

## WHERE DO WE GO FROM HERE?

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### INTRODUCTION

When Gene Kupferman and I settled on the above name for my talk, I think he was hoping that I could come up with some brilliant solutions to the present economic woes of the pipfruit industry. However, I feel a little bit more like Oliver Hardy (he was the fat guy in the Laurel and Hardy comedies) complaining to his partner, Stan Laurel (the thin guy), "What sort of mess have you got us into this time, Stanley." Like Oliver, I know we are in deep trouble, and there is no easy way out.

The key to finding a solution is to recognize what sort of trouble the industry is in. I believe the biggest problem the industry faces is in understanding just what the present situation really is and where it is headed. Once that is understood, making decisions about what to do in the future will be a lot easier.

### FOOD SYSTEM FUNDAMENTALLY CHANGED

The food system that existed when many of us entered the fruit business is no longer the system we face today. It is moving rapidly from being a rural, open market, public system to an industrial, controlled, private system.

In the rural perspective, farming and orcharding are seen as a way of life. The farmer can make a living while enjoying being close to nature, making independent decisions about his or her operation and enjoying the benefits of a like-minded rural community.

In the industrial perspective, food production and marketing is a business. Like any business, it must meet key tests of return on investment and internal efficiency. There is limited emotional attachment to the land, the region or the commodity. If the operation is not meeting external and internal performance criteria, it is terminated.

### MARKETS CHANGING

Most of us grew up with a fruit business that was made up at every level of a large number of small firms, whether growers, packers, shippers, wholesalers, retailers, importers or exporters. There were many options from whom to buy and to whom to sell. Trading was relatively free. Prices were quite responsive to shortages or surpluses in the market.

Now the fruit business, and indeed the whole of commerce, is moving to a system with fewer, bigger players at every level. They have such large investments in fixed assets around the globe that they are less comfortable relying on the open market to provide the flow of product that they need.

They are turning much more to contracting, to strategic partnerships and to special working arrangements with suppliers to get what they need. They need "CONTROL."

## **CONTROL**

This desire for greater control is what is driving consolidation at every level of the food system. Buyers used to beat you on price. Now they want guarantees of constant stock levels, assurances on the production methods you used, certifications on your food handling methods and on how you handled chemicals, workers, the environment in your orchards and packing plants, and many other issues.

Buyers want complete traceability of every product they handle. They want no surprises. They want control of product quality as well as of price. They are enabled to gain that control on a global scale by the advancement of technology and by the changed international environment. Advances in global communications and the falling cost of computing power have made it possible to collect, store and retrieve vast quantities of information rapidly.

Fewer government restrictions have made it easier for aggressive firms to operate across international boundaries. They continue to find easy pickings among the many hidebound companies that have sheltered behind national barriers for two centuries. So, their global expansion is likely to continue for some time.

## **FOOD UNDER LICENSE**

Perhaps the most dramatic change that is taking place in the food system is in the ownership of plant materials. In the past, an orchardist had to pay only the costs of developing a functioning tree. You could do it yourself, or you could pay a nursery to do it.

More and more, the plant material in the trees that you will want to produce will be owned by a private corporation. You will have to pay a royalty to produce that tree, a membership fee to maintain it and a marketing fee to sell the fruit, in addition to the usual cost of developing it into a functioning tree.

The ownership of the plant materials has now become a large and pivotal business in the food system. A lot of different types of entities are jockeying for ownership. Your future apple varieties may be owned by international nurseries, New Zealand, Monsanto, Kroger, or even specialized investors.

These sorts of entities will battle to find the “winning” new varieties. Each will have a different strategy for exploiting their varieties. Producers will have to compete to be selected to grow the best varieties. Private varieties will become another tool for control of the food system.

In the meantime, it will become increasingly difficult to maintain the existing public varieties or develop new public varieties. If present trends continue, fewer and fewer universities or public research institutes will be willing to provide their plant material free.

## **OTHER FOOD SYSTEM CHANGES**

Two other food system changes are worth noting. One is very obvious, the invasion of new technology in every aspect of the food business. To compete, every grower and packer will have to be computer literate, adopt the latest advances in electronic devices and sensors, and be linked to the internet for many purposes.

The other less obvious change in the food system is all the new competition that is entering the market. Consumers are no longer demanding foods by form, e.g., an apple or a potato, but are

demanding foods by function. What will it do to my weight, health, fitness, cholesterol level, blood pressure, longevity, etc?

Consumers are demanding targeted foods, and food manufacturers are reconstituting foods to meet those targets. The businesses of medicine, pharmacology, food and entertainment are blending. Some parts of a typical food supermarket look like a pharmacy, and some parts of a pharmacy look like a food store.

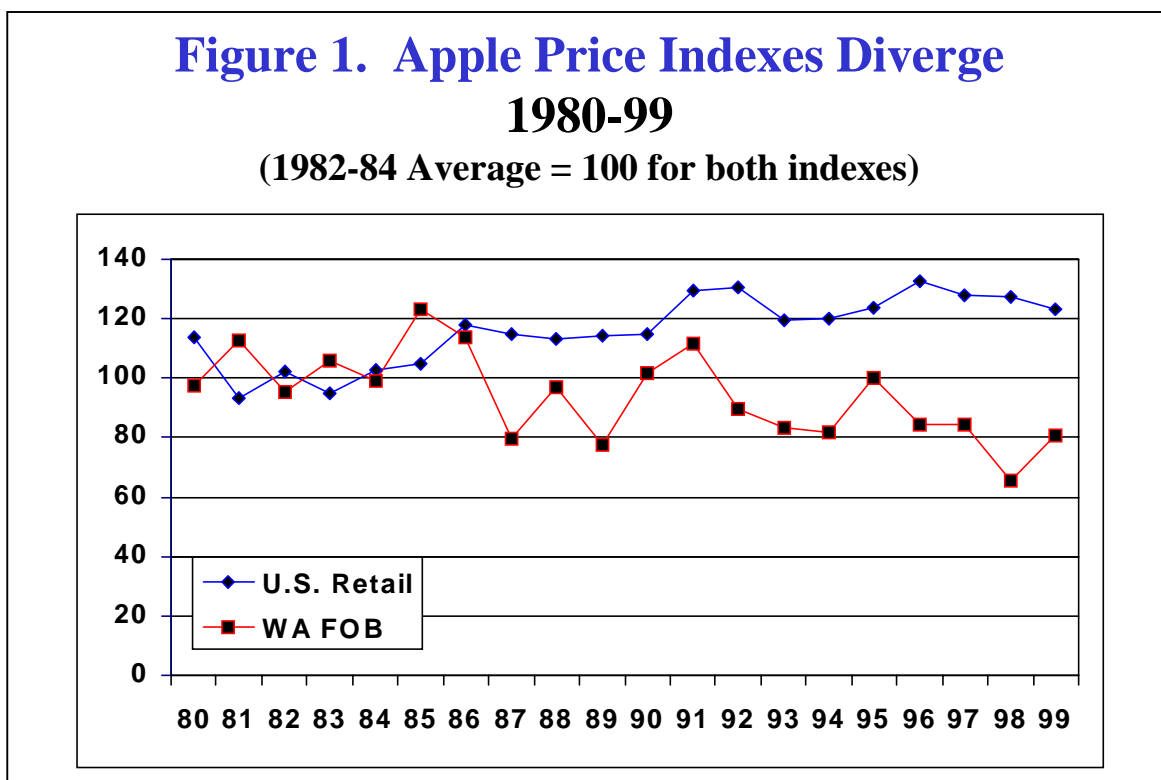
The bottom line is that there are now countless substitutes for apples, the original health food, and more substitutes are on the way every day. More and more products are competing for the market niche that apples and other fruits once occupied. To us in the fruit industry, the choice for consumers is obvious; the natural product will always be the best. However, more and more consumers are voting otherwise with their pocketbooks.

**ONE THING NEVER CHANGES**

One aspect of the food system never changes. The key weakness for apples, pears, oranges, bananas and many other fruits is still inadequate demand.

In affluent countries like the United States and Japan, demand is weak because the population is fairly static and aging, and when incomes increase, little of the extra money is spent on fruit. In developing countries like Brazil and Indonesia, the demographics are favorable. The population is young and growing and apt to spend extra income on more fruit. However, the recent severe economic setbacks have temporarily hurt demand. A full recovery is still a year or two away.

These demand weaknesses show up in a number of different ways. For example, my analysis of demand in the U.S. suggests that retail demand has remained healthy for the last 20 years. However, that has not been reflected back to the shipping point or grower level (Figure 1).

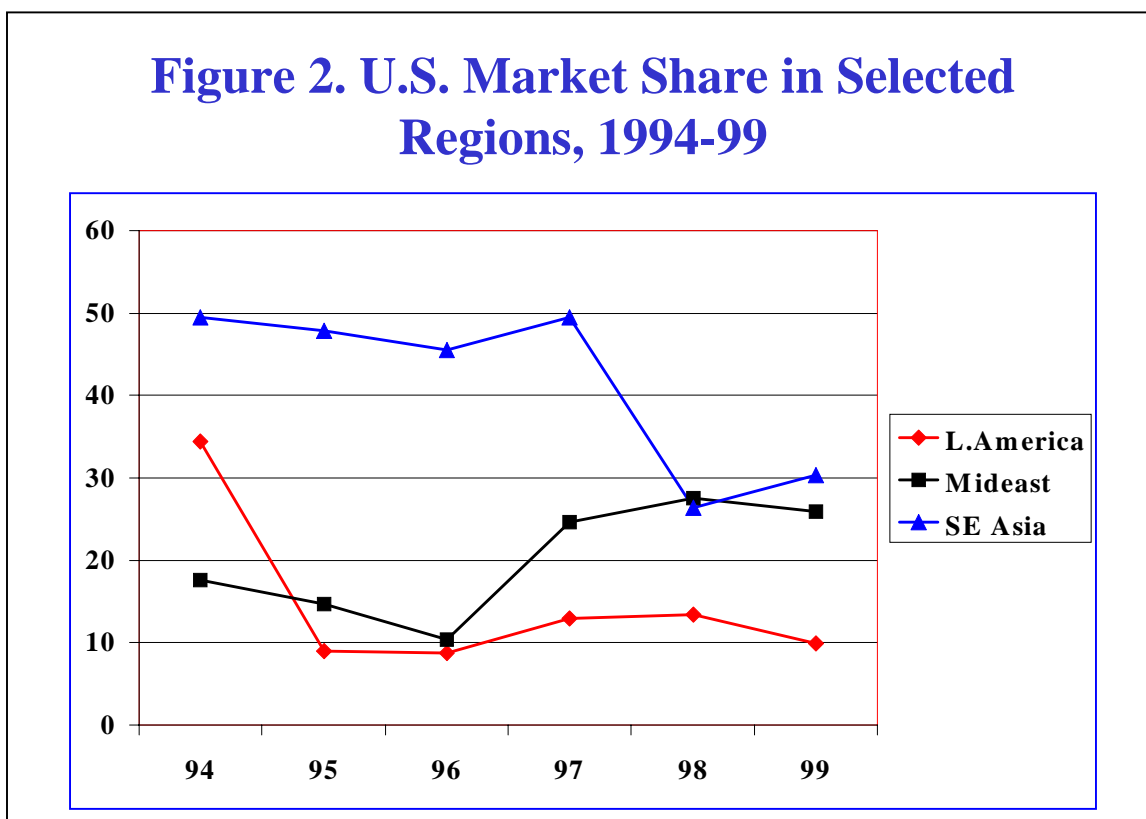


For example, the index of retail prices of all apples has moved up about one percent per year since 1980. Consumers have been willing to pay about one percent more per year for the same amount of apples. However, the index of Washington State FOB prices for apples has slipped about two percent per year. In addition, each price peak for Washington apples since 1986 has been progressively lower. Thus, even in the good years, apple growers have been less able to accumulate reserves to help them withstand the bad years.

There are a number of reasons why this divergence between retail and FOB price trends has occurred. Retailer consolidation appears to be a small factor. However, the biggest one is the volume of apples that Washington State has attempted to place on a sluggish market.

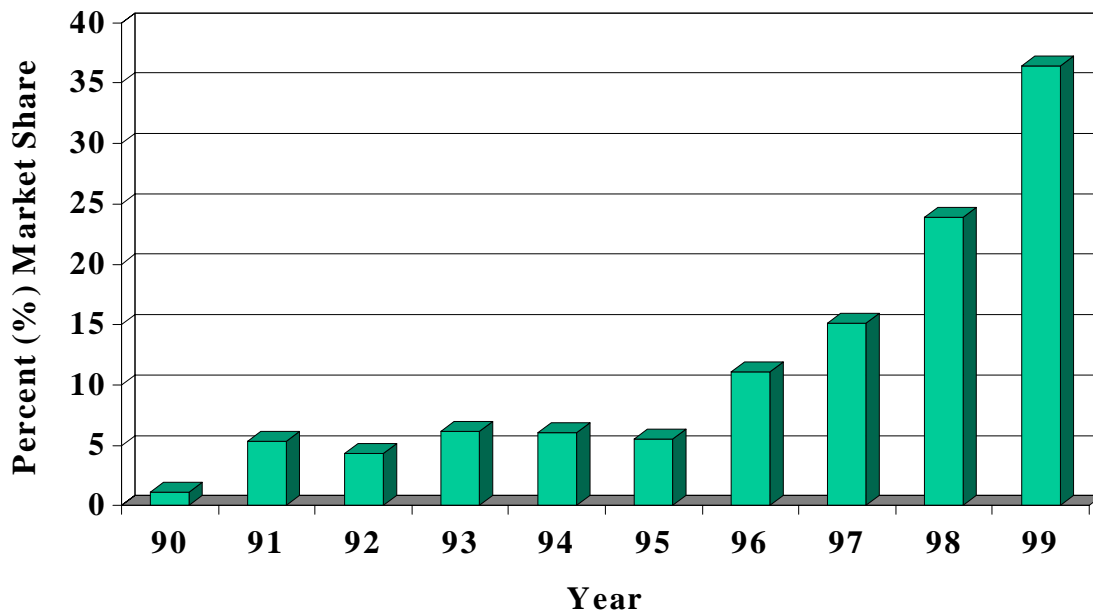
Foreign demand has also been hit hard in recent years. In the interests of space, I show data for only three regions here, but these happen to be among the three most important regions for U.S. apple exports (Figure 2).

Figure 2 shows that the U.S. lost market share in Latin America as early as 1995 and has not regained it since. In Southeast Asia, market share dropped from about 50 percent in 1997 to about 30 percent in the last three years. Sales fell by almost 6 million boxes between 1997 and 1998.



Of course, one other factor has contributed to our exporting woes in Southeast Asia. That is the phenomenal growth of exports of apples from China to that region in the 1990s (Figure 3). China's share of Southeast Asian apple imports has grown from about one percent in 1990 to over 36 percent in 1999. Chinese production and exports are likely to continue to grow for the foreseeable future.

**Figure 3. China Market Share in Southeast Asia, 1990-99**



### TODAY'S CHALLENGES

Once growers, packers and shippers come to accept the new realities that are facing them in the food system, decisions about future company and industry actions will become a lot easier to make. These realities are:

- The RURAL perspective is no longer functional
- The Big shall CONTROL the food system
- Public agriculture is fading away
- Technology continues to upset all apple carts
- New Competition in food is everywhere
- The apple's key weakness is still demand
- The New Challenge of China

Acceptance of these realities will make it a lot easier to decide what to do in your orchard, on your packing line, in your marketing or in cooperation with others. It will not make it possible to go back to the old days. But I believe that those firms and organizations that change to meet the new realities will be prosperous for a long time into the future.