



THE CHINA CHALLENGE

This is the final part of a four-day series that explores the apple industry in China and how it affects apple growers in Washington. Inside today:

- Meeting the challenges of a huge new competitor/ 8A
- Chinese apple concentrate — in juices, jellies, ice cream/ 10A
- How politics is involved in dealing with Chinese apples/ 9A
- The top 10 export markets for Washington apples/ 9A



Workers rest from stacking bags of apples on a truck along the main street of Guanshui in Shandong Province. Some of the stacked apples are separated by straw mats on the truck. Chinese farmers are expected to grow the equivalent of more than 1 billion boxes of apples this year.

Meeting and competing

GUANGZHOU, China — Guojian Liang is both friend and competitor to Central Washington. For four years, he's been buying apples from Wenatchee and selling them across China. During a one-month span in September 2003, his company imported 10,029 boxes, a feat that garnered an award from Gov. Gary Locke during a visit last year. His company, Shunfeng Trading Co., also exports Chinese apples to Singapore, Malaysia and other countries. "The Chinese Fuji can dominate in those countries," he says. "The cost is less and the quality is good." In fact, the Chinese Fuji already dominates in Singapore and Malaysia, as well as Thailand and the Philippines — all markets



Guojian Liang

Larry Olsen recalls first reading in the early 1990s about China's emerging apple industry. "The tone of the report was almost condescending," he remembers. Those days are gone. China overtook the United States as the world's largest apple producer by the early 1990s. Since then,

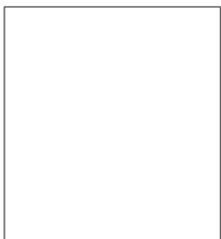
where Washington's growers have lost market share in the last decade. Across the Pacific, growers have watched as globalization raced ahead along with China's growing economic prowess.

Prosser farmer Larry Olsen recalls first reading in the early 1990s about China's emerging apple industry. "The tone of the report was almost condescending," he remembers. Those days are gone. China overtook the United States as the world's largest apple producer by the early 1990s. Since then, production has quadrupled and exports have skyrocketed by more than 1,700 percent. "Anyone who underestimates the Chinese is a fool," says Olsen, who now grows Jazz and Pacific Rose, two varieties that aren't licensed in China. "The level of awareness is growing, we've passed the point of denial," says Jim McFerson of the Washington Tree Fruit Research Commission, which is leading a broad-based effort to improve technology to make American apples more competitive. Meanwhile, China is moving ahead. In trade talks later this month, the Chinese are expected to press the United States to open its markets to their apples. This country has long banned Chinese apples

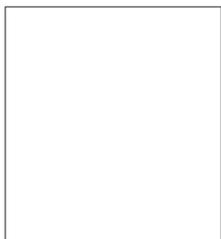
on grounds they can carry pests that endanger American crops. In contrast, U.S. apple exports to China and Hong Kong measure nearly 2 million boxes annually. "Their economic strength has increased and they are doing a full-court press to get access where they don't have access," said Desmond O'Rourke, a researcher and consultant who has long followed China's apple development. But despite the staggering growth of its apple industry, China still faces challenges. "I think we can compete, but we need to make comparable investments in the way we do things," Olsen says. "We have to figure out a way to make ourselves better producers."

Stories by CRAIG TROIANELLO, Yakima Herald-Republic • Photos by DON SEABROOK, Wenatchee World

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Countdown



17 days until Christmas

Name: Megan Hatch
Age: 6
Town: Yakima
Parents: Debbie Hatch and Steve Leslie
What do reindeer eat? Grass and milk



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Workers at the Starr Ranch Growers packing plant in Wenatchee box Washington state Red Delicious apples bound for Hong Kong. The company exports many apples with the help of Wenatchee's Oneonta Trading Corp.

Growers face challenges

China's 88 billion apples change look of the market

Central Washington apple growers had a problem. It was the first half of the 20th century and the vast orchards of New York, Michigan and Virginia were sending apples at low cost to the nation's largest markets on the East Coast and the Midwest.

Separated by 2,000 miles or more, Washington apples could reach the big Eastern cities only by railroads, which sometimes charged high rates and didn't always have box-cars available.

Unable to compete on price, growers focused on developing a better product. They eventually set the worldwide bar for apple quality. And they worked on technology. The world's first commercial controlled-storage unit was built in Yakima in the 1950s.

Today, some see those efforts as a distant echo to a new challenge emerging across the Pacific.

Eighty-eight billion apples. At least. That's the projected crop for China this year — enough to provide every man, woman and child on earth with more than a dozen apples.

Small wonder that American growers are jittery as they watch the Middle Kingdom's unprecedented march into technology and prosperity. With a mere 3 percent of its apples exported, China has gained the upper hand in Singapore, Malaysia, Thailand and Philippines. It's expanding in Europe, looking to the Middle East.

It can pick, pack and ship a box to the Philippines for less than an American grower's break-even cost. It's also pressing in on the most lucrative market of all: the United States.

On the surface the numbers are frightening, but the future is far from clear. The

outcome rests on everything from water supplies to whether consumers can be convinced to reach for an apple rather than a bag of potato chips.

In between is an uneasy blend of science, politics and trade between the world's largest economy and its fastest growing competitor.

After 45 years in the fruit business, Robert Kershaw isn't running scared.

He's heard it before. "In the 1980s, everyone was terrified of East Bloc countries" that were bringing huge tracts of orchard on line, recalls Kershaw, part owner of Kershaw Fruit Co. of Yakima. "China isn't unique. It was that way with Poland, Romania and East Germany."

"Yes, there is some short-term dislocation. (The Chinese) are hammering us in Malaysia and some markets in Asia," he said.

But he believes China's true labor costs will eventually surface and won't be able to compete with Central Washington's superior efficiency and climate.

Kershaw isn't alone in his assessment. "I think the assumption is China is this horrible new competitor," said Cragg Gilbert, whose family started Gilbert Orchards in the Yakima Valley in 1898. "But we've had a lot of competitors in the past and so far we've held our own. I just think it will take some new strategies and plans."

When the Washington apple growers talk strategy, they frequently evoke the phrase: Kia versus Mercedes. In other words, some people will want the best, even if it costs more.

"We will never be the low-cost producer," said Steve Reinhold, former export sales manager for C.M. Holtzinger Fruit Co. of Yakima. "There will always be a place for



Washington Red Delicious apples are washed and waxed at the Star Ranch Growers plant, one of many Washington packers sending apples to China.

high-end markets, even in less developed countries."

China's best apples can already compete with any other nation in the world market. But some question the reliability of that supply.

"We know the Chinese will be able to deliver some very high-quality apples. But it remains to be seen if they have the sophistication and know-how to deliver a consistent quality. We already know our industry can do that," said Jim Cranney, vice president of the Virginia-based U.S. Apple Association, which represents the industry on national and international concerns.

"If you define the issue as China's ability to produce and sell, it's a very big threat. However, there's more to the apple market. I think the Chinese are tough competitors, but it's not a homogenous, one-dimensional market out there. It's not just a question of producing a commodity and delivering it to a specific area," Cranney said.

Some U.S. growers are planting "club" apples, such as Pacific Rose and Jazz, in which planting and production is limited by licensing agreements.

This kind of high-end niche marketing will play a bigger role in the next decade.

Some shippers may adopt a strategy of "can't beat 'em, then join 'em."

With their network of buyers, Washington state packers and shippers for years have been buying and selling apples from Chile and New Zealand. It would be a natural step for some to begin trading in Chinese apples, said Desmond O'Rourke, president of Belrose, a Pullman, Wash.-based company specializing in agriculture analysis.

"If you are going to be a global player, you will need to be there," he said. "If they simply stay outside and the

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The top 10 countries importing Washington apples

The largest numbers of Washington apple exports stay on this continent, but Asia presents great future opportunities. Numbers, in millions of boxes, are from 2003.

Top 10 worldwide:		Top 10 in Asia:	
Mexico	6.08	Taiwan	2.07
Canada	4.70	Indonesia	2.02
Taiwan	2.07	China/Hong Kong	1.85
Indonesia	2.02	Thailand	.56
China/Hong Kong	1.85	India	.39
Dubai	.97	Malaysia	.39
United Kingdom	.85	Philippines	.21
Thailand	.56	Singapore	.17
Saudi Arabia	.54	Vietnam	.12
India	.39	Bangladesh	.07

Source: Washington State Apple Commission

World graphic/Cheryl Graham

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On the surface the numbers are frightening, but the future is far from clear. The outcome rests on everything from water supplies to whether consumers can be convinced to reach for an apple rather than a bag of potato chips.

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Workers push a load of Red Delicious apples into a container at the Jiangnan Wholesale Fruit Market after a day of sales in Guangzhou. These apples came from Starr Ranch Growers in Wenatchee. The packing company also exports under other labels so foreign buyers aren't competing with one another using the same brand name.



A worker loads apple boxes onto a truck in the small village of Wanzikiou, Shandong Province. The apples here are grown under the supervision of village authorities. workers are paid salaries from \$125 to \$175 a month.

Washington State apple facts

- **Estimated production this year:** 98.4 million boxes, each weighing 42 pounds (does not include apples diverted to processing)
- **Acreage in production:** 164,000 acres
- **Number of Farms:** 4,207
- **On average Washington State produces:** 50 percent of the U.S. apple crop and supplies about 65 percent of the U.S. fresh market.
- **Percent of crop by variety:**
 - Red Delicious — 42 percent
 - Golden Delicious — 16 percent
 - Granny Smith — 11 percent
 - Fuji — 11 percent
 - Gala — 13 percent
 - Braeburn — 3 percent
 - Other — 2 percent

Source: Northwest Horticultural Council

Politics enters into apple export equation

There's little doubt that Chinese apples will show up in American supermarkets. The only question is when.

Estimates range anywhere from a year to a decade. And while science is supposed to be the final arbitrator, the reality is that politics can infringe on trade policy.

Among apple growers, there's concern about the dent Chinese apples might put in their sales. But there's a larger worry that Chinese apples might carry hitchhiking pests that could wreak havoc on American orchards.

Canada, which began importing Chinese apples under a test program begun two years ago, discovered enough pest problems that it temporarily shut down imports from one province.

So far, China's ability to monitor for pests has not impressed agricultural officials on either side of the border.

"There's no border to speak of between Canada and the United States. It causes us a great deal of alarm," said Mark Powers, vice president of the Northwest Horticultural Council, a Yakima-based group focused on national and international policy issues affecting growers and shippers in Idaho,

Oregon and Washington.

Responsibility for setting the rules for any food imported into the United States rests with the federal Animal and Plant Health Inspection Service. It is looking into developing a certification process for the Chinese to export apples here.

However, there's concern among some industry officials that those efforts will be circumvented by politics.

"China's economic strength has increased and they are doing a full-court press to get access where they don't have access," said Desmond O'Rourke, CEO of Belrose, a Pullman, Wash.-based company specializing agriculture analysis.

It's possible that China could tie its continued large imports of American wheat, soybeans or other goods to a demand that the United States open its market to Chinese apples, O'Rourke said.

Writing to President Bush earlier this year, the U.S. Apple Association expressed deep concern that China might establish "an inappropriate and unprecedented linkage between potential Chinese apple imports to the United States and U.S. exports of other agricultural commodities to China."



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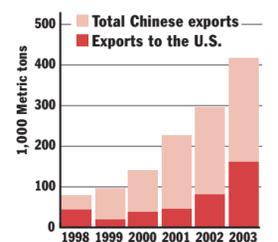


U.S. is largest buyer of China's apple juice concentrate

It's used in everything from fruit juices and ice cream to donuts and jellies. Condensed to a clear liquid seven times stronger than natural apple juice, concentrated apple juice is used as a base or extender for a wide variety of fruit drinks. It also works as a sweetener in foods ranging from baked goods to yogurt. It's a product in worldwide demand, and China has been rushing to meet that need.

Concentrated efforts

Chinese exports of apple juice concentrate have more than quadrupled over the past five years. Largest importer? The U.S., which uses more than a quarter of China's AJC.



Source: Chinese Chamber of Commerce World graphic/ Cheryl Graham

Making concentrated apple juice has long provided apple growers an outlet — albeit a lower-paying one — for surplus or low-grade apples. About 20 percent of China's apples are used for processing, mostly juice and concentrate, according to the Chinese Chamber of Commerce. About 23 percent of Washington's crop is processed.

In China, concentrated apple juice has the added benefit of being easier to transport than apples. And as a processed food, it doesn't face the more intense restrictions applied to fresh fruits headed for international markets.

The nation is now the world's largest maker of concentrate, exporting some 90 percent of its production. But not without controversy.

In 1999, U.S. trade authorities charged China with exporting apple-juice concentrate at below cost. They slapped retroactive import tariffs on five of nine Chinese concentrate exporters.

About three years later, though, most of those fees were reduced on appeal.

Meanwhile, exports to the United States rose nearly 700 percent between 1999 and 2003, making the United States the world's largest buyer of exported Chinese concentrate.

A farmer tends to a crop of seedling apple trees in a nursery grove west of Yantai in Shandong Province. Fujis are the largest variety of apples grown in China. But agricultural officials expect some future orchards to include more Japanese Tenjnu, a variety with a higher acid content that lends itself better to juicing.



Apple juice processed by Tree Top and labeled as "Washington's Best" is stamped on the bottom of the containers with "CONC OF USA CHINA."

In the village of Yang Chu, where apples represent nearly the entire town's economy, a young boy takes a bite out of the principle product of the area. There are 30,000 people in the town.

