

# WHAT LIES AHEAD? LOOKING AT COSTS AND SUSTAINABILITY FOR THE FUTURE

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## Introduction

The Food miles debate has raised the importance of keeping aware and abreast of market developments particularly in relation to attitudes towards the environment. This seminar will evaluate the existing and potential factors that may affect our access into markets, especially our premium markets. It will scope issues that may have to be addressed to maximise the premium we can obtain.

Thus the paper will review factors that can affect market access for New Zealand exports. This will include trade agreements and internal and external countries' policies especially of the EU. It will then assess consumers concerns on environment and trends can have important impacts. Finally the trend in Eco labelling and environment friendly certification protocols will be reviewed.

## Trade issues

### *World Trade Organisation (WTO)*

The Doha round negotiations in the World Trade Organization (WTO) were due to agree in modalities and draft schedules in 31 July 2006 but were suspended due to the lack of agreement on agriculture issues. The agricultural issues in discussion concerned three main pillars: market access; domestic support and export competition.

On *market access* it was agreed to apply tariff cuts based on tiered formula where higher import tariffs would suffer higher reductions. There was no agreement on the average level of cuts, yet progress was made. During July the European Union (EU) offered negotiations an average tariff cut of 48.3% (bigger than 39% tariff cut offered in October 2005) and closer to the 51% G-20 (developing countries: Argentina, Bolivia, Chile, China, Cuba, Egypt, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Philippines, South Africa, Tanzania, Thailand, Venezuela and Zimbabwe) offer. The US was asking for higher cuts (66%), which New Zealand goes along with.

On *domestic support* the United States (US), which has only partially reformed its domestic policies (Farm Bill), was reluctant to make cuts (the EU demanded 70% cuts in US overall distorting support) asking for higher tariff cuts. The EU proposed a \$13-14bn ceiling on domestic support compared with a 22.5% ceiling put forward by the US. The EU has converted most of its Common Agriculture Policy (CAP) direct payments into the Single Farm Payment (SFP), which is less trade distorting and therefore not subject to those reductions.

On *export competition* the EU has proposed to eliminate its export subsidies progressively until 2013. However, on the condition that other forms of export support are addressed as well: export credits, food aid and State Trading Enterprises (STE). The critics of the latter point toward the use of statutory privileges and regulatory benefits that have trade-distorting effects. Such activities include price-pooling, anti-trust immunity, direct and indirect preferential (re)financing conditions, preferential transport services, use of monopoly powers including single-desk selling and exclusive utilization of preferential market access quotas (European Commission 2005). These pressures may have an impact on FONTERRA whilst not being a single desk seller many has that perception.

Other chapters of importance in the WTO are the geographical indications (TRIPS) and Sanitary and Phyto-Sanitary agreement (SPS). Some trade partners, such as the EU are calling for further reinforcement of respect of regional indications. The SPS measures are becoming increasingly important in trade and are described below.

The future outcome of WTO negotiations will be very dependent on the progress achieved during November 2006 and the first quarter of 2007. The mandate that gives authority for the US President to negotiate trade deals on behalf of the congress (TPA) expires in June 2007. Also, the US administration was due to table proposals for the next 2008 Farm Bill in January 2007. A renewed Farm Bill composed of less trade distorting payments (e.g. counter cyclical payments) will contribute to a positive outcome in WTO. In the “worst” case if DOHA talks are not successful in the first quarter of 2007 they could be suspended for years. The important political context in 2008/2009 might not provide opportunity for WTO agreements (US Presidential Campaign, elections in UK and France, appointment of new WTO director general, and China and Russia can be expected to play a bigger role)(Agra Europe 2006).

A successful Doha WTO agreement will bring advantages to NZ producers as it might result in reductions in import tariffs and export subsidies. A failure or delay of the Doha agreement will bring more focus on bilateral free trade agreements (e.g. EU and Mercosur; US and Chile; NZ and China) instead of multilateral ones.

Despite these instable developments the WTO continues to expand. Recently, Vietnam joined the WTO and prospects are positive for a future Russian membership (Agra Europe 2006).

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### *Bio security controls*

The Biosecurity or quarantine controls at country borders has tended to increase and will become more important when discussing market access. Often, quarantine measures are overly applied and act as a protectionist tool towards imports. In fact, if on one hand biosecurity activities are important to New Zealand as they prevent the entry of undesirable organisms that can damage internal production, on the other hand an over use of biosecurity from other countries can affect New Zealand exports.

Invoking trade barriers to prevent local productions from biological threats are subject of discussions under the Sanitary and Phyto-Sanitary agreement (SPS) in the World Trade Organization (WTO) framework. Methodology is being developed to introduce economics in biosecurity decisions. The iso-risk-approach presented in FAO (1996) and further developed by (Bigsby 1998) allows analysis of the economic benefit of importing a certain product even though it might cause a threat to a country's domestic production. For example, James and Anderson (1998) demonstrated that removing Australia's ban on banana imports would increase net social welfare by \$100 million a year, even if the domestic banana industry were to be eliminated as a result of imports (Tanner 2006).

### *Agriculture policies*

The internal support policies for the agricultural sector will affect local competition. The EU reformed its Common Agricultural Policy (CAP) in 2003 for sectors such as cereals, beef and dairy, and is preparing a reform of their aid regime for the fruit and vegetables sector.

The CAP 2003 reform includes a Single Farm Payment (SFP) in which subsidies are decoupled from production. That is farmers receive a payment irrespective of what and how much they choose to produce. Currently the arable or beef growers that benefit from the SFP based on historical references have been barred from cultivating fruits and vegetables (see below). However, this bar should be lifted with the introduction of the SFP in the fruit and vegetables sector foreseen for 2008. This raises the possibility that subsidized (SFP-supported) growers could be competing with traditional fruit growers (Agra Europe 2006).

The CAP reform of 2003 also brings the importance of environment, quality and safety issues into the EU agricultural support. To benefit from the SFP, farmers will have to comply with existing legislation on those issues (cross-compliance). Assistance in the form of advisory services for farmers is foreseen to help EU farmers to meet the standards. In addition support for voluntary agri-environmental measures is increased. Incentives are foreseen for farmers who join food quality certification schemes and consumer information campaigns (e.g. promotion of geographical indications) (EU 2003).

The Agri-environment policies have assumed a more prominent role of developed countries' agricultural policies in the last two decades, to respond to a heightened demand of improving the environmental performance of agriculture. A number of countries including the EU, the US and Norway are increasing or converting the use of direct payments to improve

environmental outcomes. Countries like Australia, Canada and New Zealand have placed emphasis on legislation and more community-based approaches to address environmental issues (OECD 2003). This increase of environmental requirements in developed countries and public support thereof is expected to continue. New Zealand growers will have to deliver the same standards without public support. To avoid trade distortions and engage political debate the OECD secretariat is currently evaluating and comparing these policies.

### ***Importance of environment***

#### *Integrated product policies towards environment*

Since 2003 the EU is implementing the Integrated Product Policy (IPP) that seeks to minimize environmental degradation caused by product manufacturing, use or disposal. The objective is to look at all phases of a product's life-cycle and take action where it is most effective. The tools to achieve the objectives include economic instruments, substance bans, voluntary agreements, environmental labeling and product design guidelines (European Commission 2005).

The identification of products with environmental impact (action called EIPRO) is currently being held and should be finalized by the end of 2007. Food and drink, private transportation and housing all together are responsible for 70-80% of environmental impacts. Also, the EU is identifying the possible ways in which the life-cycle environmental impacts can be reduced. A set of measures are foreseen, such as state aid, environmental management system, Eco-design, labelling and product declarations (Eco-label and Energy labelling), greening public procurement, green technology and legislation. The Eco-label includes several categories of products such as cleaning products, appliances (TV, computers), tourism, etc (European Commission 2006). At the moment agricultural products are not included, although they are not excluded in the future. The IPP is an example of the upcoming trend towards improved environmental actions and correspondent labeling.

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### *Climate change, Kyoto Protocol and “food miles”*

Market access will be affected by discussions related with the global environment, in particular with the climate change, Kyoto protocol and “food miles”. Debate has been created around the assumption that traveling commodities may contribute to unnecessary greenhouse gas emissions. Research in sectors such as the livestock market as shown that production exported from New Zealand to long distant destinations like the UK are still overall more energy efficient (Saunders, Barber et al. 2006). However, one should not underestimate the possibility of future restrictions from importing countries, via regulatory means, such as taxes on imports, or via market pressure (retailers or consumers). A proactive attitude in carbon emission through certification procedure (e.g. Landcare Carbon zero certification scheme) might become more important to retailers and supermarkets (Manning 2000). This is especially the case give recent initiatives in the UK. Tesco have stated that all products in its store will receive a carbon rating and are investing 500 million pounds to do this. Marks and Spencer are investing 200 million to reduce its carbon foot print by 80 percent over five years.

Clearly the food miles argument has to be continued to be fought here. Concern about product imported by air is growing with the Soil Association in the UK refusing organic status to products air freighted.

### **Consumer trends**

#### *Supply seasonality*

On the positive side the markets of the Northern Hemisphere are looking for off-seasonal products that New Zealand has the ability to supply. This demand is also backed by growing consumer concerns on nutritional and health requirements (see Health and Nutritional aspects below).

On the negative side the transport of food to allow a full year supply is being criticized by its impacts on the environment as mentioned below and by its impact on quality and health factors.

#### *Food systems: globally vs. locally grown*

The dominant model of food consumption has been global in nature with urban/rural delineation, long-distance trade routes and industry concentration. However, an emerging model of food consumption more locally based, with urban/rural partnerships and shorter trade routes is gaining importance in food markets (Wilkins 2006). Studies in the US show that locally grown food labels play a great influence on consumers. Given a choice, consumers are more likely to purchase locally grown over organic foods produced in a distant region, even if the local foods were produced using some pesticides (Leopold Center for Sustainable Agriculture 2004).

### *Health and nutritional aspects*

Health concerns have become a strong driver of the food consumer. The world Health Organization (WHO) recommends an intake of more than 400 grams of vegetables and fruits per day. Fruits and vegetables can help preventing major diseases such as cardiovascular diseases, diabetes and gastrointestinal cancer. The UK, for instances has an average daily intake of 200g (Fisher Boel 2006). Public health legislation in some countries is shifting to the individual taking more health responsibility (Martech Consulting Group n.d).

Product differentiation on the basis of health components is critical. Also, opportunities exist to develop new varieties specifically targeted at processing fruit-based products. (Martech Consulting Group n.d).

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