SA GOVERNMENT SUBMISSION

TO THE

PRODUCTIVITY COMMISSION

INQUIRY INTO THE COMPETITIVE SITUATION AND OUTLOOK FOR THE CITRUS GROWING AND PROCESSING INDUSTRY

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1. INTRODUCTION

The Productivity Commission ("the Commission") has invited the South Australian Government ("the Government") to make a written submission to the Commission's Inquiry into the Competitive Situation and Outlook for the Citrus Growing and Processing Industry.

The first point of contact for discussion of any issues contained in this submission should be:

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2. BACKGROUND TO CURRENT CITRUS INDUSTRY PROBLEMS

2.1 Australian Government Responses to Globalisation

Since the 1970s, Australian State and Commonwealth governments have been responding to the realisation that, as a small economy dependent on exports for its economic growth, Australia has much to gain from freer international trade. As part of its efforts to reduce foreign barriers to Australian products and services, the Commonwealth Government has reduced levels of protection of Australian domestic markets. To capture the benefits from freer international trade, it has been necessary for most industries to improve their international competitiveness. This has required deregulation of many aspects of the domestic economy in order to remove distortions from the market signals flowing along the supply chain from consumers to producers.

Although the processes of dismantling international trade barriers and removing regulatory impediments to efficiency in the domestic market are still in train, the Australian economy has benefited substantially from freer trade. Many industries have shown rapid increase in exports and, despite its consequently greater dependence on the international economy, the Australian economy has shown increasing resilience to international shocks. Its response to the Asian financial crisis and to the current global downturn are examples of this.

The Australian citrus industry has been among the beneficiaries from the freer trading environment. Exports of fresh citrus fruit to the United States and South-east Asia have grown rapidly and other markets are opening, notably in Europe and India. With accession of China and Taiwan to the World Trade Organisation, those markets are future opportunities for Australian fresh citrus export.

2.2 Protection of the Citrus Industry from Global Pressures: 1975 - 1987

For most of the 1970s and 1980s, the Australian citrus processing sector was insulated from the structural adjustment process occurring in other parts of the economy. The Australian Bureau of Agricultural & Resource Economics (ABARE) reports that the Commonwealth Government intervened four times between 1975 and 1987 to protect the industry from the impact of falling world prices for frozen concentrated orange juice (FCOJ) (ABARE 1998, p.5-6). That fall in prices was driven by increasing production efficiency in Brazil, the dominant source of FCOJ, and a consequent increase in supply. The interventions included: imposition of 65 percent *ad valoren* tariff on imported FCOJ; two changes to the tariff structure and; sales tax exemption for citrus juice with more than 25 percent Australian content.

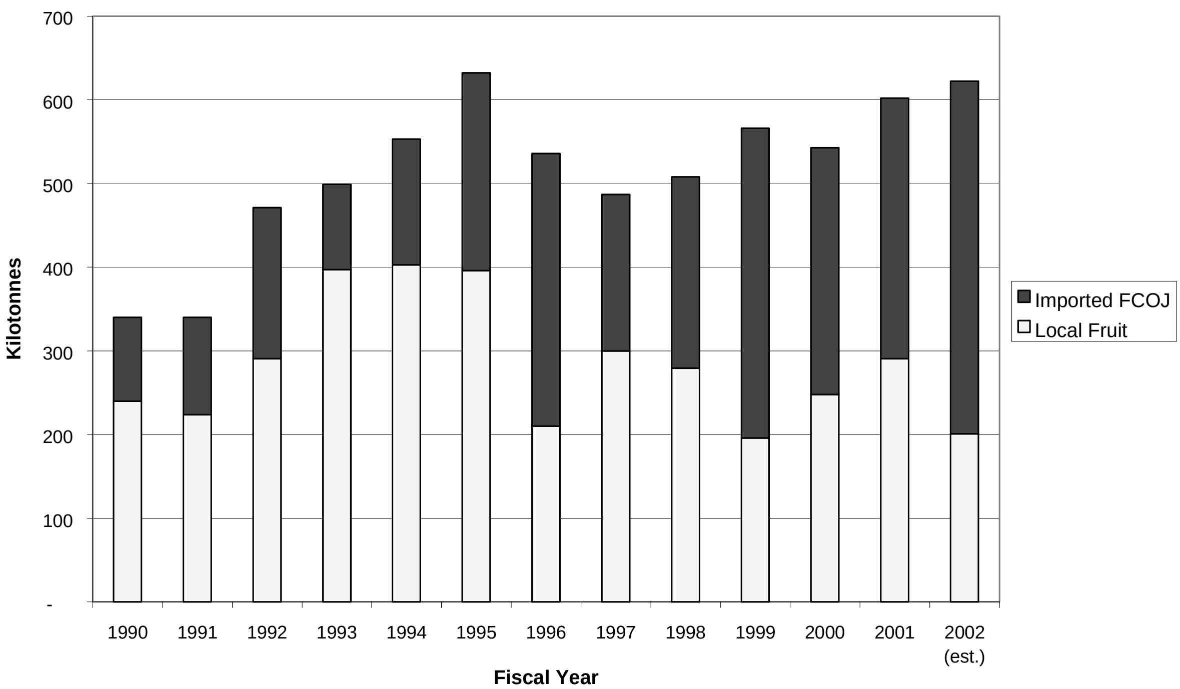
Some citrus industry leaders, after inspecting Brazilian juice production, have commented that Australia has little hope of competing with Brazil: low land and labour costs, the ability to produce without irrigation, large scale of operation and minimal energy costs (from burning sugar cane waste) all contribute to a huge competitive advantage. However, despite their deteriorating competitive position internationally, Australian growers were encouraged, by returns which grew in response to increased protection, to expand valencia plantings during the late 1970s and early-to-mid 1980s. As a result, production of valencias, the predominant Australian juicing orange, increased by 90% over the eleven years to fiscal 1993 (ABARE 1998, p.5).

The conclusion drawn by ABARE from these events was that "this government intervention has distorted price signals to growers and led to higher levels of production than otherwise would have occurred" (ABARE 1998, p.8). While the intention may have been to give growers the time and cash-flow to enable a shift to more internationally-competitive crops, in fact the reverse happened, with many millions of dollars being invested in assets which had little chance of long-term viability. Moreover, this meant that land, water and financial assets were directed away from crops, including navel oranges and easy-peel citrus varieties, which have demonstrated long-term viability.

2.3 Exposure of the Citrus Industry to Global Pressures: 1988 - 1996

Consistent with its commitment to microeconomic and trade barrier reforms, the Commonwealth Government reduced tariffs on FCOJ from 35 per cent in 1988 to 5 per cent in 1993 and, in 1996, removed the sales tax concession on juice with more than 25 per cent local content. The result has been a dramatic fall in demand for Australian juicing oranges from 400 kilotonnes in fiscal years 1993 – 1995 to between 200 and 300 kilotonnes since then. (See Figure 1.) The resulting oversupply has exacerbated the long-term decline in real prices for juicing valencias.

Figure 1: Australian Orange Processing for Juice – 1990 to 2002



Note: Imported FCOJ data is converted at the rate of 1 tonne of FCOJ per 13 tonnes of Australian oranges.
Sources: ABARE (1998); Australian Citrus Growers Inc.

2.4 The Role of the South Australian Government in Citrus Industry Adjustment

Realising that the citrus industry's future lay more in fresh fruit export and, to a lesser extent, in the domestic fresh juice market, the Government has long encouraged adjustment away from the FCOJ market. The SA Citrus Industry Act was revised in 1991 to minimise distortion of market signals: minimum price regulations were removed and the objectives of the Citrus Board of SA were changed from regulation to market information and market access. The focus of research, development and extension effort shifted to production and post-harvest aspects of improving fresh fruit quality. Efforts by the Plant Health Group were on obtaining “area-freedom” status in US and New Zealand markets for South Australian citrus in regard to fruit fly. Irrigation infrastructure was progressively rehabilitated through Commonwealth and State investment to improve efficiencies and growers were encouraged to use the opportunity to replace valencia plantings at the same time as they updated their irrigation systems.

One result of these initiatives was that, in fiscal 1993, SA led the way into the US navel market. This allowed the area freedom status to be extended to Sunraysia and the Riverina, whence exports began in fiscal 1997. In this and other respects, the SA industry has been at the forefront of the process of adjustment away from the FCOJ market. Table 1 indicates the significant changes in plantings since 1990.

Table 1: Changes in South Australian Citrus Plantings – 1990 to 2001

Variety	**No. of Trees**		**Growth /**	**Primary Cause**
	1990	**2001**	**(Decline)**	
Grapefruit	72,485	30,921	(57%)	Domestic market decline
Lemon	96,578	116,247	20%	Export growth
Mandarin	140,737	274,908	95%	Domestic & export growth
Navel	770,962	1,102,267	43%	Export growth
Valencia	1,322,227	1,040,397	(21%)	FCOJ decline; fruit export & fresh juice growth
Other Citrus	23,317	73,478	215%	Domestic & export growth: easy-peelers, etc.
Total	**2,402,989**	**2,564,740**	**7%**	

Source (tree numbers): South Australian Citrus Board.

3. THE OUTLOOK FOR THE AUSTRALIAN CITRUS INDUSTRY

3.1 The Fresh Fruit Export Market

At the 2001 Conference of Australian Citrus Growers Inc., a number of speakers reported good prospects for continued profitable expansion of fresh citrus exports, especially to Europe. In a report on a feasibility study for a citrus export market intelligence system, Australian Business Ltd presented evidence of a global shortage of fresh navels and easy-peel varieties between August and November. It was argued that this opportunity was exploitable from Australia with late navel and other varieties.

The optimism expressed at the conference is supported by the evidence of significant investment in new citrus plantings and packing facilities in the Riverland, especially by larger firms. It is also supported by feasibility analysis by the Government indicating that internal rates of return of 16 per cent or more are achievable from larger, well-managed navel orchard developments. Similar returns are likely to be available from new easy-peel varieties. Moreover, research by the SA Research & Development Institute (SARDI) suggests that available technological improvements in productivity and product quality should add to those returns.

3.2 The Domestic Market for "Fresh daily juice"

The domestic orange juice market also appears to present opportunities for expanded local production. The two main orange juice products retailed in Australia are:

- "fresh daily juice", a full-strength juice made from locally-grown oranges (when available); and
- "orange fruit drink", a product made from (usually) 25% fruit juice, the majority of which is imported FCOJ.

Figure 1 shows volumes of Australian oranges processed for juice and FCOJ imports (as equivalent tonnages of Australian oranges). Total juice production grew by 4% p.a. between 1990 and 2001 and, since the "shake-out" in 1996 and 1997, has grown by 5.4% p.a. The figure shows that, since 1997, that growth has been captured by FCOJ imports, with local fruit supplying between 200 and 300 kilotonnes annually.

While sales data for the fresh daily juice market was not available for this submission, it is believed to be growing in line with the total orange juice market. That market is subject to two constraints:

- a cost constraint imposed by its position as part of the highly-competitive soft drinks market; and
- a supply constraint imposed by the high cost of shipping whole oranges into Australia for juicing, which creates a barrier against imports.

Consequently, in March 1999, Berri Ltd (then Berrivale Ltd) organised a "Citrus Summit" to try to address what they believed to be a forthcoming shortage of fruit for the fresh daily juice market. The Summit drew little enthusiasm from growers for increased plantings of juicing oranges. This attitude was reinforced shortly afterwards by a collapse in the price of imported FCOJ and therefore of local juicing fruit as well.

Nevertheless, there does appear to be scope for increased supply of local juicing oranges, especially to cover a seasonal shortage between April/May and July/August. The problem is that a contract price necessary to attract investment into valencia or other common orange orchards may make the juice uncompetitive in the soft drink market. For example, Government feasibility analysis suggests that, based on a contract price of $350 per tonne and a mature yield of 55 tonnes, a large and well-managed valencia orchard development should generate an internal rate of return of 15 per cent. Research by SARDI suggests that certain varieties of common orange should be a viable source of fruit for the April – August period, when juicing fruit prices usually peak, and that new technological innovations could improve on the returns quoted. This issue needs to be the subject of more detailed analysis.

Berri Ltd has let fixed price contracts for fruit supply in the April – August period. If, as suggested above, the period of shortage expands with increased fresh daily juice consumption, wider use of long-term contracts may offer a potential solution. The problem for processors, however, is the risk that this might commit them to buying fruit at, say, $350 per tonne, when a collapse in the international FCOJ price depresses that of local valencias to as little as $50 per tonne and makes the contracted processor uncompetitive in the juice market.

3.3 The Need for Industry-level Strategic Planning

The likely future shortages of fruit for the fresh daily juice market suggests the possibility of benefits to both processors and growers from industry-level strategic planning and negotiation. A precedent is the process undertaken by the wine industry in recent years to achieve win-win outcomes in matching volume, quality and price of fruit supply to international consumer demand for Australian wine.

While fresh fruit exports have grown rapidly over the last decade, it appears that industry-level strategic planning could deliver benefits to both packers and growers. There is evidence that transmission of price and quality signals from the US consumer down the chain to packers and growers could be more accurate and more transparent. This would have the effect of increasing consumer satisfaction and helping the industry to compete more effectively with South African fruit as it expands its presence in the US market.

Another issue is that, in increasingly competitive international markets, particularly in Asia, consideration must be given to fostering use of freight corridors, including those that cross borders, which provide time and cost advantage to exporters. In this context, it is important that jurisdictions do not use regulation as a means of determining the port through which citrus shipments are consigned.

One effect of the transition to fresh fruit export is the increased complexity of growing and packing fruit in a way that will ensure that it is still in top condition when the consumer receives it. This requires significant investment in new technology and systems, such as quality assurance. These investments tend not to increase in proportion to the volume of fruit grown and packed, so the unit cost is higher for smaller firms.

This means that the small size of many Australian farms and packing sheds relative to world standards may inhibit the industry’s ability to compete internationally in the long term. In South Australia, for example, 53 per cent of citrus orchards are less than 5 hectares in area and another 23 per cent are less than 10 hectares. While larger firms are investing heavily and appear to be thriving, the smaller ones are struggling to make adequate returns. Finding a satisfactory way of matching farm size to the requirements of an internationally competitive industry is another issue appropriate for the agenda of industry-level strategic planning.

4. SUMMARY AND CONCLUSIONS

The SA Government supports the Commonwealth Government in its objective of improving access to foreign markets via bi and multi-lateral negotiation of lower protective barriers, as long as the lowering is reciprocal and reserves the right to argue the merits of individual cases. On the basis of past evidence, it does not support reintroduction of measures which would impede the citrus industry’s adjustment to a more competitive global environment.

Given the long term nature of citrus investments, the Government is encouraged by the adjustment which has taken place in the SA citrus industry, but accepts that the process has further to go. New opportunities in fresh fruit export provide grounds for optimism about the future and there may be some scope for expansion of fresh daily juice production. However, to capture these opportunities, it will be necessary for all sectors of the industry to engage in a rigorous national strategic planning process, as many of the obstacles will only be overcome by broad agreement about the way forward. In this, the wine industry has provided a useful case study in the inter-sectoral sharing of responsibilities and rewards.

At the invitation of the industry, the Government would be keen to cooperate in such a planning project and to collaborate with other governments and the industry in implementing some of the adjustment initiatives arising from it.

5. RECOMMENDATIONS

- If a case can be made for safeguard measures under WTO rules, the Government would support such measures, *as long as they have a clear focus on facilitating adjustment*.

- The Government *would not support measures which would impede the citrus industry's adjustment to a more competitive global environment.*

- The Government *would support combined industry and government efforts in national industry-level strategic planning to map the way forward*.

- The Government *would help implement a structural adjustment process that was developed as part of a national citrus industry strategic plan*.

- A central criterion for all adjustment measures should be that they *facilitate the improved flow of price and quality signals from the consumer along the supply chain to the grower*.

6. REFERENCES

ABARE (1998) (Author: Rees, C.), *Australian Citrus Industry and Government Assistance*, ABARE Current Issues, No. 98.2, May 1998, Canberra.