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## **A THEORETICAL PERSPECTIVE ON AGRIBUSINESS AND ETHICS IN A SOUTH AFRICAN CONTEXT<sup>1</sup>**

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### **1. INTRODUCTION**

In my presidential address in 2002 I made the point that there is a growing need to make some adaptations to the neo-classical foundations of agricultural economics if we as agricultural economists want to become useful in making a contribution to the empowerment process in agriculture. I expressed the need for much more interaction and engagement with other disciplines in the social sciences if we want to play a significant role in addressing the real challenges facing agriculture in South Africa. Some new values and understanding of the principles of humanity and dignity is urgently needed.

The theme of this conference provides an ideal opportunity to take this argument and the case I made for cross-disciplinarity a bit further. Last year I argued that agricultural economists need to utilise the strengths of sociology, anthropology and political analysis in order to be better equipped to tackle the challenge of black empowerment in South African agriculture. This year I will show how we need these disciplines and also philosophy if we want to address 'ethics' in business. The point that was made throughout my earlier paper is that economic theory sacrifices far too much relevance in its pursuit of ever-greater rigour. Given the challenges facing the agricultural sector in Africa, we need to see much stronger efforts to integrate the building of theory in economics with the study of reality.

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As agricultural economists we all agree that without profits agribusiness, just as every other business, will sooner or later fail. But there are many concerns nowadays in society – from an ethical point of view – on how the firm is making (or not making) its profit. There are now many ethical questions about business and entrepreneurial behaviour in terms of its impact on labour, the environment and society in general. In addressing this complex relationship between business and society we as economists find ourselves in unfamiliar territory. The focus in our neo-classical paradigm on the profit maximizing behaviour of the firm is partly to blame for this.

In terms of the theme of this year's conference 'Agribusiness, profits and ethics', it is important to highlight that over the past couple of years we have at our conferences and in workshops focussed on many aspects related to 'business' and 'profits'. We discussed issues related to competitiveness and supply chain management. In these discussions we have highlighted the importance of institutional economics and economic behaviour in understanding economic relationships within business and within supply chains. A number of papers ventured into issues such as transaction costs, embeddedness, trust and other softer issues that ultimately will determine the performance of supply chains and thus also business profits.

It is however so that business does not operate in isolation from society. The interaction between any business and society brings a variety of ethical issues to the fore, which in the South African context needs to be addressed. Throughout the world business organisations are now expected to exhibit ethical behaviour and moral management. In this paper I will specifically address the ethical issues/questions related to agribusiness in a South African context. What is the ethical and moral duty of agricultural business in South Africa and how do we as agricultural economists engage in this moral/ethical debate? These are the questions I argue we need to raise under this conference theme.

In addressing the issue of ethics in business we have no choice but to return to the flaws in the foundations of our neo-classical paradigm – an aspect that was also raised in my 2002 paper (Kirsten, 2002). This, plus a short discussion on philosophical foundations of 'ethics' will form the first part of the paper while the second part discusses ethical issues for South African agricultural business.

## 2. THE INCREASED FOCUS BY BUSINESS IN ETHICAL ISSUES: JUST CALLING OUR BLUFF?

A number of catastrophic corporate collapses internationally have caused harm and losses to thousands of stakeholders, most notably shareholders and employees. These were not collapses due to economic or political factors external to the organisations; they were driven by internal corporate greed, callous executive deception and failures in accounting (and accountability) systems and in corporate boardrooms. While these traumas have not been as evident (or at least as newsworthy) in agribusiness and food circles, the ever widening loss of trust in financial markets and business in general caused a sudden interest by business in ethical issues. In this context a variety of terms are used interchangeably to talk about corporate social responsibility: business ethics, corporate citizenship, corporate accountability, and sustainability.

The negative image about the unethical nature of corporate business led to the annual reports of most international companies broadening their coverage of the traditional subjects of profit, loss and business trends to include a substantial section on 'corporate social responsibility'<sup>3</sup>. In an effort to outlive the philosophy of 'corporate social responsibility' many companies have adopted a code of ethics and introduced a number of checks and balances to address corporate governance. In South Africa the *King Report on Corporate Governance for South Africa – 2002 (King 2)* was launched in March 2002 as a standard-setting document, showing the way towards building a good corporate ethics culture. Most companies are now implementing the King 2 principles.

Several initiatives have also been undertaken by a number of organisations to monitor and to assist the implementation of basic ethical conduct in business and corporate social responsibility programmes. One such an initiative is 'Business Ethics South Africa' (BESA) a programme managed by the Ethics Institute of South Africa. BESA measures the internal ethical performance of organisations by taking account of ethical compliance. The focus is on both formal ethical compliance (e.g. Does your organisation have a code of ethics?), and effective ethical compliance (e.g. Is your code of ethics communicated at induction to your employees?). Another indication of the importance attached to this issue is the establishment of units for business ethics at various leading

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<sup>3</sup> *Corporate social responsibility can be defined as achieving commercial success in ways that honour ethical values and respect people, communities and the natural environment. Corporate social responsibility is also seen as the way to address the legal, ethical, commercial and other expectations society has for business, and making decisions that fairly balance the claims of all key stakeholders.*

business schools which have the task to ensure that an ethical culture is instilled in the business leaders of tomorrow.

The process of setting up codes of ethics by business, and training business leaders in ethics are steps towards changing the perception that business is 'immoral'. It could however easily be seen as a smokescreen and just another clever propaganda trick by big business to allow them to continue with 'business as usual'. This argument is reflected by the general cynicism about business ethics. Jokes reflect this attitude: *"I hear you are taking a course in business ethics; must have the smallest textbook in the world!"* Others think the term is an oxymoron, a contradiction in terms, like 'military intelligence'. The real reason behind the introduction of good ethical practices by business could also be questioned by the fact that several textbooks on business ethics argue that 'good ethics is good business'. Nevertheless, if adherence to these principles leads to better and sounder business practices and the 'bottom line' is not the only reason for doing this, then we have achieved something.

## 2.1 Questioning the merits of business ethics

The implementation of business ethics is challenged by philosophers who think that ethics cannot be taught. Another challenge comes from those who argue that the only duty of business is to make profit and not to implement corporate social responsibility programmes. The argument is that the forces of competition and the 'invisible hand' will ensure that the quantity and variety of material goods essential to society are produced (I discuss this issue in more detail in Section 3). A confirmation of this attitude is provided by Lantos (2002) when he argued: *"...what are often considered mandatory ethical and social corporate duties are actually optional activities that should only be undertaken when it appears that they can enhance the value of the firm"*. His argument is basically that you should only introduce corporate social responsibility programmes when it is expected to yield dividends for the firm. If this is not the case, implementation of such programmes is immoral and not a legitimate endeavour for a publicly held company. This point is also illustrated by the well-known neo-classical economist, Milton Friedman (1996), who said: *"The social responsibility of business is to increase its profits as long as it stays within the rules ... open and free competition without deception and fraud"*. He went as far as arguing that it is not the role of business to solve social problems.

Critics on the left often see business as inherently immoral (Stewart, 1996). It is this perception - largely influenced by the philosophy of Karl Marx - which then presents us with the view that business ethics is an oxymoron. Although the Marxian philosophy has been discredited following the collapse of

communist and centrally planned economies there are still critics that, in the spirit of Marx, view profit as a kind of robbery. It is however true that some businesses still behave in the manner that led to Marx's belief in the inevitable destruction of capitalism. Relations between labour unions and owners are sometimes adversarial, and not all businesses hold the interests of their employees high on their list of priorities. Scepticism about business is reinforced by practices such as illegal restraint of trade, pollution of the environment, unfair marketing practices, misrepresentation of products, subjection of the work force to know hazards, and behaviour that in general violates their social contract.

It is therefore a major task for business to ensure that codes of ethics or corporate social responsibility programmes are effectively implemented. Many believe that the key to meaningful corporate social responsibility lies in the right combination of economy, ecology and ethics - the 3 Es. Business should thus find ways to effectively connect shareholder value with (ethical/societal) values. Later in the paper I specifically discuss the critical ethical aspects in the agri-food business.

It should in closing be noted that there could be substantial merit in implementing ethics in business. Moral behaviour builds trust and enhances the firm's reputation, which attracts customers, employees, suppliers and distributors and also earns the public's goodwill. Ethical actions minimise the cost of fines and litigation, and also bad publicity.

### **3. BUSINESS AND ETHICS: GOING BACK TO THE ROOTS**

Most agricultural economists and for that matter entrepreneurs, businesses and large corporations have faith in the market and in the philosophy of liberal capitalism. Reference is usually made to the working of the 'invisible hand' of Adam Smith to illustrate the benefits of free market capitalism. It is usually interpreted as if Smith would have argued that the self-interest seeking of individuals to maximise profit or maximise utility would be coordinated by a benevolent 'invisible hand' to the benefit of all the inhabitants in the country. Terreblanché (2002) and Stewart (1996) argue that Smith never formulated such a dictum, and what is usually presented in his name is a vulgarised version of his approach. Smith did, however, say that under strict institutional and behavioural (perhaps ethical/moral?) conditions all market prices would tend towards their true value - and only then will the economy through the working of the 'invisible hand' achieve a competitive equilibrium.

The main defect of a strictly competitive (free) market (even if it can be realised) is its severe moral weaknesses as we have already shown above. For even if competitive markets were to produce efficient outcomes (which is highly unlikely), these efficient outcomes would in all probability not be justifiable and would also fail to coincide with the allocation that society as a collective prefers on the basis of its definition of social welfare as expressed through the democratic process. In an environment of asymmetric information it might be that people are constantly looking for opportunities to steal and to cheat. It is only penalties and sanctions (such as ethical codes in business) that prevent individuals from doing so. We can therefore understand why Okun (1975) argued that “...*the market needs to be kept in its place ... [because] given the chance, it would sweep away all other values, and establish a vending machine society*”.

This then illustrates that the market has the potential to deliver immoral outcomes that are not necessarily to the benefit of the whole of society. It is for this reason that Ben-Ner and Putterman (2000) argue that human values could be an important force to keep ‘the market in place’. What they perhaps refer to is some ethical and moral conduct that could assist the market (or business activity) to generate an outcome that is in society’s interest. This is contrary to Okun’s (1975) plea for democratic capitalism where the state has to play a role in such a process.

The subject of values, which is central to ethics, was once considered to lie beyond the purview of economic science, but industrial civilisation now shows rising anxiety over its social health and cohesion, so we see the subject of values seeping into economic and business discourse. The work of Ben-Ner and Putterman (2000) is one of the more recent pieces of literature highlighting this trend. It is clear that more changes in economics are on the cards and it could be that economics will become a much ‘softer’ and humane science, thereby getting rid of the label of ‘dismal science’. The fact that we address this as our conference theme is thus another indication of the importance of these issues in our current discourse and also in the thinking of business.

The concept of ethics<sup>4</sup> is complex, and it is almost impossible to have a universally accepted definition of ethics. There are also diverse philosophical

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<sup>4</sup> *The Ethics Institute of South Africa defines ethics as the practice of aligning human life, individually or collectively, or institutional structures and practices, according to basic standards of conduct. Generally speaking, human conduct, practices and institutions are judged to be good or bad, right or wrong, in the light of such standards of conduct. Standards of conduct take on the form of values/principles, obligations, rights and consequences, and meeting those standards emanates from good character or virtues.*

views about those elements that constitute ethics (Svensson & Wood, 2003). The roots of the term 'ethics' emanate from the ancient Greek word '*ethikos*' meaning the 'authority of custom and tradition'. Usually 'ethical' and 'moral' are considered to be synonymous, and will be used in that context throughout this paper.

Ethics has been the focus of philosophical thought over many centuries but it has many of its foundations in the thoughts of Socrates and Aristotle (Svensson & Wood, 2003)<sup>5</sup>. On the other hand we should also remind ourselves that business and economics also have firm roots in philosophy. Both capitalist and socialist economic theories relate economic values to human values and well-being.

### 3.1 Ethical theories

Moral philosophers have developed theories that allow us to give account of such questions as how we can justify moral values, how to determine what our duties and obligations are, and how to evaluate moral pronouncements. In order to approach questions of business ethics we need to address ethical theory (Stewart, 1996). There exist three mainstream ethical (or moral) theories (Lantos, 2002):

- Teleological ethics, usually using principles of utility;
- Deontological or duty-based ethics, which focuses on people's duties to uphold norms, using principles of rights and of justice (fairness and equity); and
- Virtue-based ethics, considering whether behaviour promotes ethical values and good character, and entails caring for stakeholders.

Most modern ethicists reject teleological ethics as a foundation for ethical corporate social responsibility. Its foundation in the utilitarianism of Bentham and Mill, of striving for 'the greatest good for the greatest number', is not the most appropriate theoretical foundation for modern-day business. When this principle should be applied there is always the danger that minorities suffer harm so that majorities can enjoy benefits. Lantos (2002) also argues that such a principle will cause problems in the business environment given all of the firm's many constituencies – supply chain partners, the local community, the

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<sup>5</sup> Aristotle focused on the good life and the virtues that contributed to this good life. Another well-known philosopher, Immanuel Kant, argued that you should 'do the right thing for its intrinsic sake and not of the extrinsic worth'.

public at large, and even the natural environment – the shareholders and employees and customers will be outnumbered every time.

The deontological ethics is the branch of moral philosophy (derived from Immanuel Kant) that focuses on duties or moral obligations. It focuses on the individual and is built on three foundations: rules, duties and rights (Schroder & Muschamp, 2000). In the business context it is argued that corporations have special moral obligations to their various stakeholders, who in turn have rights to make certain claims on the corporation, such as customers insisting on reasonably priced, safe and effective products (an aspect very relevant for agri-food companies) and workers expecting safe working conditions and fair pay for a fair day's work.

The concept of 'justice' is also duty-based and forms part of the deontological theory and is concerned with 'fairness' (a person must be given just treatment) (Lantos, 2002). In the South African context this is especially relevant and it is therefore argued that 'corporate social responsibility' is necessary to make up for the 'injustices' or shortcomings of the capitalist system. Capitalism is based on the principle of equity or exchange justice and the only standard of fairness in free-market economies is on what a willing buyer and seller agree. It is however also true that capitalism provides equality of opportunity but not necessarily equality of results (Lantos, 2002). It therefore often happens that people get left behind creating 'social injustice'. Free enterprise and the liberal capitalism philosophy do not necessarily satisfy the needs of any particular group. For example it fails to provide adequate housing, medical care, food security, education and meaningful participation in economic life for disadvantaged communities. In South Africa there is still a strong belief that liberal market capitalism will provide the necessary 'trickle down' to empower and improve the quality of life of the poor. However the flaws in the free market philosophy make it impossible for the capitalist system not to create these 'injustices'. In terms of the deontological theory of ethics and given the specific context of South Africa's history, with 40% of the population living as an 'underclass', there is a good case to be made for strong ethical/corporate social responsibility activities to address the injustices of our society. In section 5, I specifically discuss what I think could be the nature of ethical issues that agribusiness would face given the South African reality and challenges.

Virtue ethics derives from Aristotle and has something in common with Kant in its emphasis on the individual. Aristotle argued that people have inherent potential and the basic criterion for judging any human action is whether or not it enhances potential. It is less elegant than teleological and deontological ethics and does not provide clear-cut rules for decision-making.



#### 4. ETHICAL ISSUES IN AGRIBUSINESS

For us to be able to address the ethical issues in agribusiness we need to remind ourselves again about the potential ethical problems that could emerge as a result of normal business/market activity. Market values (economy) and ethical values coexist since business activities take place within a societal context. Consequently one can discern a wide variety of (ethical) problems that potentially could surface in the market place. Steidlmeir (1987) categorises these problems as follows:

- *Consumerism*. This deals with deceptive advertising, pricing policy, product quality, safety, service and issues of fraud. In economics we usually deal with the allocation of scarce resources but through advertising additional and multiple needs are created which utilise scarce resources not necessarily in their best alternative use.
- *Resource use and the environment*. Issues related to pollution and waste of scarce resources through inefficient or frivolous use.
- *Labour*. Job safety, wages, worker welfare and pensions, job security, meaningfulness of work.
- *Responsibility to shareholders*. The issues here are profits and growth, disclosure and shareholder democracy.
- *Poverty and social inequality*, including rural and urban poverty, issues of plant location and abandonment, and profiteering.
- *Perversion of public purpose* through bribery, fraud, tax evasion, misallocation of resources and exploitive development.
- *Issues of industrial democracy* or codetermination of economic structures by workers and management.
- Problems of *equal opportunity and compensation* as related to social discrimination based on race, sex or creed.

It is generally perceived that the task of agriculture and agribusiness of producing food is a virtuous activity - an ethical activity - doing well for society. But today everything to do with the production, processing and distribution of food bristles with ethical issues. In linking with the problems related to market activity Schroder and Muschamp (2000) as well as Eccles (2002) highlight the specific key ethical issues in agriculture and agribusiness. Drawing from their discussions a comprehensive, but not complete, list includes the following issues:

- Malnutrition (hunger and poverty)
- Use of novel technology (e.g. biotechnology and GMOs)
- Bribery and corruption
- Child labour
- Civil rights and equal rights
- Fair labour conditions (occupational health and safety)
- Fair trade
- Local culture reinforcement
- Morality and safety of food products
- Animal welfare and usage of animals for research
- Information and transparency (bluffing, labelling and advertising, insider trading)
- Power and the control of resources (increase in buying power of retailers)

The list refers amongst others to ethical issues in the workplace where firms engage with one of the key stakeholders – labour. Here the issues of fair labour conditions (such as minimum wages, and minimum working conditions); child labour, cultural aspects, and occupational safety at farm as well as secondary and tertiary levels of the food supply chain are critical and sensitive. Legislation as well as consumer demands are the different ways society makes sure that these aspects are adhered to. Consumer demands for good ethical behaviour in the workplace have produced opportunities for price discrimination and labelling of food products produced under sound ethical conditions.

Another group of stakeholders covered in the list is consumers. To them issues of transparency (labelling, advertising), food safety, and use of GMOs are all of particular concern. In the case of consumers all of the ethical theories discussed earlier are applicable. In terms of the teleological and utilitarian approaches, the availability of safe and acceptable food is important. In terms of the deontology theory of ethics, consumers would like to see respect for individual autonomy and the right to make informed decisions. As a result issues of transparency through true labelling and non-deceptive advertising are important. Consumers do not want to, and should not, be ‘manipulated’ by the large advertising budgets of food companies. In the final instance one of the key ethical issues linked to issues of justice and rights is the universal affordability of food – an issue very relevant in the South African context (discussed in more detail in Section 5). The issues of malnutrition and hunger

and poverty in general are generally incompatible with the development of autonomy (Kant) and human potential (Aristotle).

As one of the stakeholders, farmers are concerned about fair trade and trade issues in general. The whole debate and disagreement between developed and developing countries and the recent Cancun talks rest to a large extent on the ethical aspects of the current world trade dispensation and the large scale subsidies paid to farmers in rich countries. Ultimately an unfair world trade order could have a devastating effect on producers in poor countries, potentially leading to poverty and hunger which – as we have shown above – is incompatible with the ethical issues of autonomy and human potential. Farmers are also concerned with the increased control of multinational agricultural input companies and the increased power of multinational food companies and supermarkets. These power shifts in the agribusiness system create concerns amongst farmers and also amongst people to the left of the political spectrum. Questions about the ‘fairness’ of their practices and dealings with farmers in many countries are continuously being asked. Farmers do not have the freedom (from the perspective of autonomy) to adopt or not adopt a specific technology. Then there is also the unfair treatment in terms of trade and the application of technical standards and other regulatory aspects. Aspects related to the unfair (strict) application of sanitary and phytosanitary measures are examples in this regard.

## **5. CURRENT ETHICAL QUESTIONS FOR SOUTH AFRICAN AGRIBUSINESS**

In this section I will not be advising on the most appropriate corporate social responsibility programmes for South African agribusiness but rather focus on two critical ethical questions for South African agribusiness. One relates to the current food price crisis in South Africa and the second to the role of agribusiness in the development agenda in the agricultural and food sector. I have chosen these two ‘ethical’ questions/issues since most of my research nowadays focuses on these two themes.

### **5.1 A just price for food?**

A sharply depreciating exchange rate towards the end of 2001 and early 2002 plus a shortage in staple foods in the SADC region caused the farm gate prices of basic commodities such as maize, wheat and sunflower seeds to rise dramatically. This was subsequently followed by sharp increases in retail prices of basic foodstuffs. With 40% of the South African population living in extreme poverty the ‘affordability of food’ suddenly became a major problem

for society. At the same time the sudden rise in prices created suspicion towards retailers and food manufacturers. Government shared this concern and appointed a Committee (Food Pricing Monitoring Committee) to investigate this matter. The Committee received a comprehensive mandate from the government, which included the following:

- *“Investigate any sharp or unjustified price increases*
- *Investigate price formation mechanisms within the value chain of basic food stuffs*
- *Investigate collusive, discriminatory or any unfair business practices in the basic food value chain*
- *Investigate incidents of predatory pricing and monopolistic tendencies”*

All of these aspects relate to the basic rights issue of ‘affordable food’ plus the question of the ‘just and fair price’ for food. The questions that emerge from an ethical point of view in this context are:

- What is the fair price for food?
- Were there any business practices or activities that created an ‘unjust price’?

Terreblanché (2003) explains the history of the concept of a ‘just price’ by referring to the Scholastic philosopher, Thomas of Aquino of the 13th century, who formulated the idea of a ‘just price’ as the price that will not give unfair advantage to either the seller or the buyer. If those involved cannot decide on such price when guided by their Christian conscience, the Roman Catholic Church decided what the just price should be. Adam Smith was of the opinion that under certain ideal conditions the market price will be determined on the level of the true value (or Natural Price) of the good, but the Natural Price was not determined by market forces, but by public opinion (in a well-organised society), hence nothing but Aquino's just price under a different name.

The argument about a ‘just’ or ‘fair’ price also goes back to Quesnay, the founder of the French Physiocrat School. When manufactured goods were exchanged, he argued, only equivalents were exchanged and no profits could arise in exchange. In terms of his cost of production theory the ‘natural price’ of manufactured goods was explained by a number of other prices: those of the expenses of the producers and of the merchants who brought them to the market (Roll, 1978). What Quesnay argued is that under stable equilibrium conditions, business could not charge more than a price equal to the least cost of production where a normal rate of profit determined by the opportunity

cost of management is included. Only under such conditions is the price charged legitimate and represents a positive (equilibrium value). Equilibrium prices satisfy not only the condition of a free open market but also the other standards of social justice of equity, social peace and human solidarity in the community or nation as a whole. This, according to Rugina (1998) is what the French Physiocrats had in mind.

However the idea of free and open markets – a situation of *laissez faire* or economic freedom – led to the perception that business should be free to charge any price that the market can bear. The Manchester school of economic thought in 19th century England argued that: “a legitimate price is what the market can take without any other limitations” (Rugina, 1998:850). This argument stands central to the liberal capitalism of the UK, the USA and many capitalist countries of today and which is currently under much scrutiny and debate (see also Kirsten, 2002), since it certainly does not satisfy the required standards of social equity (justice), social peace and human solidarity. It has become clear and accepted that under disequilibrium conditions no fair or equitable prices are possible. Although the liberal market philosophy is dominant amongst business in South Africa we all know that we do not have conditions of stable equilibrium in a society that has experienced tremendous injustices in the past.

The question now is how do we use these philosophical and ethical debates to inform the food price question in South Africa? On the left of the political spectrum the labour unions, NGOs and consumer activists hold the view that business and profit is immoral (in line with the deontological ethical theory and based on Marxist philosophy). Their position became ever more vocal when prices of food were increased to meet the bottom line or profit targets of large food companies. On the right of the political economic spectrum commodity traders, agribusiness and food companies generally support the merits of liberal market capitalism and argue for no intervention by government in the market. Prices of food, according to them, are determined by the working of supply and demand in a free market economy and if raw material prices increase, the final product is also most likely to become more expensive. Thus the price of food is considered to be ‘fair’ given that it is generated by market forces – “*it is not our fault – it is the market!*” would be a typical statement. Little mention is made of concentration and monopolistic tendencies in certain industries as well as the extreme inequalities in South African society. We can hardly argue that we have a competitive equilibrium and can therefore not claim that all prices will be ‘fair’ or ‘just’.

The difficulty which the Food Pricing Monitoring Committee has, is to determine whether there has been unethical behaviour by business in the food chain which resulted in unjust price increases or 'profiteering' by business on basic foodstuffs. The question is therefore: Is it possible to find evidence of price manipulation or of unfair price policies?

One problem with the food price debate is that people often forget the time dimension and only consider short-term price trends. In the process they do not acknowledge the relative stability of food retail prices over the long term and how prices are transmitted along the value chain. It is in this spirit that the current investigations of the Food Price Monitoring Committee are looking into how price shocks are transmitted along the value chain and how the chain self-corrects without exploiting consumers and partners in the chain.

#### *5.1.1 The commodity markets: were prices manipulated?*

During the 2001/2002 period accusations about unethical behaviour of certain commodity traders and the manipulation of the agricultural futures market of the Johannesburg Securities Exchange (SAFEX) were rife. Various facts and some evidence obtained by the Food Price Monitoring Committee (FPMC) and the Financial Services Board point to the potential for price manipulation. It seems however very plausible that it was more the market sentiment that was 'manipulated'. The potential for manipulation lies in the large open positions of traders, which makes it possible for larger traders to corner the market and to lead the market (especially inexperienced traders) in a particular direction. To prevent this from taking place the JSE recently announced the introduction of position limits. This is an indication that some 'regulation' as Adam Smith predicted is necessary to curtail the unscrupulous and self-interest seeking behaviour of market participants.

The debate about the manipulation of the agricultural commodity markets in South Africa links directly with our earlier discussion on the 'true', 'natural' or 'fair' price. Typically the supporters of the free and deregulated market argued that the supply and demand 'fundamentals' were responsible for all the movements in commodity prices. Most of the commodity traders and the JSE Agricultural Markets Division could in an elegant way describe how most price movements were in line with the fundamentals. However, those traders who lost in the market were the first to 'cry wolf' when the price moved against all fundamentals. There were therefore some commodity traders and buyers who believed in the market fundamentals, but experienced opposite price movements and thus suspected some manipulation. These accusations are very difficult to prove, and various independent analyses (such as Vink &

Kirsten (2002); Schimmelpfennig *et al*, 2003) found a strong correlation between changes in fundamentals such as the exchange rates and regional market conditions and the price movements on the commodity markets.

In line with our earlier philosophical discussions one can easily identify the reservations of groups to the left of the political spectrum with the SAFEX market. According to them the price formation mechanism in the agricultural futures market could create a number of possible theoretical problems. In an environment where a credible and reliable public information service on weather, supply, demand and trades does not exist it is possible that market participants could exaggerate prices in a certain direction by releasing biased or misleading information or by ignoring and under-emphasising information. The other reality is that there will always be some information asymmetries between large market participants in input supply and grain trading and others who are not in position to collect detailed information. Thus, the free market condition of perfect information does not materialise. In the final instance trading professionals or clients of traders could exaggerate prices through being greedy or not having enough experience.

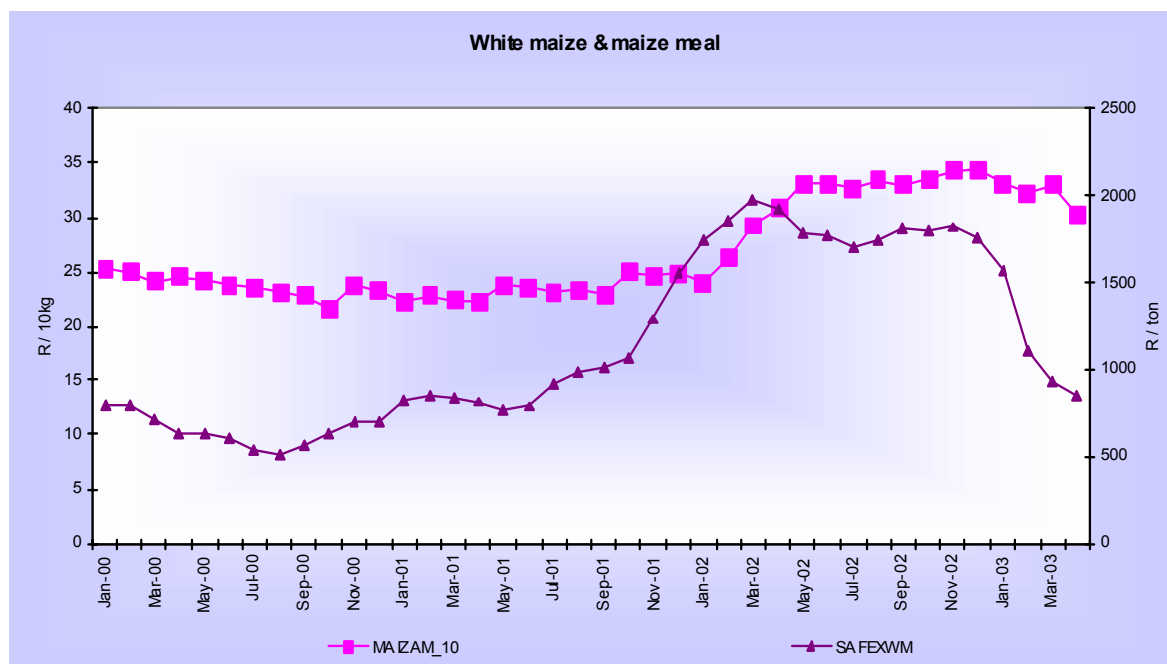
While there exists this suspicion about the futures market there is little evidence to support such assertions. The mere fact that the market corrected itself, as new information about fundamentals became known is an indication that manipulation is not really possible. The only concern could have arisen due to the fact that prices were exaggerated in the upward phase and also stayed at high levels for a too long period before it dropped by December 2002.

### *5.1.2 Food manufacturers and retailers*

Suspicion about high food prices was also laid before the doors of food manufacturers and retailers. Were they making supernormal profits? Getting information from these companies is usually impossible so the best way to test for unjust price increases at retail level is to track the trends in the farm-retail price spread. If this margin is widening there could be some aspects of ethical behaviour to be investigated. To illustrate this issue we compare the farm-retail price spread for maize meal and beef. In most of the other basic food products it was discovered that the farm-retail price spread remained fairly constant, suggesting no extreme case of profiteering.

The price of maize meal being the major staple commodity in South Africa often creates the most emotion (See the price trends in Figure 1). The supply chain for maize meal has been unpacked and analysed in full and we have obtained the cost figures for every step in the chain for the last 3 years. Figure

2 shows the change in the miller-to-retail margin, which basically compares the cost of producing ‘super’ maize meal with the average retail price. If profiteering and some unjust price increases were prevalent one would have seen a different trend. What we see here is rather a confirmation of the loss making tendencies of most of the milling operations of large food companies. This should provide a sufficient answer whether there was unethical profiteering!



**Figure 1: Producer and retail prices for white maize and maize meal: January 2000-July 2003**

A further indication of the relative stability of farm-retail margins in the food industry is illustrated in the beef supply chain (sirloin) in Figure 3. Here it is evident how the retail price is tracking the change in producer prices almost immediately with a relatively constant margin of between 52 and 62%. In addition retail prices of most beef cuts seems to be less sticky downwards than in the case of maize prices.



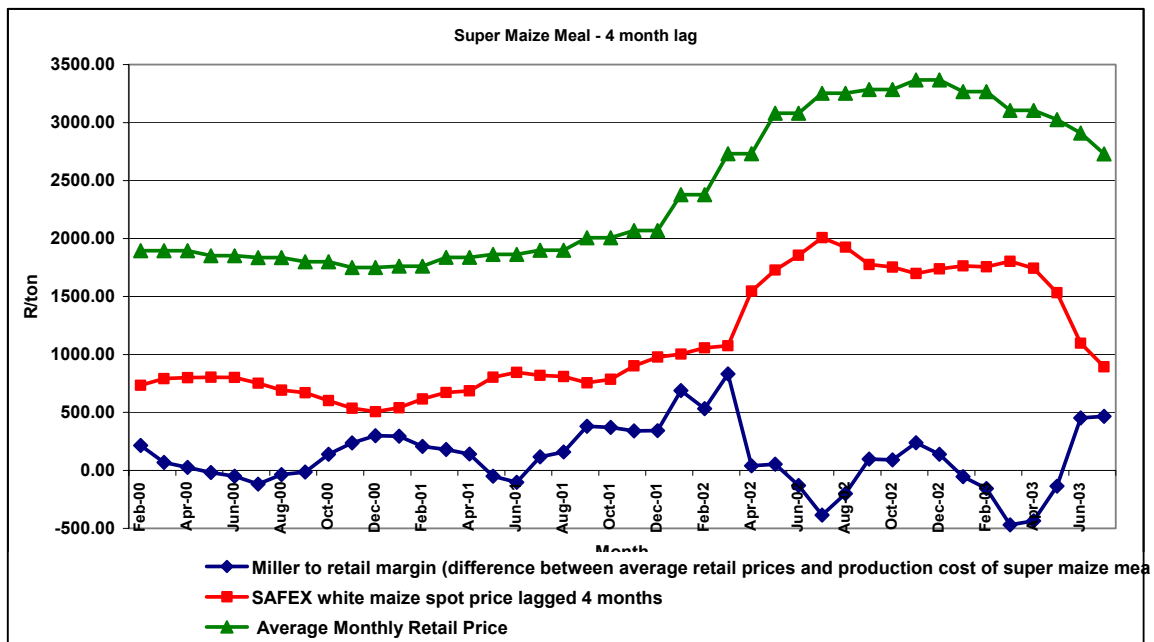
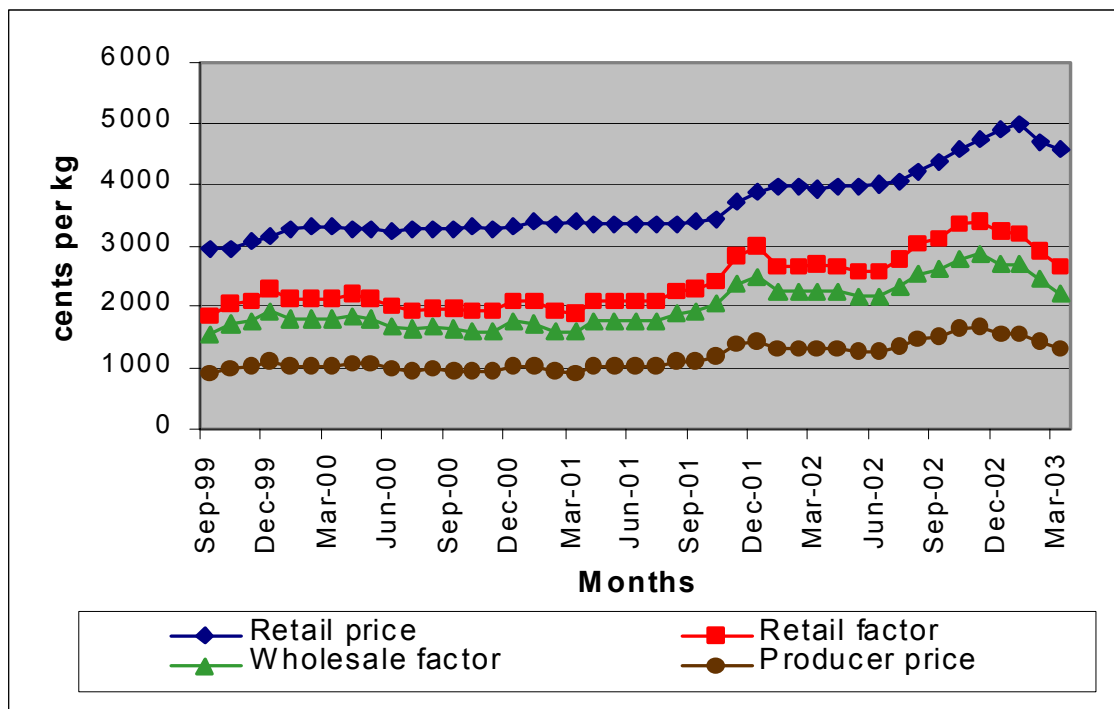


Figure 2: Miller-to retail margin for super maize meal (Rand/ton)



Source: Jooste et al, 2003.

Figure 3: Comparison between estimated and actual retail sales prices for sirloin and producer prices

Going beyond the debate about the fair price we have to emphasise that for most households in South Africa the affordability of basic food became a major food security problem. The high prices of basic food products have major impacts on poorer communities. As the maize price rose, people did not stop buying maize meal, instead they switched to what is lower quality but cheaper brands of maize meal, they bought less bread, they cut back on meat, other necessities and also school fees. In many communities the higher prices of food caused hardships, as households could not any more afford to purchase all the food items necessary for a balanced diet. As such the food price crises became an ethical issue. We cannot have justice if people cannot afford their basic food and have to go hungry and experience malnutrition. Society has therefore to be concerned about this dilemma and it is appreciated that Government has introduced relief measures, albeit in the short term, and is now considering more long term and more sustainable measures to soften the impact of high food prices on the most vulnerable households.

## **5.2 The development and empowerment task of agribusiness**

It is often argued by business and by proponents to the right of the political spectrum that it is not the task of business to address social problems. In the South African context and given the legacy of apartheid such an argument would not hold water. To operate business (any business) in such an environment of inequality cannot be just. There is thus a task for agribusiness to address this as part of their ethical duties. Bringing disadvantaged communities into the mainstream of the agricultural economy remains one of our most important challenges and it can be argued that agribusiness holds the key to this challenge. Many factors in global agricultural and food systems could exclude smallholders from disadvantaged communities from remunerative markets. These smallholders face many market entry barriers. Agribusiness can be important role players in assisting these farmers to enter markets in which they previously could not participate. The ethical duties of agribusiness are thus engage in special efforts to link smallholders to agribusiness.

Related to the arguments from the right that business is about making profit and not necessarily there to solve social or developmental problems, business is often reluctant to take up this challenge. The reluctance has its origin in the difficulties and high transaction costs as a result of the engagement with a large number of producers and also as a result of the fact that these business transactions take place across cultures bringing into play issues of trust and other relational problems. Given the legacy of underdevelopment in many rural and farming communities in South Africa it will also mean that business

will have to invest time and money in skill development, upgrading of production infrastructure, etc. Is agribusiness prepared to do this and sacrifice part of their 'profit' for the sake of a 'united and prosperous agricultural sector'? There certainly are already examples (e.g. in the sugar industry) where smallholders are linked through a variety of contractual arrangements with agribusiness and thereby gaining access to the markets for industrial and high value agricultural crops.

### *5.2.1 Dealing with high transaction costs*

In a recent case study of smallholder contractual arrangements in the sugar industry, Sartorius (2003) found that small-scale farmers generate higher levels of transaction cost than larger growers - confirming perhaps the reluctance of agribusiness to engage with these growers. This is mainly demonstrated in the start-up phase of grower activities and the administration of growers' affairs because of the smaller volumes of delivery and the higher level of use of company inputs and facilities.

By identifying the different cost elements of transaction cost, but also the reasons for the differential level of small-scale farmer cost it would be possible to design innovative ways to reduce small-scale farmer transaction cost, as well as a basis to design a small-holder contracting model and suitable control systems. The results also suggested that agribusiness can overcome the problem of high transaction costs by employing control systems like activity based costing to identify the transaction costs of different categories of suppliers. Activity based costing systems and sensitivity analysis can be used to identify the cost elements of transaction cost, as well as the differential cost of smaller versus larger suppliers. The incremental cost of small-scale growers, in turn, can either be charged back, used as a basis to organise smallholder operations into larger business units or form the basis for approaching government for some form of relief.

This research clearly shows that agribusiness can through proper planning and design overcome one of the major inhibiting factors in dealing with large number of smaller suppliers and thereby fulfilling one of their important ethical duties in the context of the development challenge of South African agriculture.

### *5.2.2 Addressing issues of trust*

Dealing with high transaction costs is one aspect agribusiness will face in their endeavour to fulfil their ethical duties. The other aspect is trust in contractual

relations, which is key to the sustainability of the grower-agribusiness relationship. In another case study in the sugar supply chain Masuku (2003) unpacks the social (or perhaps ethical) aspects of the grower-miller relationship. This study specifically applied the relational contracting paradigm, which describes relations in terms of principles and norms, such as solidarity, mutuality, integrity of functions, and flexibility. Relational contracting systems are social as well as economic. Therefore, it is critical to consider the quality of relationships within a supply chain as a social system.

The organisational literature has always posited that relational factors such as trust, cooperation, commitment and absence of opportunistic behaviour play a key role in economic exchange, particularly when one or another party is subject to the risk of opportunistic behaviour and incomplete monitoring, or when moral hazard problems arise. Masuku (2003) derived a structural model which confirms that perceived co-operation has a direct influence on satisfaction, while trust, commitment, relative dependence, and perceived opportunistic behaviour have an indirect influence on satisfaction through co-operation. The study also points to the importance of goodwill trust in contractual relationships rather than contractual trust. It suggests that the presence of contractual trust is a necessary but not a sufficient condition for farmers to be committed in their relationship. There is a need for goodwill trust or in terms of our ethical theories – there is a need for virtue ethics, or the will to do good to others.

It is worth noting that a contract works on compliance, while relational exchange requires trust and commitment. A relationship founded on trust and mutual respect is more likely to succeed than a relationship of convenience supported by legal contingencies. Therefore, relationships characterised by trust and physical and psychological commitment as well as co-operation between exchange parties is more important for mutual benefit and a quality relationship. Trust is important in facilitating exchange relationships between smallholder farmers and millers. Since smallholder farmers have limited access to legal recourse, it would be to their benefit to rely on trust as their principal governance mechanism for their exchange relationship with millers. Both cane growers and millers can develop trust by having confidence in each other and not acting opportunistically. We have argued earlier that moral and ethical behaviour and conduct from both sides of the relationship will bring trust and enhance the reputation of both partners. It will also reduce conflict and antagonism, will lower transaction costs and will improve the performance of the supply chain, which will enhance the 'profit' for the business but also ensure sustainable income levels for poor households. Under

these circumstances we can without any shame argue that “*good ethics (trust, co-operation) is good business and good development*”.

## 6. CONCLUSION

This paper provides a brief ‘journey’ through the theoretical and philosophical foundations of business profits and ethics. The intention of this ‘journey’ was to provide the context in which the ethical issues and questions for agribusiness could be debated. The paper makes brief mention of the ethical issues in agribusiness but then focuses on two important issues facing the industry in South Africa. The first relates to high food prices and the debate around a ‘fair price for food’ and the so-called unethical profiteering by agri-food companies on basic foodstuffs. The paper uses results from the investigations of the Food Price Monitoring Committee to indicate that there is little evidence that food companies are profiteering on food. It remains also very difficult to identify any unjust pricing practices in the food chain.

The second important ethical issue is the challenge and tasks of agribusiness in the empowerment of black farmers and black agribusiness entrepreneurs. In terms of the ethical concepts of justice and the deontological ethical theory, agribusiness in South Africa has a duty to ensure the empowerment of black farmers and black entrepreneurs. In this context they need to build trust and also find innovative ways to overcome transaction costs, which are usually high when businesses have to deal with many small-scale growers. The paper has in that context again confirmed how important it is for agricultural economists to utilise the new institutional economics paradigm to assist business in design institutions and organising transactions within business to ensure sustainable business and development.

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