

CONSOLIDATION AND CHANGE IN THE WASHINGTON AGRI-FOOD COMPLEX

WHITE PAPER

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Introduction

One of Washington's leading industries is showing signs of trouble. Change is constant for all industries, but the Washington agri-food complex has experienced more change than most. Commodity prices have slumped and disproportionate cost increases have reduced Washington's traditional comparative advantages in agri-food production and processing. Increased uncertainty about the business climate for this industry has impeded potential investments within the Washington agri-food complex. Furthermore, recent trends in consolidation and concentration at the food retail end have had fundamental impacts within the agri-food complex, resulting in increased consolidation at the farming, processing, and distribution levels.

Washington's agri-food complex employs more people within the state than any other sector. The agri-food complex is particularly critical to rural economies throughout Washington. This quiet industrial powerhouse is largely taken for granted; consequently, it is not recognized that a number of events—any one of which could significantly affect the complex—are simultaneously occurring. The effects of these changes have not been addressed, yet are likely to be profound and affect local communities throughout Washington. These changes include a worldwide restructuring of the food markets fueled by consolidation of the retail sector and global competition; increased costs that are reducing Washington's traditional economic advantages in food production and processing; and regulatory and policy changes that reduce profitability and discourage investment within the industry.

This white paper identifies these major trends and some of their immediate impacts. Although data exists on different sectors of this overall agri-food complex, existing information is inadequate to fully assess the extensive economic impacts of these concurrent trends upon the industry as a whole. Thus, a comprehensive understanding of the implications of policy decisions and planning for future actions by state and local governments is lacking.

Washington Agri-Food Complex: What is it?

The agri-food industrial complex consists of all businesses related to the production and processing of food, including farm production of crops and livestock, commercial fish harvesting, agricultural services, wholesale trading and warehousing of farm products, farm product transportation, farm and food machinery manufacturing, and food and seafood processing.

In 1997 the Washington agri-food complex employed 183,600 workers with a wage and salary base of \$3.5 billion. The agri-food complex sold product estimated at \$17.5 billion, including \$5.1 billion of foreign exports.

The industry complex includes 29,011 farms (with at least \$10,000 in annual sales), 1,200 food processors, 960 commercial fishing establishments, and numerous other wholesalers, agricultural service companies, warehouse distributors, machinery manufacturers, and transporters who together support the economic vitality of communities throughout the state.

<i><u>FAST FACTS</u></i>	
about Washington Agri-Food Complex, 1997	
Number of farms	29,011.
Number of food processors	1,200.
Farm cash receipts	\$5.6 billion.
Value of food shipments	\$9.9 billion.
Farm, fish & food exports	\$3.1 billion.
Wages & salaries	\$3.5 billion.
Employment	183,600.
Farm	86,300.
Food processing	41,400.
Agricultural services	14,700.
Wholesale & warehousing	15,900.
Transportation support	13,000.
Farm & food machinery manufacturing	1,800.
Fishing & aquaculture	10,500.

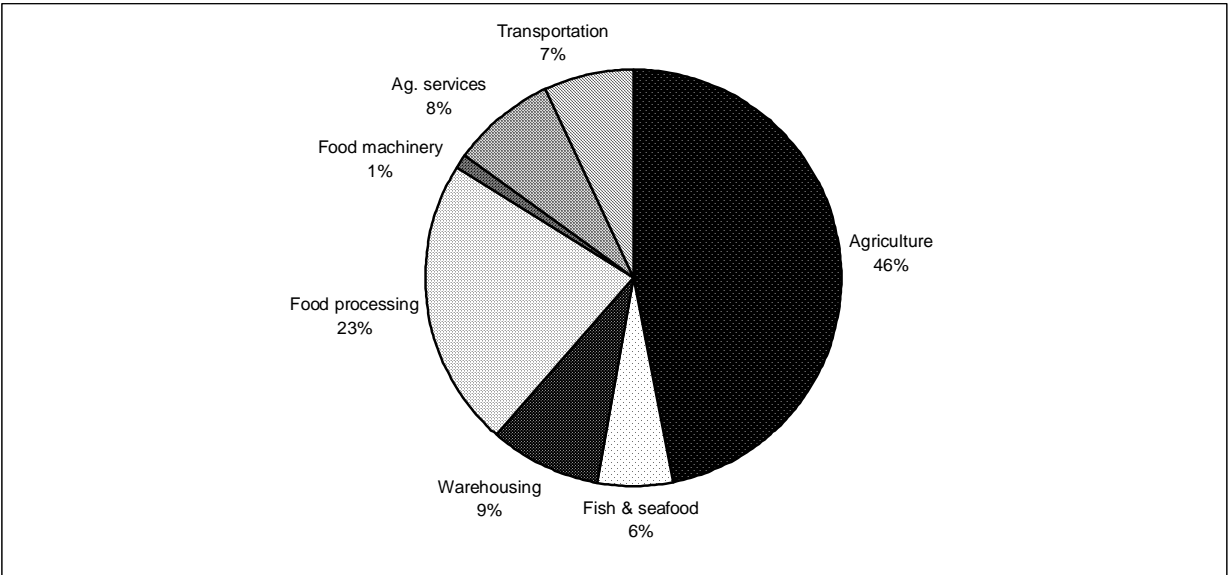
Sources: Washington Agriculture Statistics Service; Washington Employment Security Department; U.S. Bureau of Economic Analysis; U.S. Bureau of Census; U.S. Department of Commerce and U.S. Department of Agriculture.

The Importance of the Washington Agri-Food Complex

Washington’s agri-food complex encompasses a significant share of the state’s economy. Although the relative size and makeup of the agri-food complex has changed dramatically over the last century, this industry remains an important part of the state’s economy.

In 1998 the agriculture and food processing sector alone employed 128,000, making it the state’s largest industrial sector. During that same year, the state’s next two largest industry sectors, transportation and equipment and forest products, employed 122,000 and 73,200 workers respectively.

Figure 1
1998 Employment by Washington Agri-Food Complex Sectors



Note: With the exception of agriculture, employment for other agri-food complex sectors is estimated.
Source: Washington Employment Security Department.

While agriculture and food processing are considered mature industries, in aggregate both of these industries are growing in Washington. Sectoral detail, however, reveals that the traditional strongholds of agricultural production and food processing—particularly fruits and vegetables—are stagnant or in decline.

In absolute terms, the greatest number of food processing jobs is concentrated in Washington’s larger metropolitan areas. King County, Washington’s most populated county, is the state’s leader in food processing employment with over 15,000 workers. In relative terms, agriculture and food processing have forged close economic ties to many of the state’s smaller, rural counties; many of which are located east of the Cascades. In Eastern Washington, one out of every six workers has direct ties to the agriculture or food processing. What is not known is the even greater scope and scale

of indirect linkages to the entire agri-food complex and the extent of the important connection between urban centers and the rural farm economy in Washington.

Table 1
Total Employment, Food Processing & Agricultural Employment, 1997

Area	Total Employment	Food Processing Employment	Agricultural Employment	Percent Ag. & Food Processing of Total Employment
WASHINGTON STATE TOTAL	2,846,600	41,342	86,327	4.5%
Western Washington	2,241,160	25,247	16,857	1.9%
Metropolitan	1,788,072	22,239	11,463	1.9%
Non-metropolitan	453,088	3,008	5,394	1.9%
Eastern Washington	605,440	16,095	69,470	14.1%
Metropolitan	350,250	9,112	34,754	12.5%
Non-metropolitan	255,190	6,983	34,716	16.3%
STATE AGRICULTURAL AREAS				
Columbia Basin	41,150	3,886	10,499	35.0%
Adams County	7,900	1,084	2,669	47.5%
Grant County	33,250	2,802	7,829	32.0%
North Central	85,470	780	18,001	22.0%
South Central	111,820	4,151	21,653	23.1%
South Eastern	111,570	5,345	13,495	16.9%
Benton & Franklin Counties	86,600	3,412	10,672	16.3%
Walla Walla County	24,970	1,933	2,823	19.1%
Eastern	255,420	1,933	5,824	3.0%
Spokane County	195,900	1,562	1,402	1.5%
Other Eastern Counties	36,020	362	1,754	5.9%

Notes: Covers only two sectors—food processing and agriculture—of the agri-food complex. Total employment and agricultural employment have been adjusted to eliminate the effect of dual job holding. Detail may not add to total because of rounding. Source: Washington Employment Security Department.

The Changing Nature of the Washington Agri-Food Complex

Erosion in Traditional Comparative Advantages

- Traditionally, Washington farmers and food processors have enjoyed significant comparative advantages focused on adequate and reliable water supply, diversity and abundance of raw product, adequacy of year-long storage facilities, low electricity rates, and an efficient multi-modal transportation system. Dismantling or reducing drawdown of the dams would also severely threaten the cost advantage enjoyed by farmers and processors in Washington—from irrigation, transportation, and electricity.

Cost and Availability of Water

- In Eastern Washington, irrigated agriculture, food processors, transportation companies, and rural communities are inextricably linked with the Columbia-Snake River System. The increasing competition for water by other users and for the protection of endangered salmon (and the restoration of their runs) represents a major water resource issue that could significantly affect Washington’s agri-food industry.
- Currently, the erosion of certainty threatens local economies dependent on irrigated agriculture and food processors and has inhibited additional investments (both new plant and equipment and expansion of existing plant and equipment).

Energy Costs

- Washington has enjoyed a significant economic advantage in low power rates; average electricity rates in Washington are 40 percent below the national average. De-regulation and privatization within the power industry have resulted in increased costs and increasing competition with other users.

Transportation

- Washington is situated far from major U.S. markets. Transportation costs for moving supplies and products within and out of the state represent a major portion of the delivered price and thus affect the competitiveness of producers and processors.
- Drawdowns of reservoirs and/or dam breachings would adversely affect the navigability of Washington’s waterways, and eliminate one of the efficient transportation modes available to agricultural and food shippers. Efficient, reliable barge transportation also enables farmers and processors to maintain lower shipping rates against other transport modes. Findings from a recent study indicate that breaching of the Snake River dams would increase shipping costs for eastern Washington agricultural producers by 26 percent.

Labor

Competition with high technology companies for skilled and semi-skilled labor has bid up wages and salaries of food processors in metropolitan areas. Adequacy of harvest labor continues to be a concern for both growers and processors. Concerns about the availability of quality affordable housing for migrant laborers have been raised to new levels in recent years. Minimum wage increases have negatively affected growers and processors because of their narrow profit margins.

Changing Markets

Consolidation at the retail level (for instance, the recent mergers of QFC with Fred Meyer and then Kroger) is leading to a market dominated by a handful of mega-retailers. As these companies strive to reduce costs, they are driving consolidation further down the “food chain” to their wholesale suppliers, processors, and farmers. Most vulnerable are the small regional processors who are too small to dominate their market and achieve economies of scale and too large to succeed in niche markets.

Recent mergers and acquisitions in the state have resulted in the Washington-based facilities becoming branch-processing plants with executive management reassigned to headquarters out of state. This out-of-state management often leads to both less local control and commitment to maintain local production.

This consolidation is also resulting in greater integration between retailers and their suppliers. Mega-retailers are selecting a limited number of suppliers to minimize cost and to increase product consistency in supply and quality. Furthermore, this is increasing the trend towards contract farming where farmers produce specific crops to the retailer’s or food processors’ specifications. Where farmers traditionally produced crops that were sold to a variety of buyers and consequently not specific to any one end-user, farmers now are producing for a limited number of buyers with the crop, crop specifications, and price determined prior to planting. An example of the uncertainty and economic hardship that situation could create was experienced last year by the sugar beet growers with the plant in Grant and growers the Agripac growers in Walla Walla and Yakima counties.

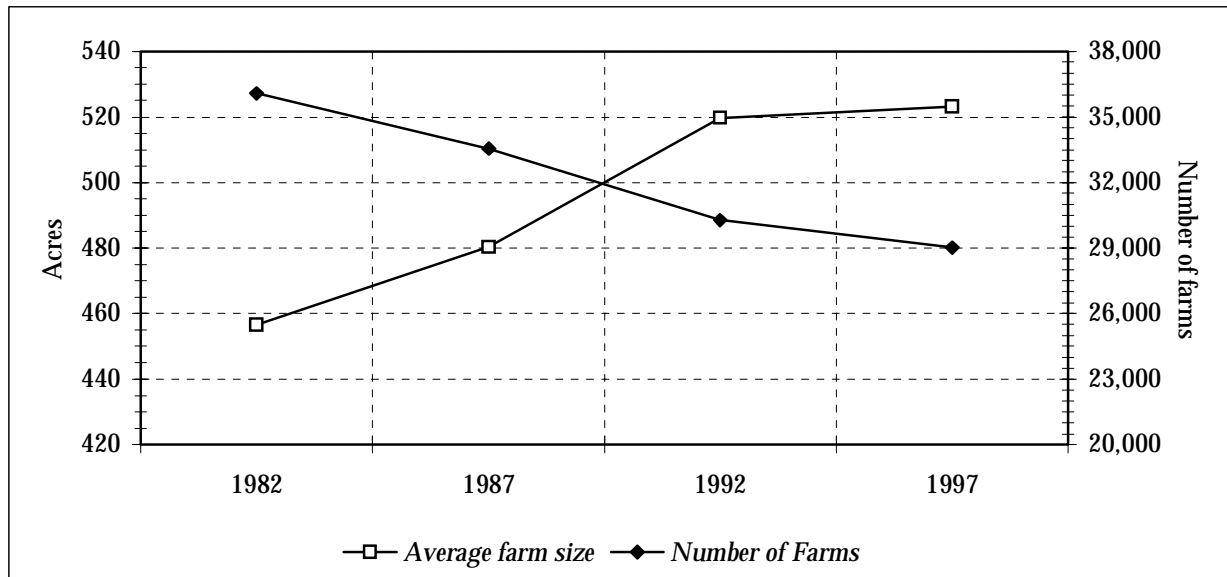
Farms are Getting Bigger and Fewer

Agricultural production is consolidating on bigger farms, leaving far fewer farmers to support small rural towns. During the last fifteen years, the number of commercial farms in Washington has shrunk by roughly one-fifth to about 29,000, while the average farm size has increased by 15 percent to about 525 acres.

These fewer farms, however, have become more productive and competitive. And, the typical consumer has benefited from this increased efficiency within the agri-food complex. In 1950 the typical American spent 24 percent of their disposable income on food and beverages; by 1998 that share of disposable income declined to 10 percent, leaving 14 percent of the disposable income for nonfood consumption. In 1998 this 14%

savings meant Washington State citizens had \$20.8 billion available to spend on nonfood uses.

Figure 2
Number and Size of Washington State Farms, 1982-1997



Sources: U.S. Census Bureau. *Census of Agriculture, 1982, 1987, 1992*; U.S. Department of Agriculture. *Census of Agriculture, 1997*.

Small farms, those with annual sales of at least \$10,000, generate a small proportion of total farm sales—a meager seven- percent. Most of these farms can be described as “life-style” or “hobby” farms that rely primarily on off-farm income. In contrast, large farms represent only six percent of the total number of farms, but produce well over two-thirds of the state’s total sales.

The consolidation of farming activity has at least two important consequences for rural areas in Washington. First, the farm population has fallen in lockstep with the decline in farm numbers. As farm population dwindles, overall demand for key elements of rural infrastructure (e.g., transportation, health care, and education) and local retail services fall below the sustainable threshold in many farm-dependent rural areas.

Second, large commercial farms operate on a scale that makes doing business in larger, more distant regional trade centers worthwhile. As a result, consolidation among farms can lead to further consolidation among rural communities, as increased efficiencies gained for large farms translate into less money being circulated within the local economy.

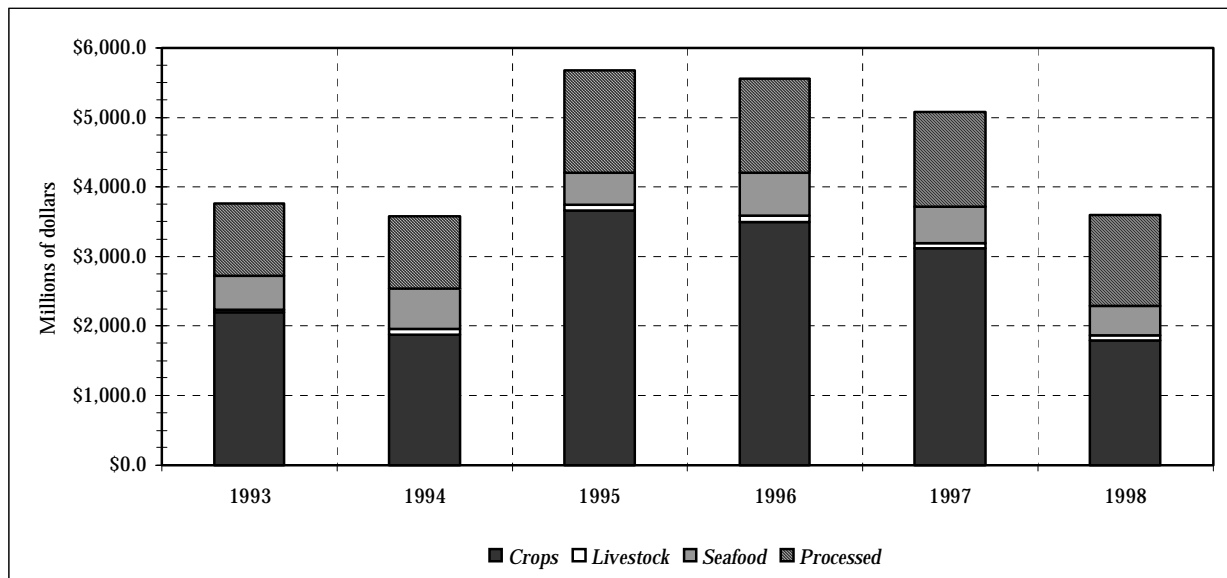
A Changing World Food Market

On a per capita basis, Washington is the most trade-dependent state in the nation. The foreign export market is critically important to the Washington agri-food complex, with upwards of one-third of the state's farm and food products destined for foreign consumers.

Two trends are occurring simultaneously within the global food market. One trend is the increased demand for high quality fresh fruit and vegetables (e.g., apples, cherries, and asparagus). This fast-growing segment of the domestic and world markets has resulted in part from the vast improvements in handling and transportation technology. The other trend is the increased demand for processed, convenience food, especially in the more advanced economies.

Washington farms and processors are very dependent upon the Asian market and will continue to be the primary export focus given the state's geographic situation and the large (real and potential) market. This makes producers and processor vulnerable to geographic shift to "new growth markets" in East Asia farm and food trade, as illustrated by the continued Asian financial crisis. Two-thirds of Washington's farm and food exports were shipped to East Asia. The value of 1998 exports from Washington farms and processors was more than one-third less than 1995.

Figure 3
Washington Farm, Fish & Food Exports, 1993-1998



Source: Massachusetts Institute of Social & Economic Research.

Increased competition in foreign and domestic markets from Asian producers, particularly China, has affected Washington producers and processors. Increases in the costs of food production cannot be passed on to the consumer because the increased level of foreign imports is keeping prices down. For example, a few years ago,

Washington dominated the world apple market. The apple industries in post-embargo South Africa, Chile, China, and others are now well developed and export-oriented.

China has now become the world's largest apple producer, and its entry into the U.S. market has sent prices plummeting especially for juice apples. A ton of juice apples fetched \$30 this year, compared to \$66 last year, and \$137 in 1997.

Regulation and Policy Effects

The reduction of direct and in-direct federal subsidizes translates into a prospective decline in government farm spending. For many Washington dairy and wheat farmers, this diminished federal presence will inevitably result in a loss of income.

Environmental regulations and other business climate issues when compared with those of other states and provinces will likely affect food processors' decisions to expand or contract operations in Washington. For example recent decisions concerning water rights, access to water, the Endangered Species Act, etc., have affected the environment for processor and producers. They have not only increased costs for energy and water, but have increased the cost of locating new facilities or expanding/upgrading current facilities due to resulting delays and the increased unpredictability in the permitting process. Together, these increase the cost of capital, discourage investor confidence, and limit quick responses to market changes.

It is necessary to recognize that government regulations, especially their cumulative effect, represent an imposition of costs on producers and processors. Isolated from each other, government-imposed costs from regulations are insignificant; however, the incremental effects are working to erode the competitiveness of Washington producers and processors.

The Future of the Washington Agri-food Complex

Restatement of the Implications of Changes in the Agri-Food Complex

- **Increased costs and the erosion of competitiveness** would logically lead to the decline in the importance of the agri-food complex to the Washington economy. The impact would especially be difficult for dependent rural communities.
- Consolidation ultimately leads to a **loss of local control** as well as a **decline in small operators**. Competitive pressures may result in the closure of less profitable plants in Washington in preference to facilities located in other states or countries.
- Washington's farming sector is highly diverse and has been characterized as **two agricultures**—one based on commodity production of grains, livestock, forage crops, and potatoes; and the other based on production of vegetables and fruits,

specialized grains, and organic crops. Changes will affect these two agricultural groupings differently, as will prospective policies. The **gap will widen** between small farmers who need to target niche markets due to their size and higher costs and large farmers who supply major processors and retailers.

- The agri-food complex's consolidation and change will **undoubtedly affect Washington's farm- and food-dependent rural communities**. Such changes suggest that Washington's agri-food-dependent communities must seek new ways to build upon the state's rich cornucopia of agriculture and food resources.
- **Increased competition in foreign and domestic markets** will continue to impact state production and market opportunities.

Where Do We Go From Here

While data exists on the food processing and agriculture sectors of the agri-food complex, adequate information is lacking on the important economic linkages amongst the various sectors within the entire complex. Additionally, the existing data is inadequate to fully assess the economic impacts of concurrent trends upon the industry complex as a whole. This prevents a full understanding of the implications of policy decisions or planning for future actions by state and local governments. Information from state and industry officials suggest that further research and analysis is needed in assessing the role of the agri-food complex in the Washington State economy and the policy implications of various trends on this complex.

The economic scope and scale of the complex needs to be further documented, including an analysis of the broad linkages of the complex with the broader economy along with an assessment of the important economic connections between urban and rural Washington. At a minimum, such an economic analysis would:

- Define and assess the important linkages between different sectors within the agri-food complex;
- Assess the economic importance of the agri-food complex to local communities, regions, and the state;
- Assess the economic connections between urban and rural Washington in the agri-food complex; and
- Provide projections under differing scenarios based on current and potential agri-food industry trends over the next decade for local communities and the state.
- Provide the basis for long and short term decisions regarding the agri-food complex by the state's policy makers.

