

Office of the Minister of Foreign Affairs

Chair,
Cabinet

Saudi Arabia Food Security Partnership

Proposal

This paper updates Ministers on progress in resolving a serious bilateral relationship issue with Saudi Arabia that poses a major threat to New Zealand's trade and economic interests.

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This paper asks Cabinet to note the proposals that have been developed to address this situation, prior to moving into the implementation phase. Broadly, the proposal involves facilitating the relocation of those aspects of the trade in live sheep for slaughter that are no longer permitted in New Zealand, to Saudi Arabia, and creating a new hub for New Zealand agribusiness service providers to build foreign exchange earning opportunities in the Middle East and Africa as a three year pilot project.

The cost of this initiative is \$4m. To leverage the benefits it is essential that it is accompanied by a NZTE-managed package of New Zealand goods and services valued at up to \$6m. Costs will be met from MFAT savings reallocated to NZ Inc leveraging initiatives.

Background

The Gulf Cooperation Council is a six member regional grouping of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. With a population of 28 million, Saudi Arabia is by far the largest and most influential GCC state.¹ The GCC comprises one of the wealthiest trading blocs in the world. Qatar has the highest GDP per capita (US\$102,000) in the world.

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The GCC countries share a common problem – an acute need for future food security resulting from a shortage of arable land (on average less than 1.5% of the land mass of GCC countries). In each case, well funded food security initiatives represent a priority for their government. The Qatar National Food Security Programme and the King Abdullah Initiative for Agricultural Holdings Abroad are good examples of well funded initiatives focused on achieving future food security, actively seeking out partners, especially from countries like New Zealand.

The threat to New Zealand trade and economic interests

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For the past three years the Minister of Foreign Affairs, supported by Ministry officials, has been working to resolve a major relationship issue with Saudi Arabia

¹ Saudi Arabia (28 million people), United Arab Emirates (7.9m), Kuwait, (2.8m), Oman (2.7m), Qatar (1.8m), Bahrain (1.3m).

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Briefly, the history of these events is:

- In 1995, acting on specific encouragement from New Zealand Ministers, Saudi interests commenced investing in the purchase of New Zealand farms in order to build a business supplying live lambs for slaughter to the Saudi market, commanding premium prices at the time of the Haj religious festival.
- In 2003, prompted by media controversy over the practice of exporting live sheep for slaughter, a de facto voluntary moratorium was introduced. The Clark Government then put in place a Customs Export Prohibition Order (CEPO) on animals for slaughter in 2007. This CEPO was renewed for three years in 2010.
- Despite this step, Ministers in the Clark Government continued to encourage Saudi interests to hold and increase their investment, promising that the issues curtailing their trade would be resolved.
- By the time the Key Government was appointed in 2008, tensions around this matter had become a serious irritant to the Saudi relationship.

s6(a) and s9(2)(g)(i) The Saudi Government stated unequivocally that the concerns of their investor needed to be addressed.

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s6(a) and s9(2)(g)(i)

- Exchanges with Ministers in the Key Government underlined the potential for major damage to our trade and economic interests and it was agreed that the Minister of Foreign Affairs would lead efforts to resolve what had become a major relationship issue.

Confidence-building steps

Following an initial visit to offer apologies for previous misunderstandings, comprehensive efforts have been made to find a solution to this problem. These have focused on the purpose of original Saudi interest in New Zealand – a need for greater food security. The Saudi Government has been clear that any solution must involve the Saudi interests that have invested in New Zealand over nearly two decades. The Minister of Foreign Affairs has initiated a process by which officials from MFAT, with input from MPI and NZTE have held discussions with those parties, and with a range of New Zealand agri-business interests potentially interested in the Saudi market. In order to provide appropriate structure, Deloitte were engaged to format these discussions in a business case and provide officials with external advice. These discussions focused on how the current stalled model for breeding Awassi sheep for export for slaughter could be reconfigured to link the benefits of the breeding programme in New Zealand to a relocated farming operation in Saudi Arabia which could then serve as a hub for the export of New Zealand agricultural services in the Gulf states and potentially Africa.

The proposal

In simple terms the proposal is to work with the existing Saudi investors in New Zealand to relocate the parts of their business that are no longer able to operate here as a result

of the ban on live sheep exports for slaughter. The objective is to use the investment they have made in the genetic development of the Awassi breed, their logistical, supply chain and market connections to create a base for New Zealand service suppliers to leverage the New Zealand brand and reputation for agricultural excellence in the Middle East market. For this purpose Deloitte conducted a modelling exercise and prepared a business case.

The resulting plan falls into two parts:

- A \$4m commitment to acquire from the Saudi investors the components of the platform to conduct a three year pilot.
- The allocation of up to \$6m for a NZTE led project to use the platform as a hub for New Zealand agricultural service providers to build an enduring presence in the Middle East and African markets.

The funding for both of these elements would be met from MFAT baseline savings reallocated to NZ Inc leveraging initiatives. The \$6m sum would be transferred to NZTE and disbursed through its usual systems and processes.

The platform

The \$4m figure has been established after negotiations with the parties who have invested in the trade in live sheep between New Zealand and Saudi Arabia, attempting to identify a commercial basis for acquiring access to the breeding systems, supply chains and trade relationships that will be required if we are to replicate in Saudi Arabia the business that they had intended to base wholly in New Zealand.

While the Saudi parties would have preferred to enter discussions on the basis of seeking compensation for commercial loss as a result of Government decisions (and indicated that they had received legal advice suggesting they pursue a claim for between \$20 million and \$30 million), the Government has made it clear that we would not be a party to such discussions.

Some consideration was given to an offer to purchase the New Zealand investments of these parties as a basis for resolution. However it became clear that the capital cost of doing so would have been much greater

s6(a), s9(2)(g)(i) and s9(2)(ba)

The focus has therefore shifted to negotiating a contract for services between MFAT and the Saudi interests to recognise the investment that has been made in the Awassi breeding programme to-date, the value of access to research and development, capital investment and market analysis, and of access to key customer, business and influencer networks in Saudi Arabia. The contracted services would also include assistance with the preparation of New Zealand agribusiness delegations to Saudi Arabia to study the in-market supply chain. This work will determine the shape of the New Zealand agribusiness hub. It also includes an obligation to use their best offices to connect New Zealand Government and trade interests with key government and commercial decision makers in Saudi Arabia.

s9(2)(g)(i) there will be strong incentives for the Saudi parties to promote the ratification of the NZ-GCC FTA as a basis for expanding this new business partnership.

Saudi interests have indicated that once the contract is signed they expect to make further significant investments in their New Zealand farming operations.

The services

The long term value of this arrangement can only be secured for New Zealand if there is an immediate engagement of agricultural service providers on the ground in the region. Extensive discussions with such providers suggest a high level of interest in becoming involved in the type of project outlined by Deloitte. Exploratory discussions with Saudi investors suggest a serious level of interest in purchasing additional services, which would see the hub grow quickly.

The range of New Zealand interests which might form part of the hub, subject to the study tour proposed for April 2013, include:

- Technical services (core science, R&D, advisors and educational courses)
- Farm inputs (animal feed and health products, fertilisers, chemical sprays, building and fencing materials)
- On-farm equipment (readers, scanners, scales, irrigators)
- On-farm business systems and expertise (specialist farm and benchmarking systems)
- Genetics testing and mapping expertise

Officials believe that a commitment of \$6m to an NZTE-led pilot programme over three years would be an appropriate investment in the pilot.

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Export of animals for breeding purposes

It is likely that the export of breeding animals, focused on Awassi sheep breeding stock currently in New Zealand, will form part of this proposal. The export of livestock for breeding purposes is permitted from New Zealand and all parties understand that they will need to meet the normal criteria and make applications in the normal way.

The opportunities

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A key goal in resolving this longstanding issue is of the GCC FTA.

on ratification

s6(a) A concluded FTA will add significant impetus to already significant trade opportunities for NZ in the Gulf.

New Zealand goods exports to the GCC already exceed \$1.57 billion (higher than the UK and India) and have grown at an average of over 10% over the past three years. This reflects a recognition by both the Government and the private sector of the fact that significant effort could see these figures lift dramatically. The only new New Zealand embassy opened anywhere in the world in the last three years was established in Abu Dhabi, and private sector interests have also invested heavily in their presence in the

Gulf. It is estimated that New Zealand exports to the GCC could double to \$3 billion (half our current exports to China) in the space of five years if we can achieve an FTA.

Around 8,000 students, mostly from Saudi Arabia, make the GCC our fourth largest international education market. The Saudi consulate in Auckland (which supports the Saudi students here on scholarships) is already the largest diplomatic mission in New Zealand. Both the United Arab Emirates and Kuwait have advised that they plan to open embassies in New Zealand during the term of this Government.

The increased tempo of New Zealand Ministerial visits into the Gulf has already attracted significant interest, with six GCC trade and investment delegations through here in recent months and several more planned. In recent weeks we have signed Government to Government partnerships with the Governments of Qatar and the UAE, creating an umbrella for a new flow of economic partnerships.

As a potential source of investment, the GCC states offer some of our largest opportunities. The Abu Dhabi Investment Authority (US\$600 billion), the Saudi Arabia Sovereign Wealth Fund (US\$500 billion), the Kuwait Fund (US\$300 billion) and the Qatar Investment Authority (\$115m) have all shown recent interest in New Zealand assets.

s6(a) and s9(2)(d)

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Conclusion

We have now reached the point at which discussions regarding proposals must move into an implementation phase. Already there is an expectation on the part of both the Saudi Government and private sector investors that discussions will now lead to actions. This sense will be reinforced by the planned study tour.

This is, then, the appropriate point to report progress and to seek the comfort of colleagues prior to embarking on the next phase.

It is my view that it is strongly in New Zealand's interests to proceed as envisaged. Even if we achieve nothing more than the removal of the source of major aggravation in the relationship, while creating a hub for New Zealand businesses to launch into the Middle East and Africa, their proposal would be justified. But the potential is there to do much more than this. There is an opportunity to unlock a huge source of badly needed capital. And there is a serious prospect of getting the GCC FTA across the line, with billions of dollars of advantage for New Zealand. For this reason I strongly support this project.

Consultation

The Ministry for Primary Industries and New Zealand Trade and Enterprise have been consulted. The Minister of Trade has been consulted and strongly supports this paper.

Financial implications

The cost of the food security partnership will be met within the current baselines of the Ministry of Foreign Affairs and Trade. Funding has been allocated for this purpose. A contribution from NZTE is also being discussed.

The \$6m funding for purchasing New Zealand goods and services as part of the partnership will be transferred to NZTE for this purpose.

Legislative implications

None.

Recommendations

The Minister of Foreign Affairs recommends that the Cabinet:

- Note the progress reported by the Minister of Foreign Affairs to address a significant impediment in the bilateral relationship between New Zealand and Saudi Arabia;
- Note the proposal to invest in a pilot agribusiness operation with Saudi Arabia as a means to resolve this dispute and form a long term food security partnership;
- Note the cost of this food security platform will be \$4 million initially, which recognises the intellectual property which the Saudi investor brings to the platform, the services and in-market networks he will contribute, as well as the settlement of the long-running dispute;
- Agree there will be an ongoing investment in the pilot agribusiness operation of up to \$6 million for the delivery of services by NZ agricultural service entities, and that the \$6 million will be undertaken in strict conformity with Government Procurement requirements;
- Note that the cost of these initiatives will be met from the MFAT baseline;
- Note that the procurement and selection of New Zealand firms and services to participate in the food security partnership will be done with agreement of the Saudi partners, MFAT, and NZTE, and funding will be disbursed using usual NZTE mechanisms;
- Note that any related proposal to export livestock for breeding purposes must meet existing MPI criteria and be the subject of an application in the normal way;
- Note that any export of livestock for breeding purposes under the partnership must be undertaken to achieve the effective relocation of breeding stock to Saudi Arabia for the purposes of shaping the new business model, and not to establish a new business in New Zealand in the export of livestock for breeding.

Hon Murray McCully
Minister of Foreign Affairs

Date: 13 February 2013

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