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FINANCIAL CRISIS, THE WORLD IS RUNNING OUT OF FRESH WATER

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Summary  
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1. (SBU) Nestle, the world's largest food company, worries more about the planet's growing fresh water shortage than the current financial crisis, which it sees as only a bump in the road in the firm's long-term development. Nestle estimates the upper limit on sustainable global fresh water withdrawals to be 12,500 cubic kilometers per year, with 2008 use running at about 6000 cubic kilometers. However, rising population, growing meat consumption, and new biofuel demands are predicted to absorb the surplus entirely by 2050. On present trends, Nestle thinks one-third of the world's population will be affected by fresh water scarcity by 2025, with the situation only becoming more dire thereafter and potentially catastrophic by 2050. Problems will be severest in the Middle East, northern India, northern China, and the western United States. The company thinks averting a global crisis



will require four strategies: (1) creation of a virtual market for water; (2) elimination of subsidies and compulsory preferences for biofuels; (3) universal adoption of more productive, water-efficient genetically modified plants; (4) and the liberalization of global agricultural trade.

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A Swiss Institution and Global Success  
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2. (U) Embassy officers recently paid a visit to Nestle, the Swiss food giant headquartered in Vevey. With its 280,000 global employees, \$90 billion in annual sales in 2008, and \$120 billion in market capitalization (more than three times that of 2nd-ranked Kraft), Nestle is the largest food processing company in the world. In fact, its market value made it the biggest firm of any kind in Europe in March 2009. The management of the 143-year old company surveys the company's world-wide operations from an idyllic Alpine lakeside setting on lake Geneva. Its glass-facaded headquarters building (now a historical landmark), was designed by the renowned Swiss architect Jean Tschumi and is filled with modern art from around the world. The building even hosts a private museum dedicated to the history of the company and its more than one hundred consumer brands.

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Financial Crisis a Bump in the Road  
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3. (SBU) According to Herbert Oberhaensli, Nestle's chief economist and director of international relations, the company had another excellent year in 2008. Shrugging off the global financial crisis, global sales rose three percent in 2008 to CHF 109.9 billion (\$90 billion), despite the strong appreciation of the Swiss Frank -- the reference currency into which Nestle's sales data are translated. Profits were up more than 60 percent to CHF 19 billion, as the firm benefited from rising global demand for its many high-margin products, which are viewed as "aspirational, trade up goods" in many emerging markets. Oberhaensli explained that Nestle operates on a long-term basis, neither expanding quickly in boom times nor shrinking in recessions. The company has plans to scale back its investment projects, which are global in scope. Oberhaensli noted the company's recent decision to proceed with a \$170 million expansion of its Nesquik and Coffee Mate factory in Anderson, Indiana, in which the company already invested \$360 million between 2006-2008. Contrary to expectations, there is no longer much specifically Swiss about the Nestle company. None of the members of the company's managing board are currently Swiss, and only about 8000 of its 280,000 employees work in Switzerland. Nevertheless, the company enjoys iconic status in Switzerland, where it almost doubles as a national trademark.



4. (SBU) Oberhaensli said that Nestle does not view the current financial crisis as leading to a depression. Instead it thinks the world economy is experiencing a severe recession of which the company has seen many over the decades. Oberhaensli noted that there is a generational split among Nestle managers in the degree of nervousness with which they view the world situation. The younger generation had never seen anything like the current financial turmoil and is quite agitated. In contrast, long-serving Nestle managers are calmly philosophical, pointing out that the firm has always continued to grow in good times and bad, since there is always solid demand for the company's food products. Thus Nestle still expects its sales to grow by roughly 5 percent in 2009, or perhaps only 4.5 percent if the most pessimistic global growth projections prove true. In a nutshell, it expects rising demand in emerging markets to more than offset slower growth or stagnation in US and European sales. Nestle has no trouble raising cash from banks, and indeed has been repurchasing its own stock in recent months, according to Oberhaensli. The company is much more profitable than most of its competitors, and feels it has a knack for spotting trends. It developed the Nespresso coffee capsule business over a decade into an Europe-wide phenomenon, which is now generating CHF 2-3 billion in annual revenues for the company even while spawning a range of imitations.

5. (SBU) Despite its size and global presence, Nestle accounts for only about 1.7 percent of global food sales according to company estimates. Thus it sees plenty of room for further growth. Nestle believes that emerging economy dietary patterns are increasingly converging with those of the US and Europe. Nestle has seen a huge increase in the demand for milk products such as ice-cream and yogurt in China, amounting to a cultural shift. Similarly, China and India are considered to be the key growth areas for the company's coffee business. Nestle's marketing staff believe that there is a strong correlation between tea-drinking and the readiness to switch to soluble coffees, as happened in Japan in the 1970's. At the moment, a 'coffee culture' is rapidly developing in Asia. Oberhaensli said that Nestle is extremely pleased with its partnership with General Mills, in which it markets the US firm's breakfast cereals outside of the US market through its unequalled worldwide distribution system. This is another product where demand preferences and lifestyles are converging. More and more Asians, Europeans, and Latin Americans are starting the day with a bowl of cereal, according to Nestle.

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The Coming Global Water Crisis  
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6. (SBU) Nestle sees the world, and global food production,



largely in terms of the water economy. Its management is convinced that growing shortages of fresh water, rather than land, will become the Achilles heel of global agricultural development. This -- and not the current financial crisis, oil depletion, or global warming -- is the most dangerous near-term threat to the planet's well-being. The company's senior managers rarely miss an opportunity to point out the dangers of present water trends to public audiences at international gatherings, most recently at the World Economic Forum in Davos. Nestle starts by pointing out that a calorie of meat requires 10 times as much water to produce as a calorie of food crops. As the world's growing middle classes eat more meat, the earth's water resources will be dangerously squeezed.

7. (SBU) Nestle reckons that the earth's maximum sustainable fresh water withdrawals are about 12,500 cubic kilometers per year. In 2008, global fresh water withdrawals reached 6,000 cubic kilometers, or almost half of the potentially available supply. This was sufficient to provide an average 2500 calories per day to the world's 6.7 billion people, with little per capita meat consumption. The company estimates that continuing population growth and modest further increases in per capita meat consumption will push annual water withdrawals to 10,000-11,000 cubic kilometers by 2050. This amount will be sufficient to provide the then 9 billion people 2500 calories a day with somewhat higher per capita meat consumption than today. However, it will require a level of fresh water withdrawals only 15% shy of the sustainable planetary maximum.

8. (SBU) Oberhaensli said that Nestle estimates that the current US diet provides about 3600 calories per day with substantial meat consumption. If the whole world were to move to this standard, global fresh water resources would be exhausted at a population level of 6 billion, which the world reached in the year 2000. There is not nearly enough fresh water available to provide this standard to a global population expected to exceed 9 billion by mid-century. Nestle has studied water use in crop growing and concluded that the main reason crops are grown in many dry regions is subsidies and mis-pricing of water. Growing a calorie of food crops in a hot dry climate such as California requires much more water than elsewhere. Current water withdrawals in some areas of the world are already un-sustainable. The water table is dropping precipitously in the Western US and in northern India. In both areas, users are withdrawing more water than can be replenished and rising salinity is reducing the productivity of plants.

9. (SBU) Nestle is also concerned by the current political push to massively subsidize biofuel use and legislate compulsory blending. The company says that in the best case, it takes 1000 liters of water to produce 1.5 liters of ethanol. There is a real danger that biofuels will increase



the price of food in poor nations. Aside from providing drinking water to a few coastal cities, Nestle also dismisses desalination as a panacea for water shortages, due to its expense, pollution, and counter-productivity. The company points out that it takes four liters of fuel to produce 1000 liters of water. It thus makes more sense to move agricultural demand for water to regions where it is in most plentiful supply. Oberhaensli said that Saudi Arabia has recognized that its water is even more valuable than oil and it has decided to stop using irreplaceable fossil water to irrigate food crop fields in the desert in favor of importing the cereals it needs.

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Four Mitigating Strategies  
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10. (SBU) Oberhaensli said that studying the water constraint provides Nestle with a lot of insights into the future of the world food industry. It is clear that current developed country meat-based diets and patterns of water usage do not provide a blueprint for the planet's future. Based on present trends, Nestle believes that the world will face a cereals shortfall of as much as 30 percent by 2025. Oberhaensli stated it will take a combination of strategies to avert a crisis.

(1) Creation of a virtual market for water, so that the scarce commodity can be traded across borders and so that its price reflects its actual scarcity value. (In Nestle's view the most advanced water pricing system currently exists in some desert areas of Oman, where water has long been scarce and valued. There water is dug from wells deep inside hillsides. It is free for humans to drink and for the mosque. After that, the daily flow is divided up into property shares, which are sold by minutes of flow. One family may have rights to 20 minutes of daily flow another to 10 minutes. Repairs to the infrastructure are financed on a pro-rata basis according to the flow-time owned.)

(2) Elimination of subsidies and compulsory blending rules for biofuels. The current rules combination of subsidized water prices combined with subsidized fuel prices distorts the market for water and fuel. Nestle believes hardly any biofuel will be produced if it accurately reflects water costs.

(3) The universal introduction and acceptance of genetically modified crops. Genetically modified crops are more productive and can be designed to resist salinity. The current European public resistance to bio-tech crops is anti-scientific and un-sustainable. In Nestle's view, the world will have no alternative but to depend on GMO's to meet its food needs and conserve water.



(4) Liberalization of agricultural trade. It makes no sense to grow crops in water-short areas via subsidies. Instead, the world needs liberal trade in foodstuffs (and correct water pricing) to allow resources to flow to areas where production is most economical and efficient. Nestle therefore supports the resumption of the Doha Round trade talks.

11. (SBU) Oberhaensli said that all of these strategies are politically controversial. Sensitive to its public image, Nestle has maintained a low profile in discussing solutions and tries not to preach. Instead, it attempts to set a good example and incentivize best practices in farming. For example, in India it does not tell farmers supplying milk to Nestle factories how to treat their milk cows. However, it pays a premium for low bacteria and high protein counts. Farmers and offers to assist farmers to introduce advanced production methods. Nestle has taken GMO's out of certain products due to market pressure, especially in Europe. However, internally the company remains convinced that they represent the future of agriculture.

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Comment  
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12. (SBU) Nestle is a Swiss corporate success story par excellence. With its global reach, its long-term perspective, and its knack for spotting trends, the firm is highly admired by its European rivals. From its stunning corporate headquarters in Vevey, the company exudes optimism and self-confidence, not surprising considering that this one-time producer of condensed milk now has a market capitalization equal to about 25% of Switzerland's GDP. It believes the present world crisis is a recession, not a depression, and is continuing with its long-term corporate investment plans. It is even picking up modern art to add to its already considerable collection. Despite the economic downturn, it expects to continue to gain market share at the expense of its rivals and grow even faster when once times improve. Though it is the largest food company in the world, the company has only a 1.7% market share by its own reckoning. It thus sees plenty of opportunity for further growth.

13. (SBU) With its warnings about long-term agricultural and water trends, the company wants to play a useful public role in the global debate on the environment. Its exceptional scale and international experience give Nestle credibility when talking to governments and agricultural policy-makers. As a result, the company is sometimes called upon to provide advice to decision-makers in developing countries. Nestle's concern for the global water supply is genuine. The company management believes that the current under-pricing of that scarce commodity will lead to huge problems. It fears that

subsidies for biofuels will potentially push the price of food out of reach for the poor in some developing nations. It is strongly opposed to water price subsidies and a strong proponent of market practices. However, the firm scrupulously avoids confrontation and polemics, preferring to influence its audience discretely by example.

CARTER



