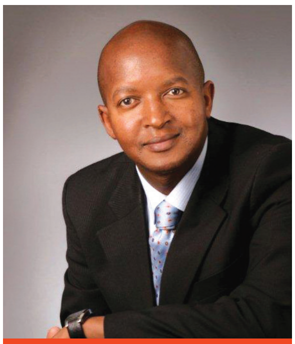
International Trade Administration Commission of South Africa

IMPORT TARIFF SETTING FOR AGRICULTURAL PRODUCTS



Mr Siyabulela Tsengiwe,
Chief Commissioner
International Trade Administration
Commission of South Africa

Import tariff setting in particular for agricultural products is complex. This complexity is due to inter alia the uniqueness of the sector in the light of large subsidies offered in a number of developed countries and the impact that these have on the global supply with a concomitant depressing effect on world prices. Domestic farmers also do not have much bargaining power as they are price takers in the agriculture value chain. The fact that not only the profitability of farmers has to be taken into account but also the interests of producers of agricultural products down the value chain as well as possible inflationary effects for consumers of food, in particular the poor, does not make this task easier. The objective is food security, which is much more nuanced than simple food self-sufficiency.

This complexity is aptly demonstrated by a recent investigation by the International Trade Administration Commission of South Africa (ITAC) of an appropriate import duty dispensation for wheat and wheaten flour, which led to the Minister of Trade and Industry approving increased support for wheat farmers, through an increase in the domestic dollar based reference price for wheat. This increase has been factored into what is known as the variable tariff formula for wheat. The decision of the Minister of Trade and Industry is effective from 25 April 2013.

In the domestic agriculture sector, variable tariff formulae are applied to sugar, maize and wheat. This particular dispensation has been considered the most suitable support mechanism for the heavily internationally traded and, in some countries, subsidised agricultural commodities of wheat, maize and sugar. Grain farming is also susceptible to the quirks and ravages of nature. This particular dispensation is deemed to better suit the circumstances surrounding the production and trade of these commodities than the normal *ad valorem* import duties that are in place for other products. The reason for this is that rapid reaction is required due to the high frequency of the sudden and sharp peaks and troughs evident in the price cycle of wheat and other commodities. The formulae also accommodate exchange rate fluctuations.

The variable tariff dispensation operates on the premise that South African domestic prices should be equal to a notional long-term world reference price after adjustments for transport costs and the subsidies provided by some other wheat producing countries.

To achieve this, the specific customs duty for wheat is calculated as the difference between the domestic reference price for wheat and the world reference price, where the domestic reference price is the five-year average US No.2 HRW (ord) Gulf price after adjustments for ocean transport costs and a distortion factor (caused by subsidies) and the world reference price is the three-week moving average US No.2 HRW (ord) Gulf price for wheat as published in the IGC Grain Market Report.

Adjustments to the level of protection are based on quantum movements in the world wheat price as follows:

The difference between the three-week moving average of the US No. 2 HRW (ord) Gulf settlement price (world reference price) and the domestic Dollar-based reference price for wheat is calculated on a weekly basis. If the three-week moving average of the US No. 2 HRW (ord) Gulf settlement price is lower than the domestic reference price and shows a variance of more than $10/ton from the previous trigger level for three consecutive weeks, an adjustment to the tariff is triggered and a new duty calculated. The resulting dollar specific duty is converted to Rand according to the Rand/Dollar exchange rate prevailing on the day that the adjustment is triggered. Logically, when the world reference price is higher than the domestic reference price (as now), the formula will not yield any duty. Domestic producers would not require protection under such circumstances due to the high prevailing import prices. It will only trigger again when the world reference price dips below the domestic reference price.

Grain South Africa, in terms of the variable tariff formula for wheat, applied for an increase in the domestic Dollar-based reference price of wheat (in essence a floor price) from US$215/ton to US$326/ton.

As reason for the application, the applicant stated that the existing free of duty rate, in terms of the variable tariff formula, does not provide sufficient protection or encouragement for the wheat industry. It was submitted that the current rate of duty is based on a domestic Dollar-based reference price of US$215/ton, and does not encourage farmers to invest in planting wheat, as it does not favourably compete with other grain crops, i.e. maize and soya beans.

Grain SA requested that the domestic Dollar-based reference price of US$215/ton be adjusted by using the latest five-year average US No. 2 HRW (ord) Gulf wheat price of US$288.31/ton and that this price be further adjusted by including a distortion factor (caused by subsidies) based on the latest relevant Producer Subsidy Equivalent for the Agriculture sector, estimated at an average of 10.35%. Transport costs from the Gulf ports to South Africa add an additional protection to tariff protection and should be deducted to determine the level of the price disadvantage experienced *vis-à-vis* the landed costs of imports.

Grain SA further motivated for the inclusion of a self-sufficiency factor in the calculation of the domestic Dollar-based reference price. The motivation for this is based on the fact that during the years 2000/01-2002/03, South Africa was able to supply between 93% and 97% of the domestic demand in wheat for commercial consumption. Since 2002/03 the self-sufficiency in wheat decreased significantly. Grain SA is of the view that South Africa has the potential to produce substantially more wheat if it is more profitable to do so.

The application attracted support from various interested parties within the wheat value chain, namely wheat producing organisations such as agricultural unions and agricultural cooperatives.

A number of organisations, representing downstream producers such as the National Chamber of Milling, Pioneer Foods, and the Animal Feed Manufacturers Association, objected to the application.

During its deliberations and in arriving at its recommendation, the Commission considered the application in the light of the information at its disposal and with due regard to food security in its full context.

In the tariff-setting process, the cost and price implications for the full and complex wheat value chain have to be considered.

Domestic wheat farmers (the first tier in the value chain) are burdened by relatively high input cost structures, such as high fertiliser costs. The next tier comprises the millers, followed in the third tier by the bakers and other wheat-based goods manufacturers. The third tier also includes the animal feed manufacturers. The fourth tier comprises the wholesale and retail trade as well as poultry and red meat farming. An increase in the price of wheat and wheaten flour will affect the price of bread, pasta and breakfast cereals and also that of poultry and red meat, and other value-added products. These price ramifications down the value chain will ultimately affect the consumer.

High quality wheat is produced in South Africa although the country is not self-sufficient as far as wheat production is concerned. Domestic demand outstrips domestic supply by a substantive margin. South Africa has been a net importer of wheat as far back as the early 1990s and imports have increased steeply over recent years.

Currently, world wheat prices are relatively high. However, having taken into consideration the decreasing profitability and diminishing returns of the domestic wheat producing sector and its overall competitive position *vis-à-vis* foreign producers, the Commission found that the existing domestic reference price support for wheat should be increased from US$215 per ton to US$294 per ton by factoring in the latest price trends and cyclical movements in the global wheat price, the level of subsidisation, and transport costs.

It is the Commission's considered opinion that, into the future, South Africa will remain a significant importer of wheat.

Analytical projections at the Commission's disposal indicate that under the requested reference price of US$326 per ton, the domestic wheat price would increase, on average, by roughly 12% per annum over the next decade leading to an increase in domestic production of approximately 8% in the long run, far below the self-sufficiency level. Under the recommended reference price of US$294 per ton, the domestic price of wheat would increase on average by approximately 4% per annum, which would lead to an expansion of wheat production of between 2% and 3% in the long run. It is projected that bread prices would increase by approximately 1.6% per annum under a reference price of US$294 per ton and approximately 4.1% under a reference price of US$326 per ton.

The Commission found that there is no appreciable correlation between higher domestic wheat prices through an additional price support mechanism (self-sufficiency factor) and the expansion of wheat production, and that the ultimate cost of such support will be borne by the consumer, especially the poor. Agronomical factors such as soil (moisture) conditions and rainfall patterns play the dominant role in decisions affecting total plantings of wheat. It is unlikely that plantings of wheat will increase significantly as wheat is not an economically attractive option relative to other grains whose plantings have increased significantly over the last years.

In light of the foregoing, the Commission decided to recommend an increase in the domestic Dollar-based reference price of wheat to US$294/ton, based on the latest five-year (2008-2012) average US No. 2 HRW (ord) Gulf settlement price calculated at US$294/ton plus an adjustment for a distortion factor of 10.5% (as per the OECD producer subsidy equivalent for agriculture) less the average ocean transport cost (over the latest five-year period) of imported wheat to a South African port, of US$33/ton. The latter adjustment is made to adjust for the natural or geographic protection that wheat producers enjoy in order not to overprotect or over compensate the industry causing adverse cost-raising effects downstream.

Given the domestic reference price of US$294/ton, the current three-week moving average world reference price, and the existing R/$ exchange rate, the duty will remain at zero.

In terms of the current formula and the multiplier of 1.5, the duty on wheaten flour will also remain at zero.

Although the rate of duty will remain at zero, the level of protection (price support) would effectively be raised from the current US$215/ton to US$294/ton. Therefore, should prices fall below US$294/ton, a duty will be triggered to offset the effect of lower-priced imports.

This support would place the South African wheat producers on the same competitive footing as their counterparts abroad, would allow for a fair and reasonable profit for farmers, and would not have an undue price-raising impact on consumers.

ITAC follows a developmental approach to tariff setting for both agricultural and industrial goods and not a rigid blanket increase or reduction in tariffs. The Commission's recommendations are evidenced-based and investigations are conducted on a case-by-case basis. The focus is on the outcomes: increased domestic production, investments, job retention and creation as well as international competitiveness.

In closing, it should be borne in mind that the agricultural sector's problems are multifaceted and that import tariff support is not a panacea. The need for agricultural sub-sector strategies with packaged responses to the multiple challenges facing the sector cannot be overemphasised.

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