

SUMMARY OF CHALLENGES FACING THE SA POULTRY SECTOR

Presentation to the Portfolio Committee on Trade and Industry

23 March 2017

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Trade and Industry
REPUBLIC OF SOUTH AFRICA

Overview

- Status of the domestic industry
- Why is there a crisis?
- Why it is important to support the industry and the trade-offs?
- Trade Policy instruments and measures implemented to date
- Task Team: possible support measures

Snapshot of the industry

- Poultry sub-sector key component of broader agro-processing sector with labour intensity across the value-chain.
- Direct Employment: 48,000. Indirect: 63,000
- Producers undertaking some retrenchments. e,g RCL – 1,300.)
- Industry is competetive but there are limited domestic capabilities in mechanically deboned meat (MDM) in SA

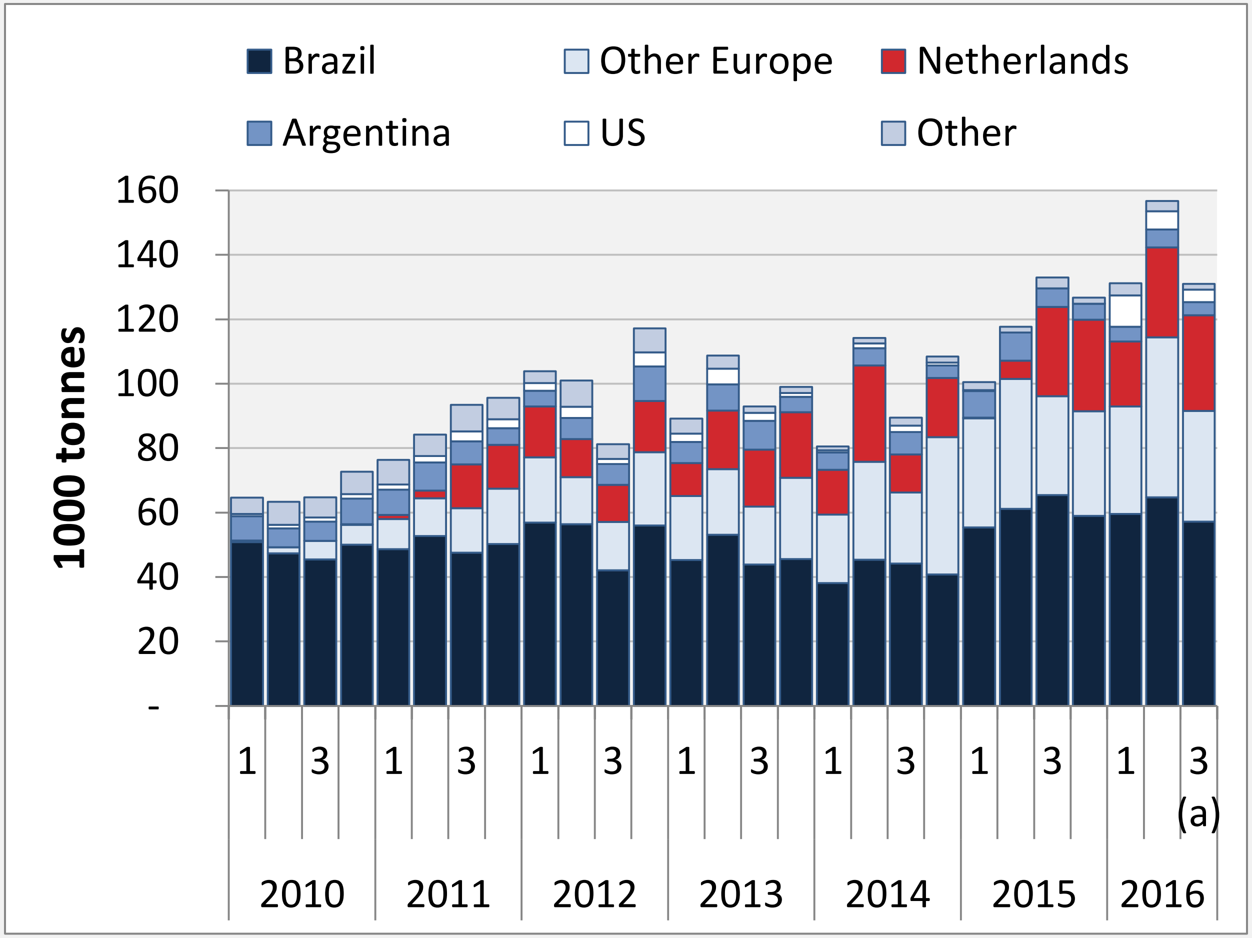
- High cost of inputs (maize and soya) exarcebated by the impact of the drought in previous growing season
- Surge in imports results from an increase mainly of ‘bone-in quarters’ which industry argues is a ‘waste product’ in European process and market structure.
- There are high levels of concentration in the industry with several anti-competitive fines and investigations in recent years.

Why is there a domestic crisis in the poultry sector?

- Market dynamics - developed countries consume mainly white meat and export brown meat portions.
- Distortions in the global agriculture market – subsidies - including 'hidden' subsidies upstream in the value chain - feedstocks.
- Increase in key domestic input costs in the recent period:
  - Feedstocks (maize and soya.)
  - Electricity (especially where municipalities add significant sometimes triple digit premiums) and
  - Labour
- Increase in imports, mainly of brown meat portions, which industry argues constitutes an unfair rade practice.
- Increasing use of SPS measures in other jurisdictions as barriers to trade – limiting access of domestic poultry exporters. With SA not always securing 'equivalence' with similar measures.

Poultry sector - data

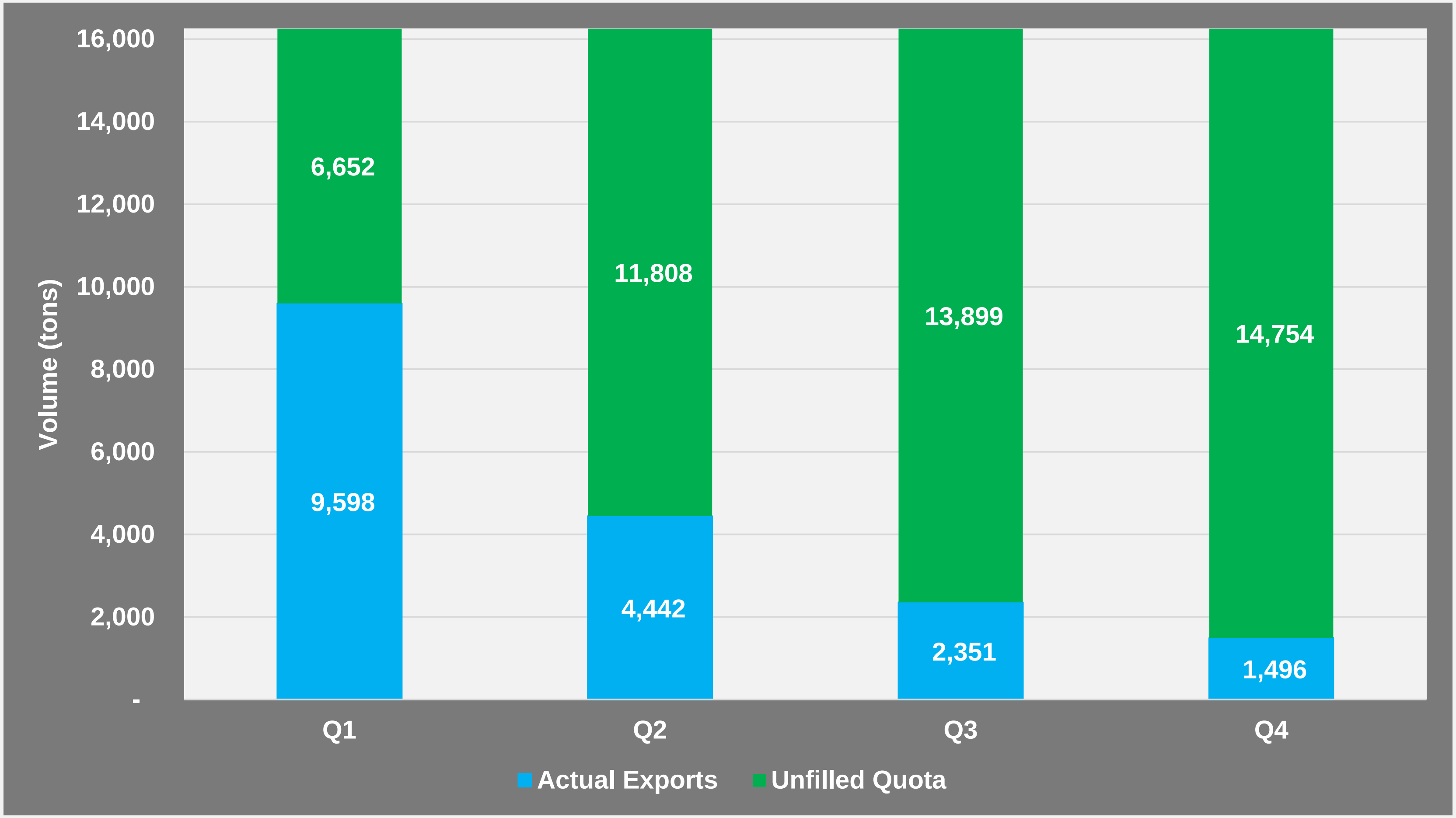
- Poultry companies point to surge in imports in 2015 and first half of 2016
- Spike in Q2 2016
- Growth almost entirely due to imports from Europe



Source: SARS

While there are US imports, these are not the source of the crisis

December unaccounted for. Not yet reported.



Source: AGBIZ using SARS data

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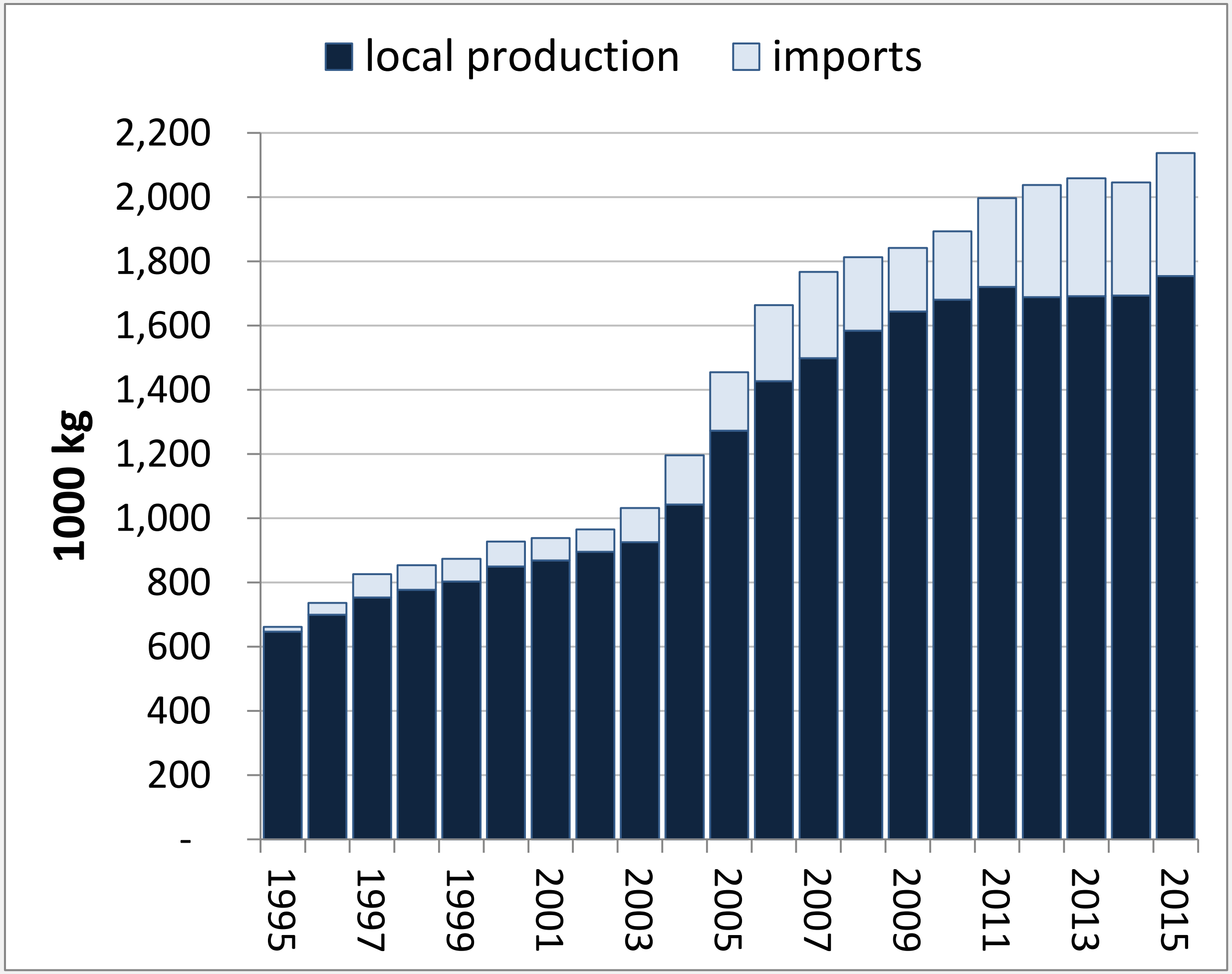
Domestic demand and production has increased alongside significant import penetration

- Poultry consumption soared in period up to 2010 (roughly coinciding with commodity boom) but levelled out from 2010
- Imports climbed from 8% of total consumption in 2003 to over 20% from 2010 to 2013
- From 2003 to 2010, imports rose 11% and local production 7% a year



Source: DAFF

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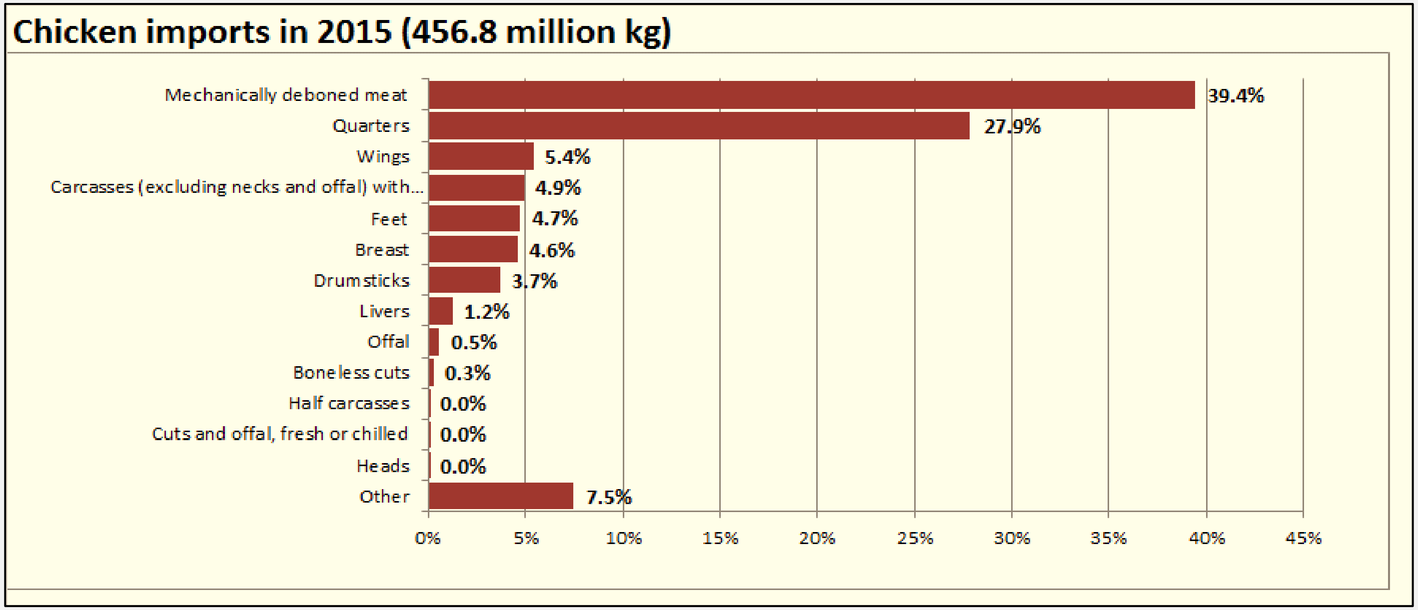
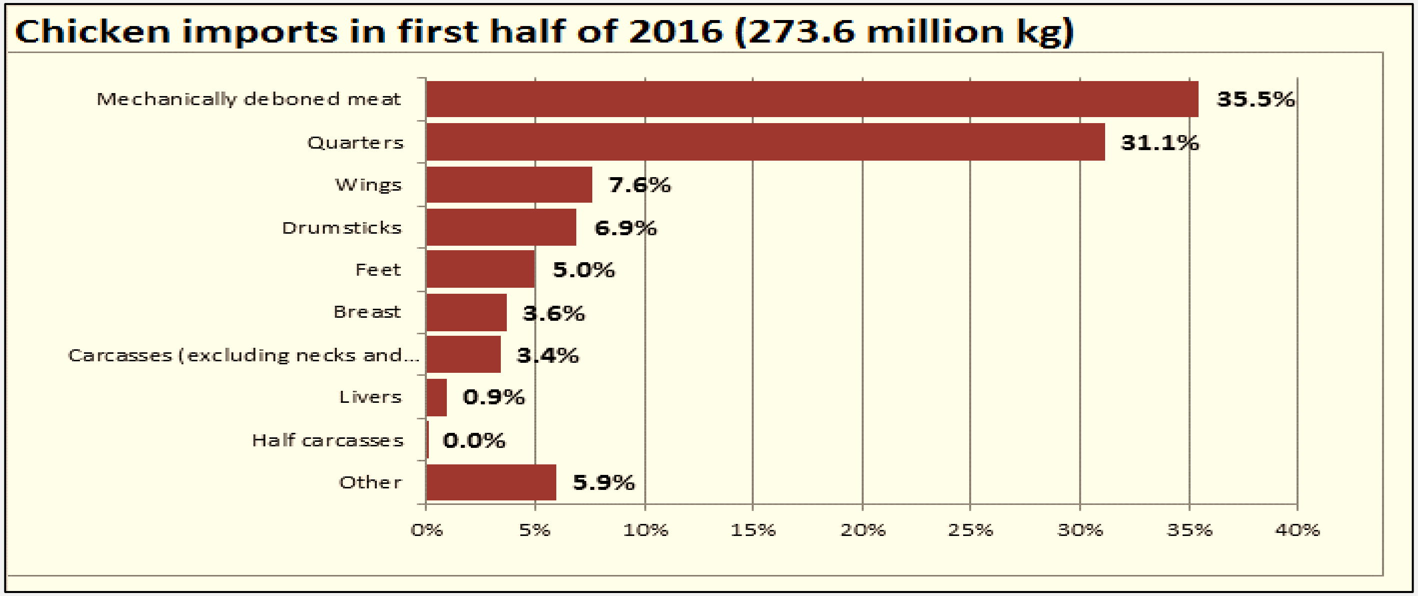
Imports: Of what?

- High levels of imports in mechanically deboned meat / MDM (mainly from Brazil)
- Quarters (EU and now USA)
- SA can produce whole chickens cheaper than most EU countries & USA
- SA more expensive than Brazil
- Core issue is the MDM & Quarters – significant export penetration.





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Factors behind the trends

Demand factors

1 Slowdown in domestic demand in adverse economic conditions

2 Slower global growth and demand in other markets which leads to aggressive market penetration in developing countries.

3 Market demand dynamics facilitate exports of brown meat into domestic market where SA producers are less competitive.

- Developed markets – consumption mainly of breasts – export the 'by-product' .
- Developing countries - mainly leg & thigh demand (bone-in quarter) and boneless (processing) – aggressive market penetration.

Factors behind the trends

Supply

Estimated unit price in 2015*

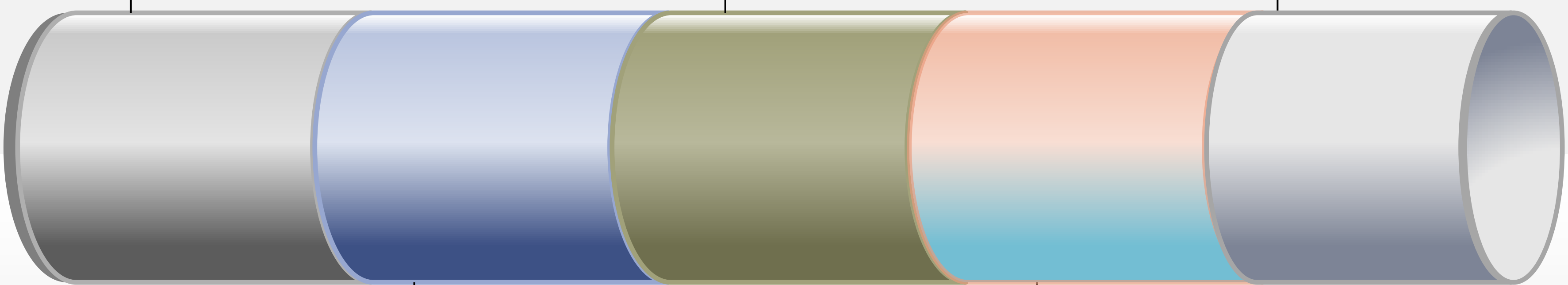
- SA: R20/kg (up from R15/kg in 2011)
- US and European imports of bone-in quarters: R14/kg
- Brazilian imports (mainly of mechanised deboned meat, used in polonies and patties): R4.10/kg

Average agricultural subsidies as % of output:‡

(Mainly of feed and other inputs)

- SA: 2%
- Brazil: 4%
- US: 10%
- EU: 18%

VAT: chicken is not zero rated



Main cost driver is feed (between 65% & 70% of cost)

- Drought has increased maize and soy price. (SA soya bean production is increasing and should be encouraged.)
- Soy at import parity is largely imported (although local production almost quadrupled from 2003 to 2014), with rising prices especially given currency depreciation

Retail mark-up on chicken is over 50%

(Cold chain and packaging add to overheads)

* Based on DAFF and SARS data)

‡ Source: OECD

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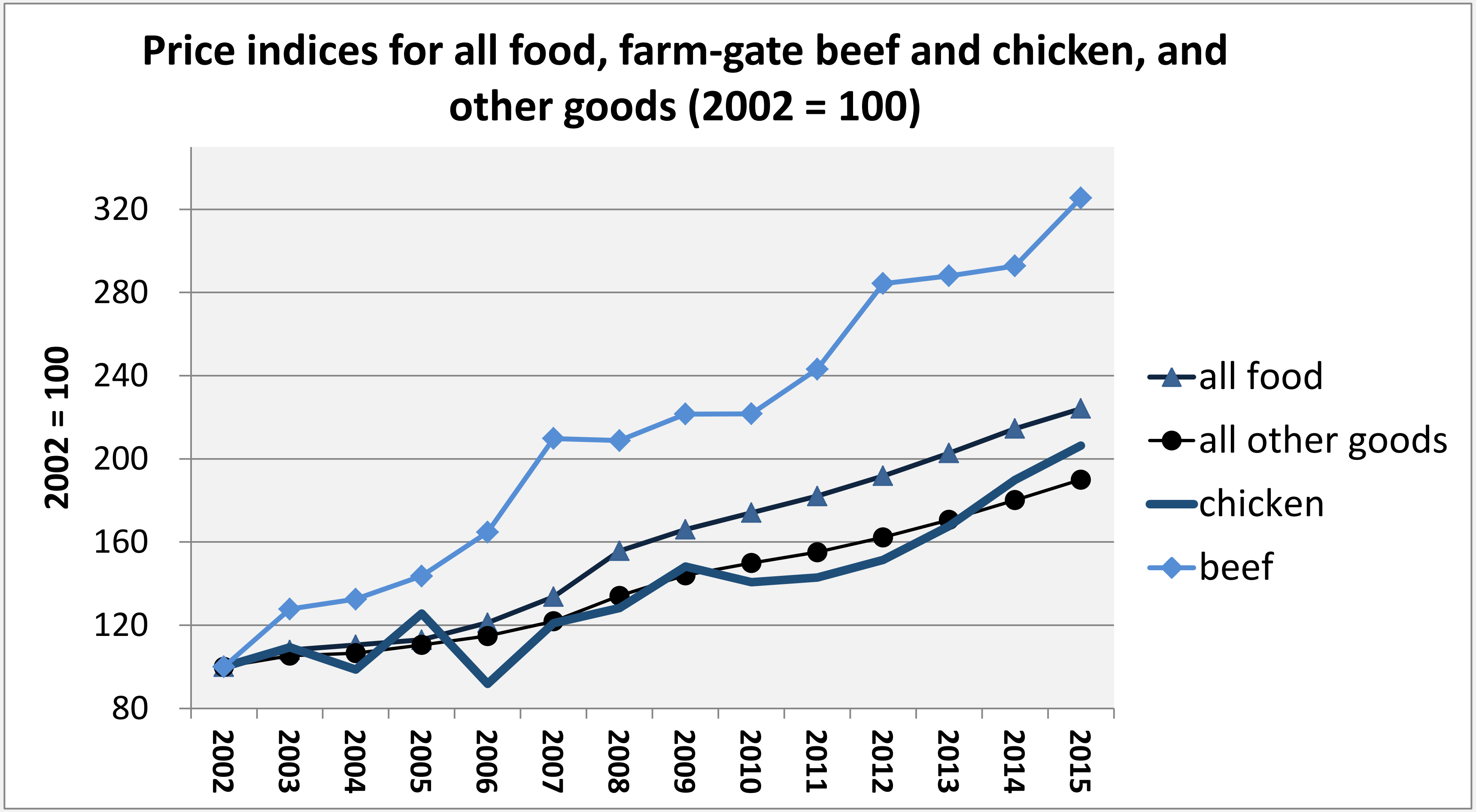
Comparative price increases 2002 -2015



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Selected socio-economic considerations

- **Implications for poor households**
  - Chicken is a wage good and the main source of protein for poor households
  - Price has risen at 15% above the overall inflation rate, while other food prices increased around 30% faster. Chicken price increases have remained below the all food index.
  - Trade measures required to protect the industry (job losses and plant closures) from unfair competition but important that these do not lead to high consumer price increases and price ‘gouging’ along the value chain.
- **Industry is highly concentrated and vertically integrated**
  - Two production companies control around half of production with limited transformation and high barriers to entry
  - Approximately 2% of formal production from emerging farmers

Selected socio-economic considerations II

- Poultry industry: sophisticated industry across the value-chain, critical to domestic industrial capacity

  SA can ill-afford to lose industrial capacity in the poultry sector

  And, dependence on poultry imports constitutes a level of risk to national food security, especially given volatile rand
- Chicken is a major source of protein for poor and working households
- Employment creation:
  - About 48,000 workers in broiler production, processing and distribution
  - Major source of demand for maize and soy – upstream economic and employment multipliers
  - Downstream – logistics and retail (but value-addition and exports limited)

Trade Policy

- Tariffs are instruments of industrial policy. Respect the integrity of the International Trade Administration Commission. An evidence-based, case-by-case assessment will inform changes to tariffs (not *a priority* position).

- Strategic approach to tariffs to support industrial and employment objectives. Use of anti-dumping, countervailing and safeguard measures to address unfair competition and surge of imports.

- Concurrently build and deepen production capabilities with support for investment in capital equipment, new production systems and human resources to build efficiencies and competeveness along the entire value chain.

- Build a collaborative effort between the producers, retailers and the private sector to raise aggregate demand for domestic producers and export promotion effort in traditional and new markets.

Tariffs/Trade Remedy Measures - Overview

- Several rounds of tariff increases over the past decade
- Bone-in portions: tariff was increased but still below the WTO bound rate
- Tariff on whole chicken already at the WTO bound rate
- Tariff increases/trade measures on chicken products from trade partners with whom a preferential trade agreement is in place requires negotiations with those partners (should be kept in mind that those partners have also provided market access to SA products)
- Provisional safeguard duty (13.9%) in place on EU imports and under further consideration by ITAC
- Distortions in the global agriculture market – subsidies.
- Premium prices for breast meat in EU & US;
- Tariff increases have short term potential to raise prices for bone-in portions but can negatively effect consumers

Preferential Tariff Regime

- SA's World Trade Organisation commitments: bound rate on frozen chicken, whether cut in pieces or not, is 82%. The ordinary customs duties [also called the Most Favoured Nation (MFN) rate of duty] on the tariff lines for frozen chicken can therefore not be increased to more than 82% ad valorem.

- SA has free trade agreements with the EU through the Trade, Development and Co-operation Agreement (TDCA) between South African and the European Union (EU) which has been replaced by the Economic Partnership Agreement (EPA) and the Southern Africa Development Community (SADC) EPA States, that comprise of Botswana, Lesotho, Mozambique, Namibia, South Africa and Swaziland. The EPA replaced the trade chapter in the TDCA on 10 October 2016.

- Under the TDCA, SA agreed to start reducing the tariff duties on frozen bone-in cuts of chicken imported from the EU, 5 years after the entry into force of the TDCA (2005). The duty was fully liberalised in 2012.

- Both the TDCA and the EPA contains provisions that provide for safeguards to the domestic industry in the event that imports of a specific product increase to such an extent that it causes injury or disturbance to the domestic industry of such a product.

- There are no preferential tariffs for poultry under the SACU MERCOSUR Preferential Trade Agreement and thus poultry imports from Brazil are subject to the MFN duty.

Increase in Ordinary Customs Duties

- Following a tariff investigation by the International Trade Administration Commission (ITAC) in 2012/13, the ordinary tariff duties on a number of frozen chicken products were increased in 2013, as follows:
  - whole bird: 27% to 82%
  - carcasses: 27% to 31%
  - boneless cuts: 5% to 12%
  - offal: 27% to 30%
  - bone-in” portions: 220C/kg (18%) to 37%

- The above duties are applicable to imports of all countries except the member states of the EU and SADC.

- The domestic industry can at any time submit an application at ITAC to increase the ordinary customs duties on those frozen chicken products where there is still water between the applied rate of duty and the WTO bound rate of 82%.

Anti-Dumping Duties

- "Dumping" occurs when a company exports a product to another country at a price lower than the price it normally charges for the product on its own home market. If the exports of this "dumped" product causes material injury or threaten to cause material injury to the domestic producers of a like product, an anti-dumping duty can be imposed.
- Following an application by the SA Poultry Association (SAPA), ITAC initiated an anti-dumping investigation on frozen bone-in chicken pieces being imported from or originating in Germany, the Netherlands and the United Kingdom (UK).
- In January 2015, anti-dumping duties were imposed:
  - between 31,30% to 73,33%; Netherlands: between 22,81% to 30,99% (3 companies excluded from anti-dumping duties); UK: between 12,07% to 30,99%
- The current anti-dumping duties will remain for a period of 5 years and can be further extended for another 5 years following a sunset review investigation that considers the likelihood that dumping and material injury will continue or recur if the anti-dumping duties are removed.
- Industry can submit an interim review if the duties are not sufficient or no longer needed due to changed circumstances. Or can submit application for new ADD against any other countries if evidence indicates that dumping is taking place.

Safeguard Investigation

- In terms of the WTO provisions a country can take a safeguard action when there is a surge of imports that cause or threatens serious injury to a competing domestic industry. The safeguard measure must be temporary and generally applied against all countries. Upon application by industry, ITAC would undertake an investigation and make a recommendation to the Minister of Trade and Industry.

- The TDCA, and now the EPA, makes provision for a preferential safeguard action to be taken by parties to the Agreement. The preferential safeguard differs from the WTO safeguard since it is specific to only the parties to the TDCA/EPA and can be used to address an increase in imports from the EU that causes or threatens to cause a serious disturbance to the domestic market (not serious injury as is required under WTO provision).

- SAPA submitted a preferential safeguard application on bone-in chicken imports from the EU. ITAC initiated an investigation and recommended the imposition of a provisional safeguard duty of 13,9% ad valorem.

- This duty will stay in place until 3 July 2017 while ITAC finalises its investigation.

Avian Influenza Outbreaks

- A number of countries are currently experiencing Highly Pathogenic Avian Influenza outbreaks and consequently, in line with the guidelines of the World Organisation for Animal Health, South Africa has placed a ban on imports of poultry from these countries.

- Currently no poultry products can be imported from, France, Germany, Hungary, Israel, the Netherlands, Poland, Spain and the UK. DAFF recently lifted the prohibition of imports from Denmark and informed importers accordingly.

- 7 of the 10 EU countries authorised to export poultry to South Africa can not currently export due to avian influenza outbreaks in those countries.

Government interventions: 1

- Broad agreement: manufacturing-led growth is critical - high economic and employment multipliers. Poultry sector is critical to this effort.
- Sector in crisis and a range of further policy inventions needed
- Action-focused Government Task Team established November 2016
  - ☞ Establish a fact and data base for decision making and engagement with key stakeholders.
  - ☞ Identify possible areas for intervention and ensure proactive and timely interventions including by government departments.

Government interventions: 2

- A number of trades-offs to be resolved:
  - Industry protection/support of various forms
  - Consumer prices and impact on wage earners
  - Support increased investment by private sector to raise capabilities and competitiveness especially in sub-sectors such as MDM
  - Transformation – address low levels of transformation across the value chain.
  - Establishment of a Task Team comprised government departments (DTI, EDD, DAFF, IDC) and representatives of Business and Labour.
  - Ongoing engagement and work-streams to develop collaborative short and long term solutions.

Task Team: Work-streams

1. **Trade measures**
   - Tariffs, safeguard measures: led by DTI and EDD
   - Health, quality, packaging. Ensure equivalence between SA exports conditions imposed in other markets and imports into SA market - DAFF
2. **Competitiveness**
   - Lowering costs of inputs (grains, soy, electricity, water); DTI , EDD and IDC
   - Technology upgrading especially MDM : IDC, DTI and EDD.
   - Breeding: DAFF
3. **Consumer behaviour and demand**
   - State sector procurement – localisation under the new regulations of the Preferential Public Procurement Act (PPPFA): DTI.
4. **Export support**

   (Currently only 1.4% exported & mainly to SADC)
   - Support with products, access to markets, market research, trade diplomacy : DTI.

5. Industrial Finance and incentives:

- Industrial finance and incentives with reciprocal conditions.
- Ring-fenced component of agro-processing fund to be launched in April – DTI.
- Agro-processing industrial finance : IDC

6. Transformation: linked to reciprocal conditions for support across value chain. EDD, DTI, DAFF, IDC and Land Bank.

Task Team: Update on Work-streams

WORK STREAM	INTERVENTION	DURATION	RESPONSIBILITY	STATUS
Trade measures	Review of tariffs and safeguards	Medium term	ITAC and EDD	Review of tariffs and safeguards currently underway. Update is expected in April 2017.
	Health, quality and packaging	Short term	DAFF	DAFF to urgently implement existing measures which do not require legislative amendments **based on equivalence**.
	Sanitary and Phyto-sanitary	Short term	DAFF	As above **based on equivalence.**
Competitive ness	Lowering inputs costs	Medium term	the dti, EDD and SAPA	Measures to lower input costs – espcially feedstocks.
	Technology upgrading	Long term	the dti, IDC, EDD and SAPA	Viability of investment in MDM plants to raise capabilities in key sub-sector.
Consumer demand	Public sector procurement	Medium term	the dti, EDD and NT	Localisation of public procurement under the new regulations of the PPPFA
Export support	Market access	Medium term	the dti	Export promotion effort in traditional and new markets
Finance	Industrial finance and incentives	Medium Term	the dti, EDD and IDC	Ring-fenced agro-processing incentive and industrial finance for green and brownfield investment especially in MDM

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Thank You