

The evolving NZ-US trade relationship

Selected case studies

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Authorship

Each year NZIER devotes some of its resources to undertake and make freely available economic research and thinking aimed at promoting a better understanding of New Zealand's important economic challenges.

The preparation of this paper was funded from those resources.

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About this report

NZIER contributes to book that outlines ways to enhance the U.S. – New Zealand relationship

The bilateral relationship between New Zealand and the U.S. has never been in such good shape. The Trans-Pacific Partnership trade agreement currently under negotiation presents a further opportunity to deepen links between New Zealand and U.S. businesses, and to enhance the broader bilateral relationship.

A recently-released book, titled *Pacific Partners – The future of U.S.-New Zealand relations*, looks at the relationship between New Zealand and the U.S. across five areas: political and security cooperation; trade and investment relations; science and technology cooperation, educational and cultural linkages; and cooperation on transnational issues.

The book was produced by the Centre for Strategic and International Studies (CSIS) in Washington DC and the New Zealand institute of International Affairs (NZIIA) in Wellington. It was formally launched at the United States-New Zealand Partnership Forum in Christchurch on 21 February 2011.

The key conclusion of the book is that now is the time to move the relationship to a higher level of engagement. It provides 32 specific recommendations as to how this could happen.

The full report can be downloaded here:

http://csis.org/files/publication/110211_Bower_PacificPartners_web.pdf

NZIER contributed the trade and investment chapter of the book. We drew on statistics and interviews with firms to highlight that:

- The bilateral relationship has evolved beyond trade in primary and bulk manufactured goods
- Niche manufacturing, services trade, environmental and agricultural technology exchange, investment flows, and movement of people are now much more common
- U.S. businesses and government agencies benefit from using New Zealand goods and services to improve their productivity, and U.S. consumers are enjoying the safe, sustainable products that New Zealand makes and exports.
- New Zealand firms benefit from the scale of the U.S. market, and U.S. investment in New Zealand supports innovation and capital deepening.
- There are substantial opportunities for New Zealand and the U.S. to work together to open up new markets in the fast-growing Asian region.
- Concluding negotiations on the Trans-Pacific Partnership trade agreement, and then seeking to expand it to include Japan, Korea and other Asia-Pacific economies, will deliver benefits to both countries.

The chapter concludes with five recommendations about how to build better links between New Zealand and U.S. firms:

1. Conclude a high-quality Trans-Pacific Partnership (TPP) trade agreement as soon as possible.

2. Create a joint United States–New Zealand Eminent Persons Group (EPG), including the leaders of the United States–New Zealand and New Zealand–United States Councils, to further explore smart partnerships.
3. Initiate congressional/parliamentary visits aimed at deepening understanding of the opportunity to expand trade and leverage commercial relationships.
4. Develop a series of economic dialogues with the Asia-Pacific countries most likely to be interested in, and able to join, the TPP.
5. Identify areas of common interest and jointly promote those positions in key regional trade and investment forums such as the TPP, APEC, Closer Economic Partnership for East Asia (CEPEA), and the East Asia Summit (EAS).

The case studies that lay behind the trade and investment chapter have now been published on NZIER's website. These case studies were developed to inform and illustrate the conceptual ideas presented in the chapter, and to provide real world examples of how New Zealand and U.S. firms are working together for mutual benefit.

For any questions on the trade and investment chapter and the accompanying case studies, please contact John Ballingall on 04 470 1804 or john.ballingall@nzier.org.nz

Key points

The trade and investment relationship between the United States and New Zealand has evolved significantly in recent years. Increasingly the links between the two economies are moving well beyond primary product-based trade. Niche manufacturing, services trade, environmental and agricultural technology exchange, investment flows and people movement are much more common.

There are many examples of sectors where mutually beneficial business relationships have developed, including:

- Dairy
- Meat
- Healthcare
- Agri-tech
- Environmental goods and services ('green growth')
- ICT
- Niche manufacturing

This Public Good report presents short case studies on these sectors. This material was gathered by John Ballingall when he co-authored the trade and investment chapter of a recent book on U.S.-NZ relations. The book, titled *Pacific Partners – The future of US-New Zealand relations*, was produced by the Centre for Strategic and International Studies (CSIS) in Washington DC and the New Zealand institute of International Affairs (NZIIA) in Wellington.

The full report can be downloaded at the following website:

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1. The dairy sector - opportunity and challenge

The global market for dairy accounts for 7 percent of global trade (US\$4,270 billion) and of that amount, US dairy farmers and companies have around a 10 percent market share while New Zealand dairy companies and farmers account for about 30 percent.

Supporters of the TPP agreement note that it would likely drive investment and new partnerships among US and New Zealand companies in the sector, strengthening their collective ability to expand and develop global markets together instead of protecting existing markets and passing on higher prices to consumers. With their significant share of international dairy trade, the US and New Zealand could become a powerful market-opening team supporting global expansion of dairy markets.

An October 2009 study for the US dairy industry¹ emphasised the potential for the US to become a committed exporter of dairy products. It is clear that future demand growth will be driven largely by consumers in Asia, particularly China and Southeast Asian nations. For example, Chinese dairy consumption is expected to grow at up to 10% per year, with Southeast Asian consumption growth of 4-9% per year.

These countries' production of dairy products will not be sufficient to keep up with demand, creating a 'latent demand gap'. It is very unlikely that current exporters including New Zealand could fill this additional demand. This presents a clear opportunity for the US dairy sector to become more export-oriented. The US has the scale and cost structure in some regions such as California, Idaho and New Mexico to be able to expand dairy production in anticipation of exporting to growth markets in Asia.

It is in neither US nor New Zealand's interests to hold up the TPP over the dairy issue. On the contrary, including dairy in an Asia focused trade agreement designed to be the foundation for competitive liberalization is vital to the long term interests of farmers, companies and workers in both countries. Developing new and more sophisticated markets for dairy products will have a clear expansionary impact on the sector in both countries.

¹ See Innovation Center for US Dairy. (2010). 'The Impact of Globalization on the U.S. Dairy Industry: Threats, Opportunities, and Implications'. Presentation to Dairy Industry Advisory Committee, June 2010.

Box story - dairy cooperation

The US and New Zealand dairy sectors have established a high level of cooperation in areas such as research and development, the formation of international standards, working together in international institutions such as Codex and the International Dairy Federation and in taking common positions in global trade negotiations.

The Fonterra Cooperative Group is the largest dairy processor and exporter in New Zealand. It exports to over 140 countries including the US. While it has a long history of exporting to the US, it has expanded its activities in recent years to processing US origin milk and dairy products for use in the US market. This occurs through DairiConcepts which is a joint venture with Dairy Farmers of America.

In addition Fonterra works with Dairy America, the major US exporter of milk powder, in selling US milk powder to export markets.

2. The meat sector - complementary products

New Zealand exports lean grass-fed beef to the US. In recent years, US beef imports from New Zealand have been around 400 *million* lbs (180,000 tonnes), equivalent to 1.5 percent of US production of 24-26 *billion* lbs (11 million tonnes).

The US ground beef market is a complex mix of supply and demand, which combines domestic and imported products, to provide a wide range of different types of beef items for in-home and away from home consumption. Ground beef is a blend of domestic meat, so-called 50s (50:50 lean: fat from U.S. grain-fed beef production), and leaner beef known as 90s (90:10 lean:fat) from imported grass-fed beef or older domestic cows.

By itself, the US supply of 50s is too high, and the supply of 90s too low, for ground beef production. As a result domestic 50s have little value and most would enter the waste stream unless mixed with imported 90s. Therefore, rather than producing beef from grass-fed steers and heifers to make lean ground beef, the US has developed the feedlot system to produce its tender, high-value beef. Through trade – particularly by importing beef for ground beef production – American producers can focus on putting as many animals as possible through feedlots to increase their value.

Box story - meat cooperation

The Tri-Nations Lamb Group

The Tri-Nations Lamb Group (TNLG) is a collaborative initiative between lamb producer organisations from the United States, Australia and New Zealand to enhance the profitability and sustainability of the lamb market in the United States for the three supplying countries. Broadly, the key goal of the TNLG is to improve demand for lamb in the United States and halt the decline in per capita consumption without reducing current farm-gate prices. The TNLG meets regularly to coordinate activities to reach this objective. A major focus of the group's work has been a promotion project that aims to promote the nutrition, health and well-being benefits of eating lamb (regardless of origin). Another goal is to enhance export market opportunities for lamb and lamb products.

The members of the TNLG are the National Lamb Feeders Association and the American Sheep Industry Association (United States); Sheepmeat Council of Australia Inc and Meat & Livestock Australia Limited (Australia); and **Beef + Lamb New Zealand** and **Federated Farmers** (New Zealand).

Five Nations Beef Alliance

The Five Nations Beef Alliance (FNBA) includes the national organizations representing beef cattle producers in the United States (National Cattlemen's Beef Association), New Zealand (Beef + Lamb New Zealand), Australia (Cattle Council of Australia), Canada (Canadian Cattlemen's Association), and Mexico (Confederación Nacional de Organizaciones Ganaderas). Increasing global income and a more liberalized trading environment has resulted in global beef trade increasing over the past few decades, with these five beef-producing nations accounting for 20 per cent of this trade. When cattle exports are included, almost half of the world's beef and cattle exports are from these five nations.

The success in beef and cattle production of these five nations has been achieved through internal efficiencies and through a lack of government and other artificial support. Global beef trade is expected to continue to increase, however efficient trade in beef has been restricted by a variety of factors. Many regions still operate with trade distorting measures including high tariffs and quantitative restrictions. More recently, trade has been obstructed severely by animal health issues. The FNBA has adopted a shared vision on these matters, and has coordinated efforts to work with members' respective national governments and other international and inter-governmental organizations that influence trade in beef and livestock.

3. Helping with health

Both New Zealand and the US are facing up to the considerable challenge of the impending pressures on the health sector due to an ageing population. Finding innovative medical solutions that improve the productivity of the health sector is therefore critical. New Zealand firms have already shown that they have expertise in developing such solutions, and are working closely with US organisations to generate better health outcomes at a lower cost.

Fisher and Paykel Healthcare (F&PH), for example, has its headquarters in New Zealand, makes its medical equipment in New Zealand and in a plant in New Mexico, and distributes it via the company's 150-strong workforce in the US. F&PH is one of the global leaders in the provision of equipment to treat obstructive sleep apnea (OSA) – a condition that leads to a lack of oxygen flowing through the airway during sleep. It is associated with obesity, which is an ever-increasing problem in the US. The result for sufferers is very poor quality sleep, and a multitude of associated problems such as anxiety, hypertension, diabetes and poor concentration. As there are around 12 million OSA sufferers in the US, this condition generates a significant amount of healthcare costs, lost productivity and workplace accidents. F&PH provides masks, Continuous Positive Airway Pressure (CPAP) devices and humidifiers to treat OSA, working with homecare dealers and hospitals' sleep labs.

F&PH also provides US healthcare providers (via a US company Carefusion) leading edge technology in the field of respiratory humidification. These products are used when patients can no longer breathe by themselves and need assistance via ventilation masks. F&PH have developed products that humidify the cold gas that usually flows through ventilation masks. This reduces the risk of pneumonia and other complications associated with wearing masks for extended periods. Its 'Nasal High Flow' technology is another product that has been highly successful as it reduces the need for invasive ventilation – making life with ventilation problems more pleasant for US sufferers.

Orion Health is a provider of clinical workflow and integration technology, based in New Zealand (its development arm is based in Mt Eden, Auckland) and operating in the US and around the world. Orion has offices in Santa Monica and Boston, and is considering starting a development arm in the US. It is poised to use its software capabilities to help US health authorities achieve some of the goals of President Obama's healthcare reforms related to linking patients' records across the various parts of the US health sector. By creating a unique portal for each citizen, Orion's product means that doctors, hospital, emergency rooms, pharmacies and specialists can all access the same information, in real time. This should lead to better quality decision making, efficiency gains and reduced administrative costs across the health sector.

These two examples demonstrate that New Zealand firms are well placed to deliver innovative, tailor-made and advanced health technologies to US providers. These

products can make a very positive contribution to some of the most pressing health challenges facing the US now and into the future.

4. Agri-tech exports: Kiwi technology, US potential

New Zealand has long been well regarded for its agricultural efficiency, innovation and early uptake of on-farm technology. Increasingly New Zealand firms are using their expertise, especially in the agri-tech sector, to help overseas companies to lift their productivity.

In the US, this involves adapting (rather than simply imposing) New Zealand farm models to the specific geography, climate, management and worker skill level requirements of US farms.

This has a number of economic benefits for US primary producers:

- It allows them to shift their focus from bulk commodities towards high value added products, which should lift their farm's profitability over time.
- It allows yields to increase in areas where there is strong local demand, better matching production and consumption and reducing the need for costly long distance transporting of crops and foodstuffs.
- It encourages technology transfer so that US farmers are better placed to use modern farming techniques to improve yields, reduce costs and be more flexible and responsive to changing weather or market patterns.
- It helps farmers become more internationally competitive so that they can position themselves to meet the strong demand for primary products from China and other fast-growing Southeast Asian economies.
- The nature of the New Zealand - US relationships in agri-tech is necessarily long term, which provides US farm producers with certainty and stability for their planning purposes.

A good example here is **PGG Wrightson Seeds** (PGGWS). PGGWS exports forage and pasture seeds to the US beef and dairy farm market, with the objective of helping US farmers to lift their on-farm productivity. However, PGGWS also 'exports' New Zealand intellectual property. It has invested in building a R&D and product development footprint in the US, often working with agricultural universities (e.g. in Kentucky and Georgia) to create New Zealand-US 'hybrid' seed solutions that are specific to the local climatic and soil conditions.

PGGWS therefore fills a gap in the US market for seed products. While seeds are available from domestic producers in the US, these producers run a somewhat different business model to PGGWS. They focus on production volumes and bulk sales at low prices, whereas PGGWS aims to work with individual farmers to determine exactly what their needs are, based on where they are located and the farming techniques they use, and develop tailor-made products each time.

The level of US interest in grass-fed farming systems has increased in recent times, driven in part by high prices for corn-based feed and the presence of a premium on

locally produced milk on the East coast. This has created opportunities for companies such as New Zealand's **Livestock Improvement Corporation** (LIC), which specialises in dairy genetics. LIC is able to produce sires and provide bovine semen and grazing management advice that allow US farmers to switch milk production from cows that are suitable to be grain-fed in confinement systems to crossbreeds that are based on genes from New Zealand's proven grass-fed cattle strains. LIC has partnered with Taurus Service Inc and Dairy Farmers of America to deliver these services, which are essentially New Zealand farming systems but adjusted for local soil and climactic conditions in the US. The use of New Zealand-based technology allows US dairy farmers to deliver more reliable supplies of high quality milk, lifting their profitability.

These examples illustrate that there are considerable opportunities for the US agricultural sector to generate additional income by using New Zealand's 'exports of experts' of primary production techniques.

5. Encouraging green growth

New Zealand and the US are cooperating strongly in the area of developing technology and new farming practices to reduce agricultural greenhouse gas emissions. These efforts have been formalised through one of the few bright spots to emerge from the December 2009 Copenhagen meeting of the IPCC – the Global Research Alliance on Agricultural Greenhouse Gases ("the Alliance"). The Alliance was developed and promoted by New Zealand, and the US is one of the founding members.²

The Alliance is a voluntary network of countries, organisations and individuals that aims to increase international cooperation on research into agricultural greenhouse gas emissions, with the ultimate objective of growing more food without growing emissions. Since agriculture accounts for around 14% of global emissions³, and the demand for food is set to double by 2050, this is a considerable challenge. The Alliance's work includes encouraging technology transfer to developing countries, who may not have the capacity or resources to engage in emissions-reducing activities in the food sector.

New Zealand currently acts as the Alliance Secretariat, coordinating its five main areas of research focus:

- Livestock (led by New Zealand and the Netherlands)
- Cropping (led by the US)
- Paddy rice (led by Japan)
- Soil carbon and nitrogen recycling
- Inventories and measurement

² The full list of 30 members is Argentina, Australia, Canada, Chile, Colombia, Denmark, Finland, France, Germany, Ghana, India, Indonesia, Ireland, Japan, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Pakistan, Peru, the Philippines, Russia, Spain, Sweden, Switzerland, United Kingdom, United States, Uruguay, Vietnam.

³ <http://www.globalresearchalliance.org/about-us.aspx>

The Alliance is in its set-up phase, sorting out its governance structure and conducting a stocktake of relevant research in the 30 member countries with a view to identifying overlaps and information gaps. A Charter and research programme will then be developed by mid-2011.

The Alliance is a good example of how New Zealand and the US are working closely and constructively together on three major global challenges:

1. Mitigating climate change
2. Lifting agricultural productivity and enhancing food security
3. Assisting developing countries via technology transfer and capacity building.

The US and New Zealand have also worked together in the WTO negotiations on environmental goods and services. These negotiations aim to reduce trade barriers on goods and services that deliver environmental benefits when they are consumed. By lowering tariff and non-tariff barriers to these products, a number of positive outcomes occur:

- the standard allocative efficiency gains associated with trade liberalisation, which lift incomes and living standards
- the cost of accessing green technology in the importing country falls, which encourages greater consumption of that technology and should lead to a greater reduction in the negative environmental externalities associated with economic activity
- developing countries are able to obtain the goods and services they need to reduce the environmental damage caused by their sometimes rapid economic development.

While the WTO negotiations as a whole have stalled, and there are ongoing debates over the definition of what goods and services should be classified as 'environmental', New Zealand and the US have similar interests and approaches to this important aspect of encouraging sustainable development through trade liberalisation.

6. Enhancing productivity through ICT

The emergence of new business models presents New Zealand and the US with a host of commercial opportunities outside of the more traditional export and import trade channels. The ICT sector is probably the best example of this.

One New Zealand firm – **Renaissance** – has moved from being primarily an importer and distributor of US ICT products in New Zealand to now generating and exporting its own IP, applications and services back to the US and elsewhere. Its American CEO has used his entrepreneurial skills to commercialise and then export the bright ideas generated by create staff in New Zealand.

In doing so, Renaissance has exploited its relatively small size to earn a reputation in the US as being nimble, flexible and responsive to changing demands. Larger companies in larger economies are less able to respond so rapidly, which provides Renaissance with a real point of difference. It has turned what has traditionally been

seen as a competitive disadvantage for New Zealand firms (a lack of scale) into a positive brand attribute which US corporations value highly, as witnessed by its securing of a number of very large US contracts.

The value proposition of Renaissance to the US has thus shifted considerably over time. Initially it generated export revenue for US ICT product manufacturers. Now it uses US commercialisation acumen applied to New Zealand ideas to offer custom made ICT packages to US firms. These packages are US *imports* in the trade statistics, but the value is now in the productivity gains that Renaissance's products create for US purchasers.

7. Niche manufacturing: opportunities through innovation

Clearly New Zealand's lack of scale means that it cannot compete with global superpowers in the production of low-value, bulk-produced manufactured goods. Instead, New Zealand's niche manufacturers aim to harness some of the competitive advantages that New Zealand *does* have, such as its unique plant and animal materials, and innate ability to be innovative.

There are myriad examples of New Zealand niche manufacturers succeeding in the US. The baby buggy and accessories company **phil&teds** is well regarded for using innovative designs, colours and fabrics. It has developed an edgy website to assist its offshore presence, including in the US.

The garment manufacturer **Icebreaker** specialises in sustainable, natural outdoors clothing made from high quality New Zealand merino wool. It uses a unique traceability angle for its marketing – meaning that any US consumer can type in a code on their piece of clothing and see where its wool was sourced from, the farmers who own the sheep and other parts of the supply chain.

A number of New Zealand producers are able to combine their natural products (such as Manuka honey) with New Zealand's reputation as a clean, green, '100% Pure' exporter and sell to US pharmaceutical processors and distributors. New Zealand wine producers are becoming increasingly interested in the US market, where New Zealand wines are regarded as being of high quality and competitively priced.

There are a number of features that are common across these New Zealand niche manufacturers:

- They are small on a global scale, but are starting to dominate the niches in which they operate
- They are high end products that focus on delivering value-add to the customer and being different to the rest of the products in the market
- They are creating additional choice for the US consumer by expanding the scope of existing markets, rather than displacing US-produced items
- They provide innovative products with a unique feature that is New Zealand-specific, such as their quirky design or natural ingredients/inputs

- They are partnering with US organisations to help them process, market, distribute and sell their products.

This last point is critical. The US is a large and complex customer market. Without deep networks, strong branding, tailored marketing strategies and a catchy online presence, New Zealand firms are likely to find it difficult to break into the US market in any significant way. They need on the ground assistance from US firms. So rather than displace any economic activity in the US, New Zealand's niche manufacturers positively contribute to the US economy.