Food production in South Africa: corporate conduct and economic policy

IPD Africa Task Force Meeting

Pretoria

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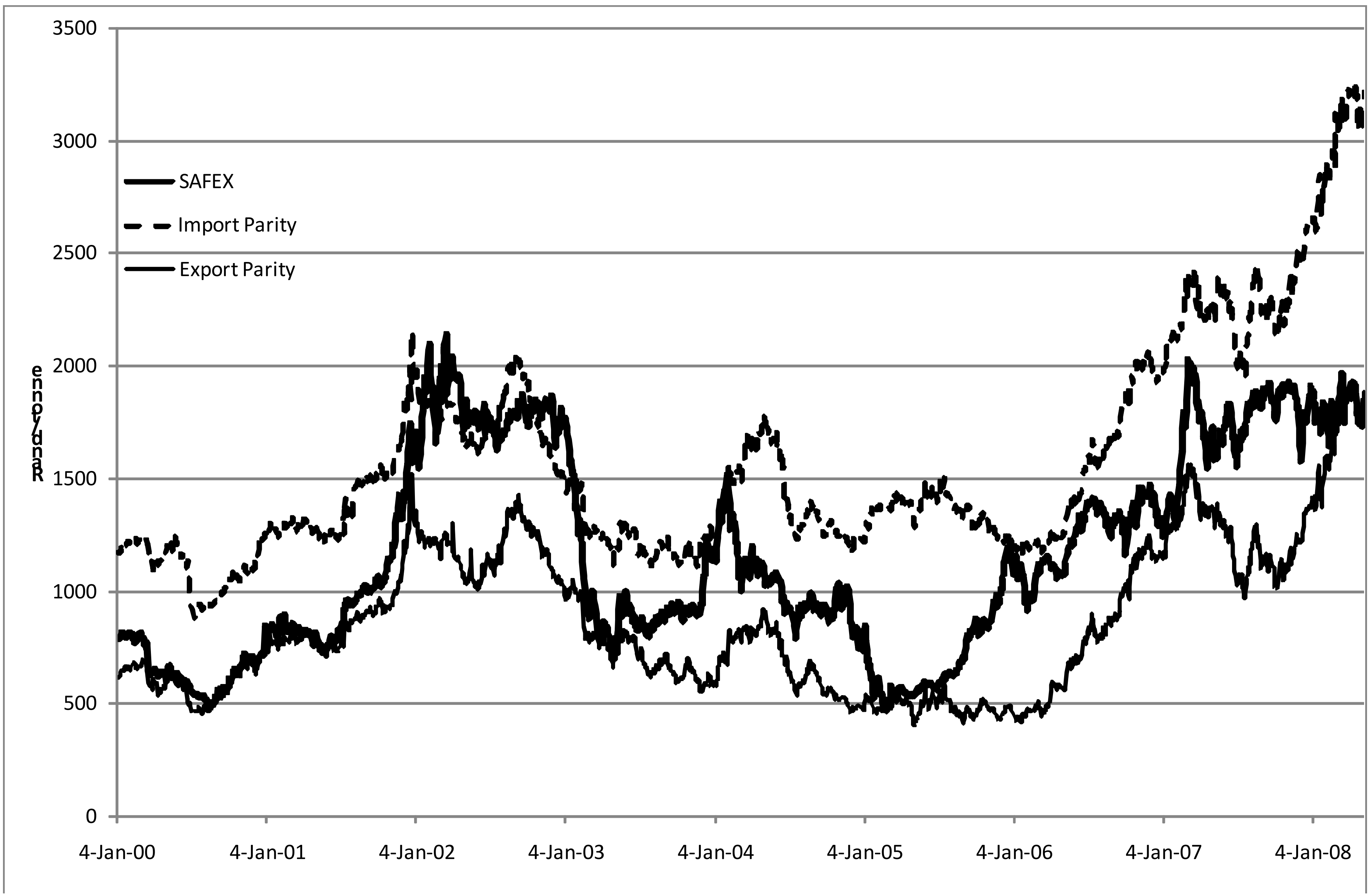
Introduction

- South Africa as case study of sweeping liberalisation of formerly highly regulated food & agriculture markets
  - Control boards governing marketing and controlling prices for almost all agricultural and food products
  - Subsidies and support, including through co-operatives
  - To support white farmers
- Liberalisation, and 1996 abolition of almost all Control Boards
- Expectation that liberalisation of agricultural markets would yield efficiencies, lower consumer prices.
- Greater volatility anticipated, but faith in efficient markets –hedging and derivatives would be used by farmers
- Was major restructuring in agriculture, reduction in farmers, 30% reduction in employment, changing land use
- Conversion of co-ops to private companies
- Vertical integration and concentration throughout supply chains
- Widespread cartel conduct being uncovered (dairy, bread, maizemeal)

Wheat, maize, baking and milling

- Under regulation the maize & wheat board as main intermediaries between farm gate and processing levels
- 4 000 – 6 000 grain producers
- Bulk storage (Silos): Former co-ops, now privatised
  - Dominated by three main firms (Senwes, OTK/Afgri, Noordwes), regional dominance; also involved in trading
- Grain Milling: 4 main firms controlling approximately 90% of the milling of maize and wheat
- Vertical integration into animal feed, baking and production of other foodstuffs such as maize meal, cereals and pasta.
- Liberalisation -> grain traded on SA Futures Exchange
  - SAFEX markets for grain: international prices, and local supply and demand balances
  - Huge volatility
  - Issues of transport differential & speculative conduct (one major known case of speculative manipulation)

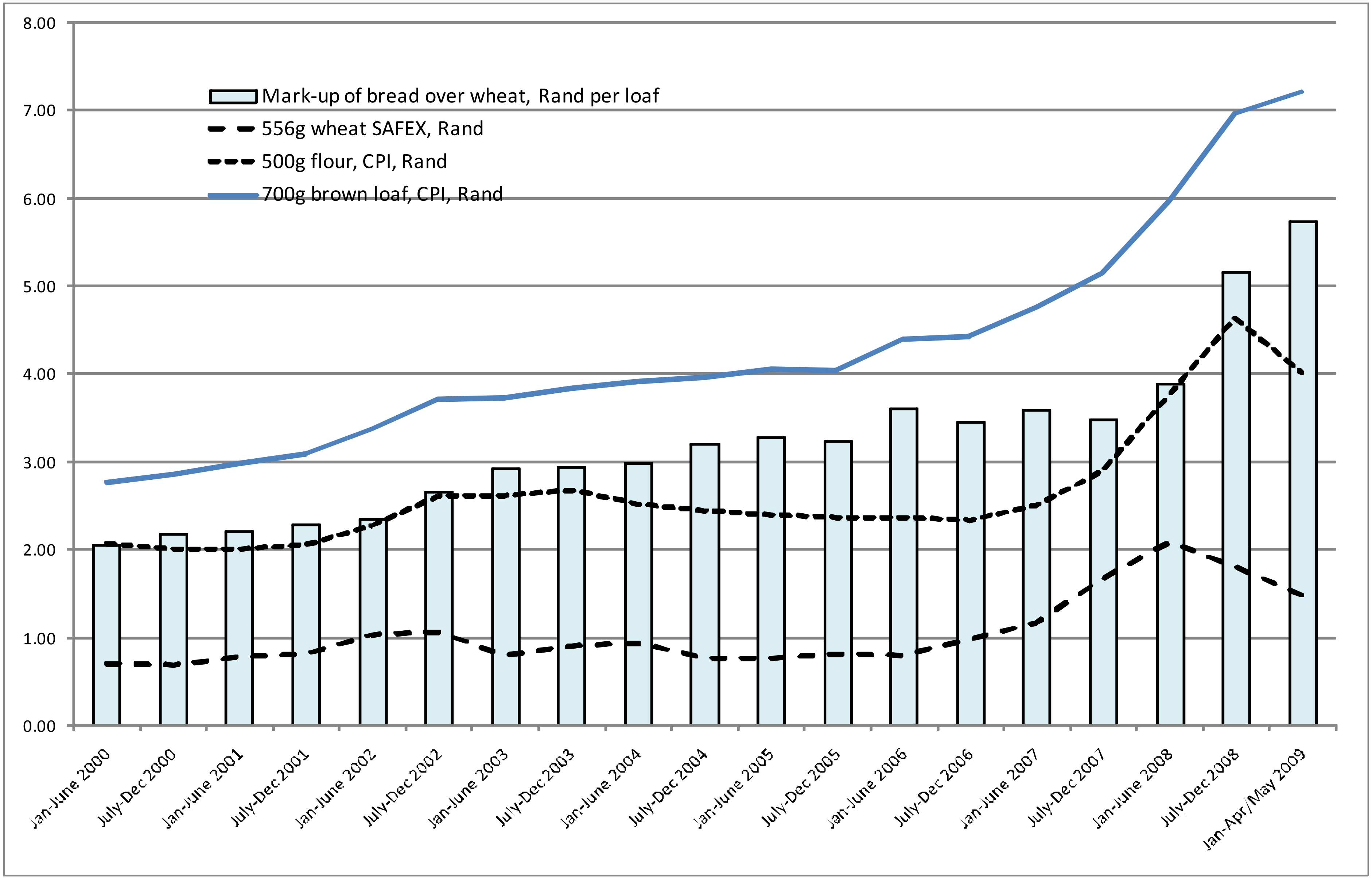
SAFEX White maize prices, Randfontein



Firm conduct & Market outcomes

- High entry barriers at some levels (e.g. silos), and abuse of dominance (main silo owners are also big traders)
- Buyer power concerns in grain (and other products)
- Returns to farmers have declined – becoming ‘contract growers’
- High processing margins maintained and grown
- Collusion at processing level: bread and milled maize meal
- Concentration has been maintained where barriers appear lower, to prevent cartels being undermined (possible predation and other exclusionary conduct)
- Asymmetries in price transmission – market power
  - E.g. maize price no higher in 2008 than 2002, but mealie price substantially higher
  - Wheat prices fluctuate, bread prices never fall (‘consumers don’t like it’)
  - Means exchange rate volatility is inflationary
- Important links to animal feed

Bread, flour and wheat prices, Rand per 700g brown loaf



Poultry

- Main source of protein for the majority of South Africans
- Concentrated, with two major firms vertically integrated
- Continued tariff protection, and a trade deficit
- Three main levels of the poultry value chain:
  - Breeding; Production and rearing of broilers; Poultry products.
- High entry barriers:
  - Few international IP holders of breeds
  - expertise; volumes to justify breeding programme
- Vertical integration, including animal feed (two-thirds of input costs)
- IP leveraged to requirements on feed supply
- Outsource broiler production – supply day old chicks and feed
- Alleged exclusionary conduct and collusion
- Companies operate regionally

Fertilizer

- Concentration in many inputs to farming, including fertilizer
- Fertilizer is the single largest input cost in production of crops such as maize, wheat:
  - competitive pricing crucial for increased food production
- Main producer state-owned until 1989; markets regulated
- South Africa makes two of the three main ‘building blocks’ for fertilizer: nitrogen (in form of ammonia) and phosphoric acid
- Each controlled by local monopoly:
  - Sasol is local monopoly in ammonia production, charges inland import parity prices; cases proceeding of abuse of dominance
  - Foskor is local monopoly supplier of phosphate rock – reaching settlement with Commission
- Long running cartel from 1990s
  - Sasol reached settlement with Commission, with penalty of R250mn; case proceeding against Omnia and Kynoch/Yara

Conclusions

- Liberalisation has not led to more efficient market outcomes in many products because of anti-competitive conduct
  - Far reaching ‘regulation’ of the markets by processors
  - Increased concentration and vertical integration
  - Margins from farm gate to retail increased substantially, after controlling for other costs
- Negative impacts on both farmers and consumers
- Despite high prices, SA moving into a net food import position
- Prices flexible up, sticky down – because of cartels, but also where concentration → exchange rate volatility impacts on inflation
- Competition policy as answer?
  - One part – finding hardcore cartels, addressing abuse of dominance
  - But: slow, limited
  - Important in uncovering firm conduct → inform other policy levers
- Big opportunity now for increased food production in region, but action needed urgently on e.g. fertilizer