand (the Trans-Pacific Partnership or TPP agreement). New Zealand is the world's most successful dairy exporter, in part because of natural climatic advantages and in part because it has consolidated its dairy industry around one export-focused company, Fonterra. U.S. dairy farmers and many members of Congress believe that Fonterra engages in unfair trading practices and exercises excessive power over the global dairy market. They want to exclude U.S.-New Zealand dairy trade from the proposed TPP. New Zealand and its defenders in the United States claim that the Pacific island nation's success must be attributed to its free market, subsidy-free, and deregulated agricultural policy. But, America's dairy farmers have the ear of Congress.

### *New Zealand's Comparative Advantage and Export Strategy*

New Zealand's comparative advantage and low production costs result in part from its almost uniquely lush environment and mild climate, which are ideally suited to pastoral agriculture. New Zealand has large tracts of abundantly-watered land on which cows can graze outside all year long, usually without the need of shelter and with only occasional need for additional silage and feed supplements (mainly on the cooler South Island).<sup>1</sup>

New Zealand has sought to build on its natural advantages by:

- Encouraging the consolidation and integration of its dairy industry to produce economies of scale;
- Ending farm subsidies and price supports; and
- Construction of an international marketing, logistic, transportation, and sales network that operates through subsidiaries, joint partnerships, contractors, and direct overseas operations extending to 140 countries around the globe.<sup>2</sup>

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<sup>1</sup> Camilla Ohlsson , "New Zealand Dairy Cooperatives –Strategies, Structures, and Deregulation," Swedish University of Agricultural Sciences, Uppsala, 2004, p.5, available at [http://epsilon.slu.se/8080/archive/00000400/01/Ohlsson%2C\\_Camilla.pdf](http://epsilon.slu.se/8080/archive/00000400/01/Ohlsson%2C_Camilla.pdf).

<sup>2</sup> Ohlsson p.21; *See generally*, Jerker Nilsson, Camilla Ohlsson, "The New Zealand Dairy Cooperatives' Adaptation to Changing Market Conditions," *Journal of Rural Cooperation*, Vol 35(1):43-70, 2007, available at <http://www.ernac.life.ku.dk/~media/ERNAC/LIBRARYPAPERS/JN15.ashx>.

All this resulted from New Zealand's plan for developing a world-beating dairy industry by investing almost complete corporate control of New Zealand dairy in one company, the Fonterra cooperative company.<sup>3</sup> Fonterra is the successor to New Zealand's state dairy trading enterprise (that was arguably privatized in order to avoid WTO rules) and New Zealand's two dominant dairy cooperatives.<sup>4</sup>

According to its website, Fonterra is "the world's leading exporter of dairy products and responsible for more than a third of international dairy trade."<sup>5</sup> Fonterra has succeeded in its goal of becoming the world's lowest-cost supplier of dairy commodities, and now is increasingly focused on manufacture of value-added goods and sale of consumer products.<sup>6</sup>

Fonterra processes 95% of all New Zealand milk, earns 20% of New Zealand export receipts, and generates 7 % of New Zealand's gross domestic product.<sup>7</sup>

### *The Rationale for Excluding U.S.-New Zealand Dairy Trade from the TPP*

On March 11, 2010, thirty U.S. Senators wrote to Ron Kirk, the U.S. Trade Representative, arguing that dairy farmers in the United States could lose \$20 billion over ten years if the TPP does not exclude New Zealand dairy imports. "Because of the anticompetitive practices in New Zealand's dairy industry and the extensive degree of control it wields over world dairy markets to the detriment of the U.S. dairy industry," says the letter from Senators Russ Feingold (D-Wis.), Mike Crapo (R-Idaho), and 28 others, "we are deeply concerned that an expansion of U.S.-New Zealand dairy trade would further open the U.S. to these imports while providing little additional market for American farmers in New Zealand and the other Pacific countries."<sup>8</sup> The back story to this controversy is the significant increase in recent years of imports from New Zealand of milk protein concentrates (MPCs) and casein<sup>9</sup> that are believed by U.S. dairy farmers to displace domestic milk in cheese manufacturing and to depress domestic milk prices.<sup>10</sup> The senators are also concerned that the TPP would further

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<sup>3</sup> Ohlsson, pp.25-30, p. 41.

<sup>4</sup> Ohlsson pp.22-23.

<sup>5</sup> [www.fonterra.com](http://www.fonterra.com).

<sup>6</sup> Ohlsson, p. 26; Nilsson, pp.11-12.

<sup>7</sup> Nilsson, p. 2.

<sup>8</sup> The March 11 letter is available on Senator Feingold's website, [http://feingold.senate.gov/pdf/itr\\_031110\\_tpp.pdf](http://feingold.senate.gov/pdf/itr_031110_tpp.pdf).

<sup>9</sup> The main protein in milk.

<sup>10</sup> Ralph M. Chite, Congressional Research Service, CRS Report for Congress, RL 33475, "Dairy Policy Issues," June 16, 2006, pp.11-13. "Certain concentrations [of MPCs and casein] are not covered by tariffs and quotas under

open the U.S. market to New Zealand exports of higher-valued dairy products currently covered by U.S. tariff rate quota (TRQ) restrictions.<sup>11</sup>

Similar complaints were voiced by House members of the congressional dairy caucus, including Rep. Steve Kagen of Wisconsin, who says that the U.S. dairy industry could be “jeopardized” if the TPP goes through in its current form, based on the NAFTA/CAFTA model, because it costs so much more to produce milk in United States. “Kagen says it costs between \$13.00 to \$17.00 to produce a hundred pounds of milk in Wisconsin, while in New Zealand those expenses are less than half that cost.”<sup>12</sup>

In testimony before the U.S. International Trade Commission on February 18, 2010, the National Milk Producers Association (NMPA), representing U.S. dairy farmers and marketing cooperatives, opposed the inclusion of U.S.-New Zealand dairy trade in the TPP on the grounds that the New Zealand dairy industry engages in monopoly practices and manipulates global dairy markets.<sup>13</sup>

According to the NMPA: “This extraordinary level of control reaches as high as 40-46% ... for certain heavily traded dairy products such as whole milk powder (40%) and butter/anhydrous milkfat (46%). These figures do not even take account the widely expanded scope of control that Fonterra enjoys through its investments and business partnerships with a number of dairy industries around the world.” For example, Fonterra has 12 manufacturing plants in Australia and is investing in large-scale “factory farms” in China. It owns Saprole, a

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the existing World Trade Organization agreement. The importation of these products was not an issue when the agreement was formulated in the 1990s.” Chite. p.11. Measures have been introduced in Congress to impose tariff rate quotas, *see below*, on certain MPCs because of alleged anticompetitive dumping by New Zealand and other foreign producers. Chite. p.12.

<sup>11</sup> A tariff rate quota is: “A trade policy tool used to protect a domestically-produced commodity or product from competitive imports. A tariff rate quota (TRQ) combines two policy instruments that nations historically have used to restrict such imports: **quotas** and **tariffs**. In a TRQ, the quota component works together with a specified tariff level to provide the desired degree of import protection. Imports entering during a specific time period under the quota portion of a TRQ are usually subject to a lower, or sometimes a zero, tariff rate. Imports above the quota’s quantitative threshold face a much higher (usually prohibitive) tariff. Currently, TRQs apply to U.S. imports of certain dairy products, beef, cotton, peanuts, sugar, certain sugar-containing products, and tobacco.” Jasper Womack, Congressional Research Service, “Agriculture: A Glossary of Terms, Programs, and Laws, CRS Report to Congress, 97-905, June 16, 2005, p.254.

<sup>12</sup> Congressman Steve Kagen News [Wisconsin AgConnection], May 17, 2010, available at <http://www.kagen4congress.com/news/kagen-says-trade-deal-could-make-or-break-us-dairy-industry-wisconsin-agconnection>.

<sup>13</sup> Dr. Peter Vitaliano, Vice President for Economic Policy and Shawna Morris, Vice President for Trade Policy, “Written Testimony by the National Milk Producers Federation to the International Trade Commission Concerning the U.S.-Trans-Pacific Partnership free Trade Agreement,” Investigation Numbers TA-131-034 and TA-2104-026, February 18, 2010, pp.5-11.

major dairy manufacturer in Chile, and is a 50% partner with Nestle in Dairy Partners of the Americas, which operates throughout South America.<sup>14</sup>

The NMPA concludes that: “the uniquely anti-competitive situation in New Zealand whereby one single company is permitted to control over 90 percent of the country’s milk production and more than 40 percent of global dairy trade in key product areas creates a unique market advantage. Given that situation, our industry believes there is simply no alternative to address these exceptional circumstances aside from a total exclusion of all U.S.-New Zealand dairy trade under the TPP.”<sup>15</sup>

### *The Rationale for Including U.S.-New Zealand Dairy Trade in the TPP*

In response to such criticism, Roy Ferguson, New Zealand’s Ambassador to the United States, said on March 2 that; “We take great pride in the success of the New Zealand dairy industry ... A quarter of a century ago we chose to eliminate subsidies and other forms of protection for our industry ... That is working, as we see from the number of new industry players and the influx of new investment, some of it from offshore ... For those who believe in the benefits of free markets and strong competition, success of this sort is something we should celebrate.”<sup>16</sup>

The Grocery Manufacturers Association agrees: “U.S. manufacturers of processed products are ... unable to compete globally because of quotas on imports of major ingredients. New Zealand is the lowest-cost major producer of milk and the largest exporter of SMP and WMP in the world ... GMA encourages USTR to allocate additional access for dairy products from New Zealand.”<sup>17</sup> The National Confectioners Association, representing candy, chocolate, and gum industries, takes the same view.<sup>18</sup>

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<sup>14</sup> Vitaliano and Morris, p. 6.

<sup>15</sup> Vitaliano and Morris, p. 11.

<sup>16</sup> Roy Ferguson, “Trans-Pacific Partnership: New Zealand Submission to the US International Trade Commission,” March 2, 2010, p.1, available at <http://www.nzembassy.com/usa/news/trans-pacific-partnership-new-zealand-submission-to-the-us-international-trade-commission>.

<sup>17</sup> Grocery Manufacturers Association, “Submission to U.S. Trade Representative, Request for Comments Concerning Proposed Trans-Pacific Partnership Trade Agreement,” January 25, 2009. p.5-6.

<sup>18</sup> Lawrence T. Graham, President, National Confectioners Association, “US Chocolate and Confectionary Industry Priorities for the Trans-Pacific Partnership FTA,” submission in response to USTR Federal Register notice, docket no. USTR-2009-0041, January 25, 2010 (“A successful TPP must also include increased access to milk and milk products from New Zealand, the world’s leading supplier of dairy. Requests from US domestic commodity groups urging no additional US access for New Zealand dairy and no regional use of New Zealand dairy products would virtually exclude our sector from any benefits.”), p.3.

Although the International Dairy Foods Association (IDFA), representing dairy processors, has kept a somewhat less visible profile on the TPP/New Zealand dairy debate, the IDFA has, in the past, opposed bills that would impose tariff-rate quotas (TRQs) on certain milk protein concentrates (MPCs).<sup>19</sup> The IDFA has also adopted a strong policy in favor of liberalizing international trade in dairy commodities and products: “IDFA supports the liberalization of the global dairy market and has consistently been a champion of trade agreements that eliminate tariff and non-tariff barriers to trade. These barriers include export and other trade-distorting subsidies, discriminatory or arbitrary technical standards and regulations, and a myriad of other obstacles to free and open markets.”<sup>20</sup> Specifically, IDFA policy states that: “Presently, only New Zealand and Australia depend on foreign dairy markets for the lion's share of their dairy revenue. Liberalization of the global dairy market will allow U.S. dairy manufacturers to gain more valuable global opportunities for their products. As more market barriers fall, and the gap closes between U.S. dairy prices and world market prices, competitive opportunities for U.S. dairy foods will expand and more U.S. firms will take advantage of foreign markets.”<sup>21</sup>

### *Conclusion*

Even supporters of New Zealand and its market-oriented policies are skeptical about gaining greater access for its dairy exports to the United States. The libertarian CATO Institute is a big fan of New Zealand's economic, regulatory, and trade policies, and it regularly ranks New Zealand as one of the two or three most business-friendly and globalized countries in the world. But, Sally James of CATO doubts that the TPP will result in a significant opening of the U.S. market to New Zealand dairy products. She says: “the bruising experience with the sugar lobby during the negotiations for the FTA with Australia serves as a warning for those that hope a TPP might, through freer trade with New Zealand, bring U.S. consumers long-overdue access to competitive dairy products. Dairy would likely be subject to significant carve-outs and delayed liberalization, especially if, as Ambassador Kirk threatens, members of Congress are intimately involved with proceedings.”<sup>22</sup>

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<sup>19</sup> Chite, p.12 (IDFA argues that MPC imports are not displacing U.S. production of nonfat dry milk.)

<sup>20</sup> International Dairy Foods Association (IDFA), “Benefits of Liberalizing Global Dairy Markets”, available at <http://www.idfa.org/key-issues/category/global-markets/processor-benefits/>.

<sup>21</sup> IDFA.

<sup>22</sup> Sally James, “Is the Trans Pacific Partnership Worth All the Fuss, Free Trade Bulletin, no.40, March 15, 2010, CATO Institute, available at [http://www.cato.org/pub\\_display.php?pub\\_id=11443](http://www.cato.org/pub_display.php?pub_id=11443)

Without question, America's dairy farmers are raising their pitchforks in opposition to more New Zealand dairy imports under the TPP.

### *Appendix I*

#### *Questions for Consideration if the TPP Includes U.S. - New Zealand Dairy Trade*

- (1) Will inclusion of New Zealand dairy trade accelerate the horizontal concentration and vertical integration of the dairy agriculture sector in the United States? If so, will this increase market efficiency or facilitate anti-competitive practices?
- (2) Will inclusion reduce the cost of dairy inputs for U.S. dairy manufacturers, allowing them to compete effectively in the world market in the same way New Zealand does?
- (3) If New Zealand dairy trade is included in the TPP, are there sectoral or regional trade-offs in terms of U.S. food manufacturers, dairy farmers, and marketing cooperatives? If so, are the U.S. job trade-offs positive?
- (4) Would inclusion of New Zealand dairy trade be a form of "unilateral disarmament" by the United States, in the face of subsidies and protection of local dairy farmers in Europe, Japan, and other truly important markets?
- (5) Would it be a foolish bargain, given that none of the countries that are to be parties to the TPP promises to be a significant market for U.S. dairy and agricultural exporters?
- (6) Or, would it be a smart bargain in return for a secure beachhead for U.S. services exporters in the fastest-growing market in the world: Asia and the Pacific Rim? For example, if the U.S. decided to sacrifice domestic market share in dairy in order to help service exporters, such as financial institutions, what are the U.S. economic development and job trade-offs on that score?

### *Appendix II*

#### *Broader Questions Raised by the U.S. - New Zealand Dairy Trade Controversy*

- (1) In order to compete internationally, does the US dairy industry need a different export vehicle, e.g. an export cooperative on a larger scale, than now exists? If so, would this necessarily, as suggested above, come with the cost of further consolidating U.S. dairy farms into larger operations and the cost of greater vertical integration of the U.S. industry that might result in a loss of bargaining power for family farmers?
- (2) Do the various U.S. trade associations making competing claims regarding this issue have solid data and economic analysis to back up assertions about the efficiency of international

markets on the one side or the anticompetitive practices of dairy multinationals on the other side?

- (3) Is there any way to preserve the agricultural policy goals of a fair farm gate price and commodity price stability, if the U.S. dairy industry is further globalized?
- (4) Beyond the economic policy debate, what would be the social and cultural costs for family farms and rural America, if the U.S. dairy sector is further globalized?