Increased Investment in Research could potentially save South Africa's Wheat Sector

Wandile Sihlobo argues that import tariffs in South Africa's wheat sector will not save the industry, the focus must be placed on breeding new wheat cultivars which will give higher yields.

Trade policy debates are incomplete if argued without due consideration on the effect of selected instruments on both the consumption and production side. Ideally, policy seeks a balance on producer and consumer welfare, in equal measure. This perspective resonates with recent increase in South Africa's wheat import tariff, which is currently at an all time high of almost R1600.00 (around US$115.00) per ton, 30 per cent up from the previous level. On the consumer side, higher wheat import tariffs are adding to the bullish pressure on staple food prices. On the producer side, South African wheat farmers also need to be protected against unfair competition from highly-subsided foreign imports.

The underlying logic of the tariff mechanism is admittedly simple. An increase in import tariff would keep the domestic wheat prices at a level attractive enough to incentivise farmers to increase production, the knock-on effects of which would ultimately moderate prices in the long run. Of course, in the short run, prices would inevitably increase, the extent and contribution of the tariff to which, remains debatable. While it is important to take a long term view, it is important to note that achieving a supply response of the magnitude that would lead to self sufficiency is impossible, at least not in a season or two, given that South Africa currently produces just 40 per cent of its annual wheat consumption of 3.4 million tons. From this perspective, a tariff is not a dismissible option, but a strategic necessity.

A wheat field in the Western Cape
Photo Credit: slack12 via Flickr (http://bit.ly/2bzhpyy) CC BY-NC-ND 2.0

The question is, how should such a tariff be structured in order to attain the delicate balance that promotes domestic production on one hand, while fostering food security on the other. The levels to which the tariff has reached so far has led to emerging concerns regarding the "variable tariff formula" method that had worked so well in the past. South Africa is facing a unique season, in which a severe drought, high fuel prices, a weak rand all simultaneously conspired to brew a perfect storm that has led to exceptionally high food prices. Meanwhile, as the variable tariff formula triggered naturally in response to falling international wheat prices, which are currently at a six-year low of roughly US$193 per ton. As a consequence, the import tariff escalating to a record high, attracting the unintended consequences of food inflationary pressure. In essence, the high wheat import tariff is a double-edged sword, protecting farmers from unfair international competition on the one hand, but burdening consumers through increased prices on the other.

Well-placed concerns have brought the import tariff mechanism in the limelight, with a government-sanctioned review in order, which now extends to all other formula-determined import tariff lines such as corn and sugar. The argument is not to do away with the import tariffs entirely, but to identify a more appropriate and less complicated instrument of protection. The belief is that due consideration is being placed on the exceptional circumstance of food markets in this production and marketing year. Given that this season is unprecedented, care should therefore be taken not to make decisions based on short-term outcomes, but which could attract potentially negative long-term consequences.

Important to bear in mind, with insights from Grain South Africa's data, that South African wheat production has been steadily decreasing over the years. This decrease could be attributed to the effects of climate change, which has resulted in many farmers, particularly in the Free State province, opting out of high risk wheat production. At the same time, wheat imports have been increasing gradually due to increasing demand and decreasing production. Given this scenario, the question remains – just how long and how much of societal welfare is being sacrificed, if import tariffs increase against an increasingly widening wheat deficit? The trend is somewhat disturbing. Unless there is an active drive to increase investments in seed breeding research, which would lead to higher yields, and thus reduce the country's dependence on imported wheat, a tariff escalation of the magnitude that we have seen lately would only serve to hurt consumer welfare.

In the long term, it is increased investment in research, which will save South Africa's wheat sector. In the short term, it is perhaps trade policy that can help to balance consumer and producer welfare. The question, however, is which instrument will work better – an "ad-valorem tariff" or a "formula-determined tariff"? The latter seems to have become unbearable, and the former seems a more plausible option.

Wandile Sihlobo is Head of Economic and Agribusiness Intelligence at the Agricultural Business Chamber (Agbiz) in South Africa. Follow him on Twitter: @WandileSihlobo.

The views expressed in this post are those of the authors and in no way reflect those of the Africa at LSE blog or the London School of Economics and Political Science.

August 24th, 2016 | Featured, Resources | 1 Comment