



SUMMARY CHALLENGES FACING THE SA POULTRY SECTOR

**Presentation by the dti to the
Select Committee on Trade and International
Relations**

01 February 2017

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



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Department:
Trade and Industry
REPUBLIC OF SOUTH AFRICA

Snapshot of the industry

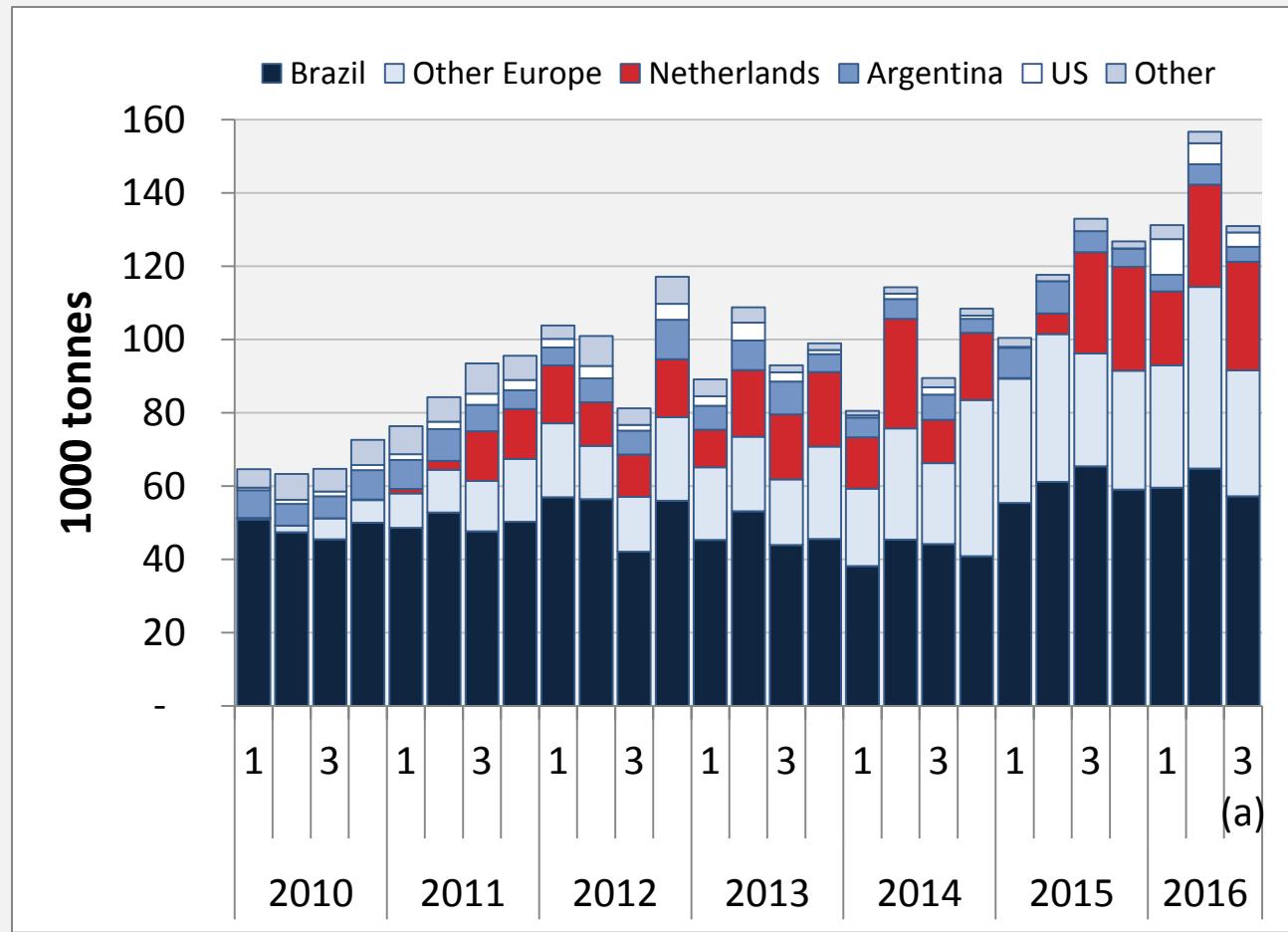
- Direct Employment: 48,000 people
- Indirect: 63,000
- Plants with old assets (20yrs+)
- Limited capacity in mechanically deboned meat (MDM) in SA
- Retrenchments underway (Rainbow – 1,300; others in the ‘pipeline’)
- Concentrated Industry: several anti-competitive fines and investigations over the past few years
- High cost of inputs and impact of the drought
- Increase is from imports of ‘bone-in quarters’

Why is there a Crisis?

- Market preferences - developed countries consume white meat and developing countries brown meat
- Distortions in the global agriculture market – subsidies
- Competitiveness
- Increase in key input costs:
 - Feed
 - Electricity
 - Labour
- Drought
- Increase in imports
- Increasing use of SPS measures as barriers to trade – limiting access to export markets

Why is there a Crisis?

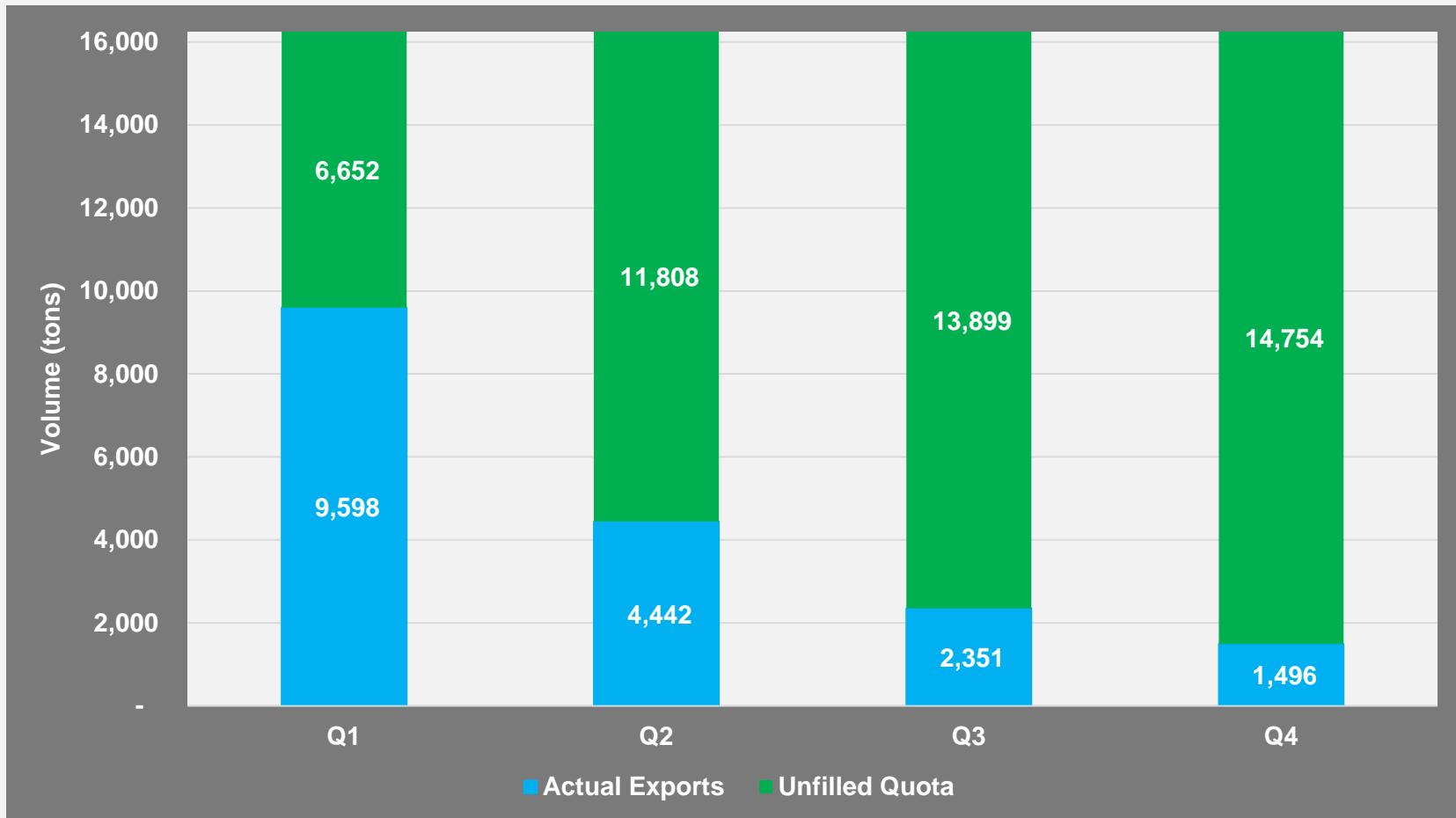
- Poultry companies point to surge in imports in 2015 and first half of 2016
- Spike in Q2 2016
- Half of exports from Brazil; but growth almost entirely due to imports from Europe



Source: SARS

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

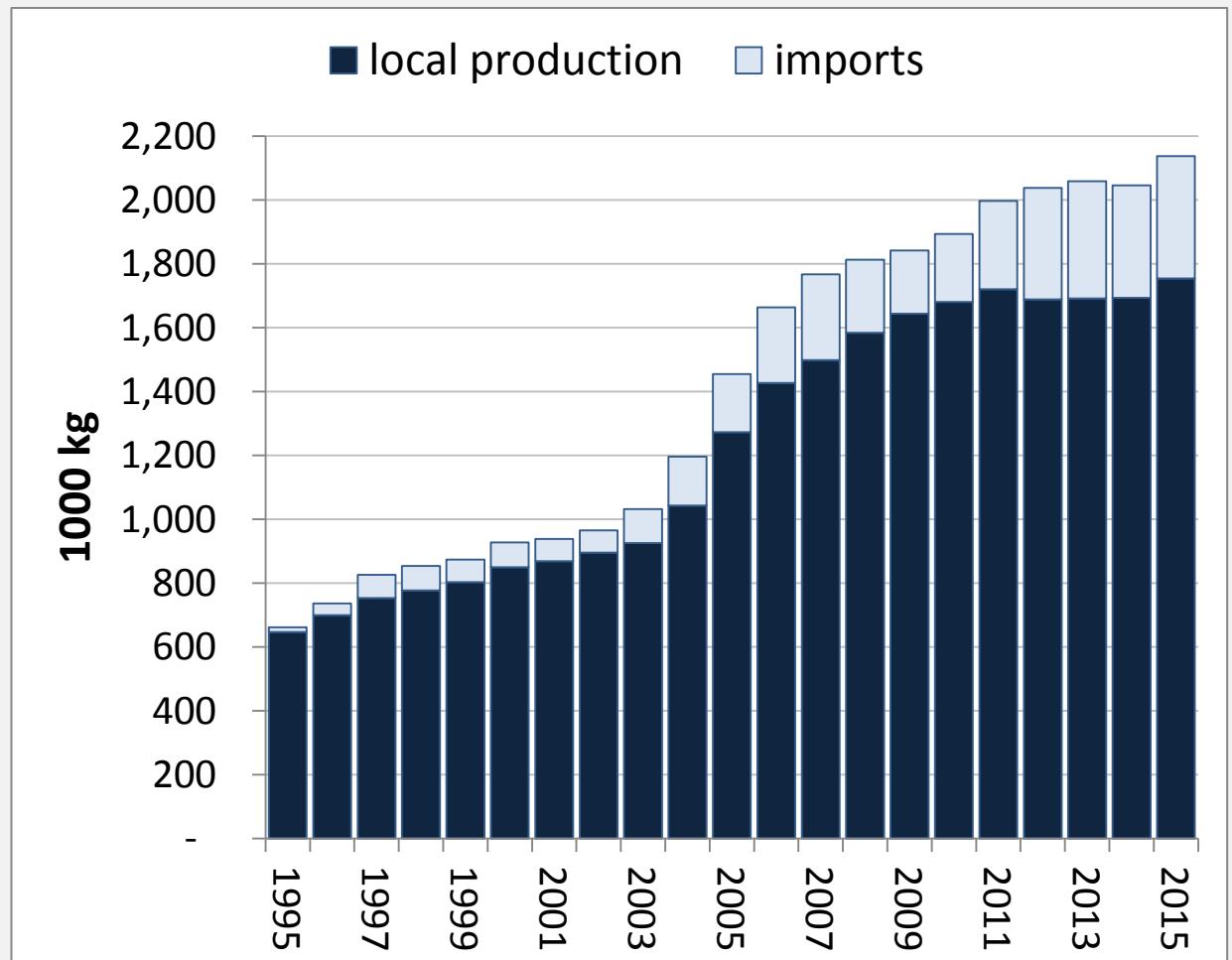
December unaccounted for. Not yet reported.



Source: AGBIZ using SARS data

Longer term trends: imports, not domestic production, feeding growth in demand

- 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

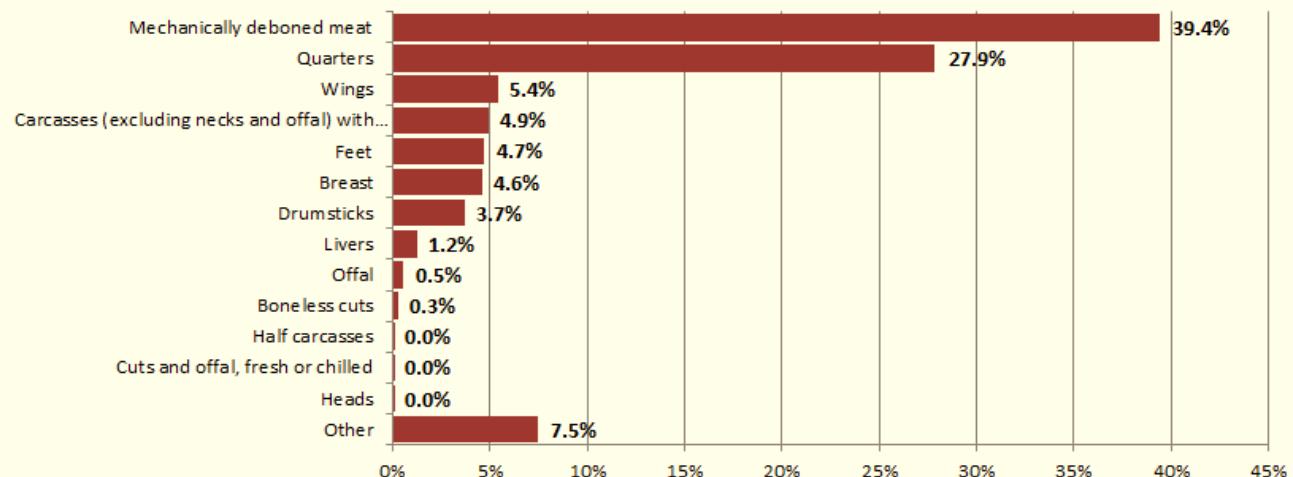


Source: DAFF

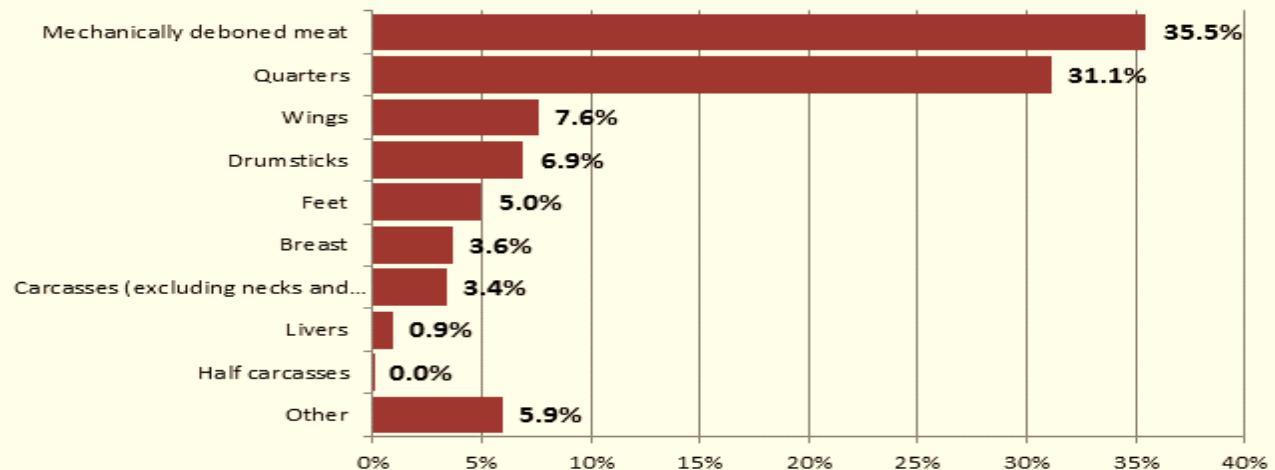
Imports: Of what?

- 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.

Chicken imports in 2015 (456.8 million kg)



Chicken imports in first half of 2016 (273.6 million kg)



Factors behind the trends

Demand

Slowdown in domestic demand in adverse economic conditions and end of commodity super-cycle

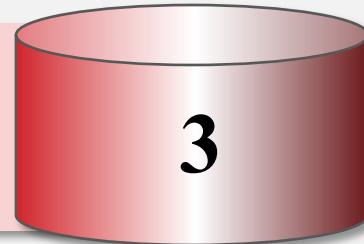


Slower global growth and demand



- Slowdown in China
- Russian sanctions

Complementary tastes



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

Factors behind the trends

Supply

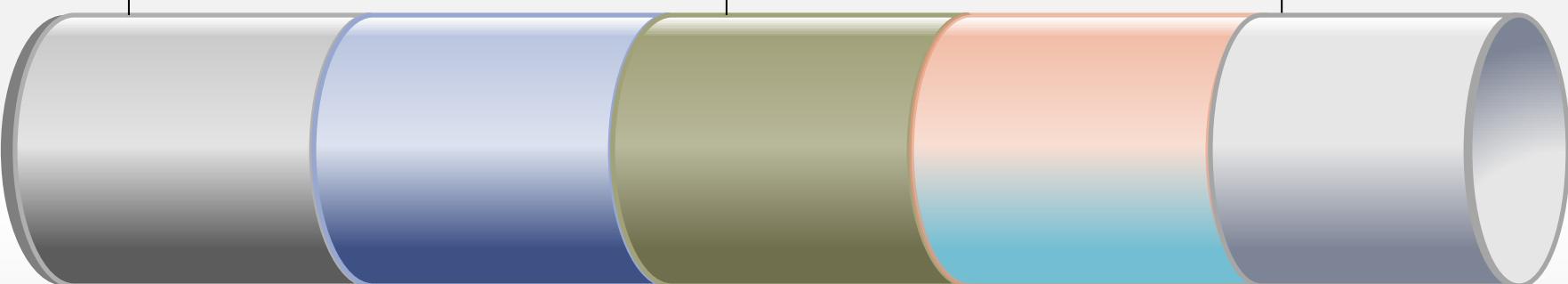
Estimated unit price in 2015*

- 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)

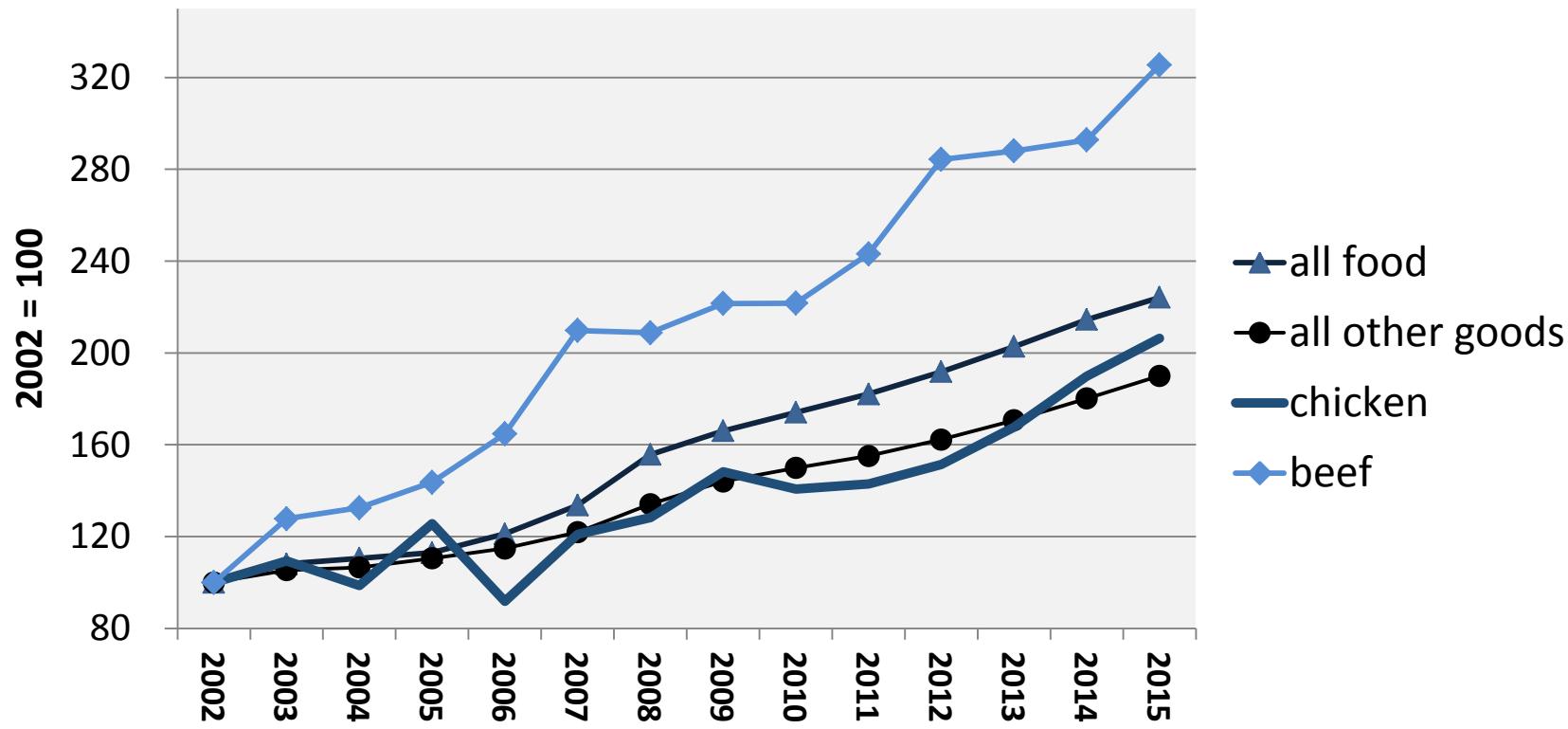
[‡] Source: OECD

Trade-offs: chicken is a basic staple and price increases have been moderated

Staple for poor households	High average consumption levels	Prices
<ul style="list-style-type: none">▪ 20% of food costs for poorest decile, rising to 27% for richest▪ But top decile accounts for over half of total sales due to much higher incomes	<ul style="list-style-type: none">▪ Poultry: 40 kg: 84% increase from 2000▪ Beef: 19 kg: 50% increase from 2000	<ul style="list-style-type: none">▪ Prices have risen much faster for beef than for chicken▪ Difference probably due to rising imports of chicken and falling imports of beef▪ Beef imports have fallen from 8% in 2000 to 2% in 2015

Comparative price increases 2002 -2015

Price indices for all food, farm-gate beef and chicken, and other goods (2002 = 100)



Difficult socio-economic trade-offs: 1

□ 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.
- Tariff increases could protect the industry but also impact negatively on the poor, unless domestic prices can be moderated

□ Industry is highly concentrated and vertically integrated

- Two companies control around half of production
- Approximately 2% of formal production from emerging farmers

Difficult socio-economic trade-offs: 2

- Poultry industry: sophisticated industry across the value-chain, critical to domestic industrial capacity
 - There are risks of further de-industrialisation across the economy in a number of sectors
- But dependence on poultry imports constitutes a level of risk to national food security, especially given volatile rand
- Chicken is a major food 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

- ❑ Strategic approach to trade policy - purposeful intervention to build and deepen production capabilities, investment in human capital, research and innovation & technology
- ❑ Tariffs are instruments of industrial policy
- ❑ Strategic approach to tariff reform to support industrial and employment objectives
- ❑ An evidence-based, case-by-case assessment will inform changes to tariffs (no *a priori* position) – Vital role for ITAC
- ❑ Implies
 - Reduce tariffs on mature *upstream* input industries → lower the costs for downstream, labour creating manufacturing
 - Raise tariffs on *downstream* industries with employment or value-addition potential → ensure sustainability and job creation (observing international trade obligations)
- ❑ Build trade and investment relations – developed, emerging economies and promote regional economic integration

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 Southern Africa Development Community (SADC).
- 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.
- 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.

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: 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 export 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)

Anti-Dumping Duties

- In January 2015, anti-dumping duties were imposed:
 - Germany: from 31,30% to 73,33%
 - Netherlands: from 22,81% to 30,99% (3 companies excluded from anti-dumping duties)
 - UK: from 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 ADD against any countries if evidence indicates as such.

Tariffs - background

- ❑ Several rounds of tariff increases over the past decade
- ❑ Bone-in portions: increased tariff, but still below the WTO bound rate
- ❑ Carcasses and offal already at the WTO bound rate
- ❑ Provisional safeguard duty (13.9%) in place on EU imports and under further consideration by ITAC
- ❑ Several countries (including EU countries) provide subsidies (particularly for feed costs) to support their poultry industry, which lowers their poultry prices and makes poultry exporters more competitive
- ❑ Premium for breast meat in EU & US; SA industry argues that quarters are therefore sold below cost (should be characterised as a 'waste' product.)
- ❑ Tariff increases have short term potential to raise prices for bone-in portions – detrimental to consumers, especially wage earners and poor households
- ❑ Tariff increases and trade measures require negotiations with trade partners where agreements are in place and partners have provided market access to other SA products

Safeguard Investigation

- Upon application by industry, ITAC would undertake an investigation and recommend a safeguard duty where there is an increase in the volume of imports causing a threat of serious disturbance in the SA market.
- In the case of the EU, ITAC recommended the imposition of a provisional safeguard duty of 13,9%.
- 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 Denmark, France, Germany, Hungary, Israel, the Netherlands, Poland and the UK.
- ❑ DAFF is closely monitoring the developments in regard to these outbreaks and will take the appropriate actions to address any health and safety concerns

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
 - ☞ Receive inputs and undertake research where required: IDC, TIPS, ITAC, Competition Commission
 - ☞ Identify possible areas for intervention
 - ☞ Engage with different stakeholders
 - ☞ Recommendations for intervention
 - ☞ Unblock areas for intervention

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 and raise competitiveness levels
 - ☞ Transformation - importers are largely white with some BEE companies involved but low levels of transformation in domestic production firms
- ❑ Task Team expanded to include Business and Labour (in January 2017) – ongoing dialogue and work-streams to develop a ‘shared’ short and long term solution

Task Team: Work-streams to develop a shared solution

1. Trade measures

- Tariffs, safeguard measures etc.
- Health, quality, packaging. Ensuring equivalence with SA exports as with imports

2. Competitiveness

- Lowering costs of inputs (grains, soy, electricity, water)
- Technology upgrading, new streams (i.e. MDM)
- Value addition, modernisation
- Breeding

3. Consumer behaviour and demand

- State sector procurement – designation and use of the Preferential Public Procurement Act (PPPFA) – Clause 9.3.
- Zero rating for VAT
- Dietary issues

4. Export support

(Currently only 1.4% exported & mainly to SADC)

- Support with products, access to markets, market research, trade diplomacy, bureaucratic compliance

5. Finance

- Industrial finance and incentives with conditions for competitiveness raising:
- Technology
- New product lines
- Risk mitigation

6. Growth and transformation

- Opportunities across the value chain



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Thank You



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