IGC CONFERENCE, LONDON: 16 JUNE 2004

TRENDS IN THE GRAIN TRADE - EFFECTS ON THE SOUTH AFRICAN FOOD AND FEED MILLING INDUSTRY

By: Jannie de Villiers
Executive Director
Chamber of Milling
South Africa

1. INTRODUCTION

Ladies and Gentlemen!

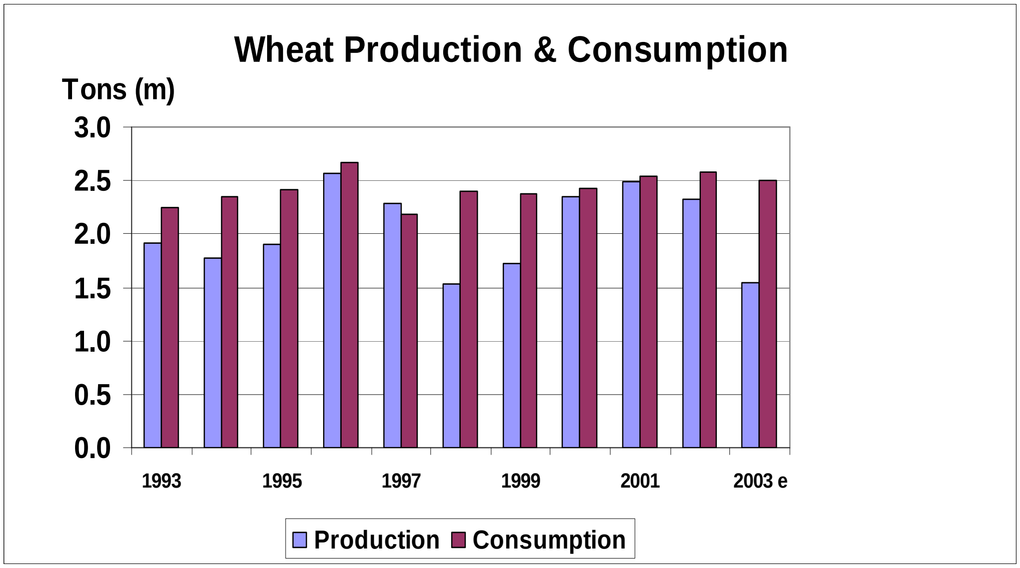
It is a pleasure to be here today to address the International Grains Council's annual conference.

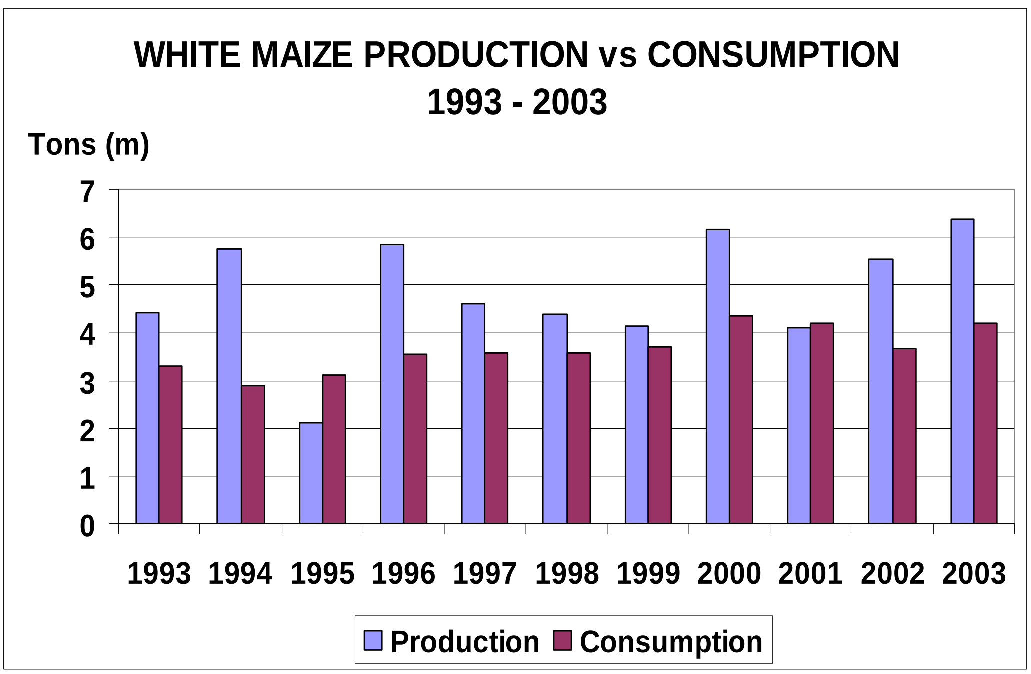
Despite the moderate size of the South African grain market, we are experiencing a very dynamic time in our history and I would like to share some of the excitement that we are going through as a young democracy in Africa. In my presentation today I will briefly outline the size and scope of the milling industry in South Africa, take you briefly through the deregulation phase that we undertook in the 1990's and highlight a few of the results from that process.

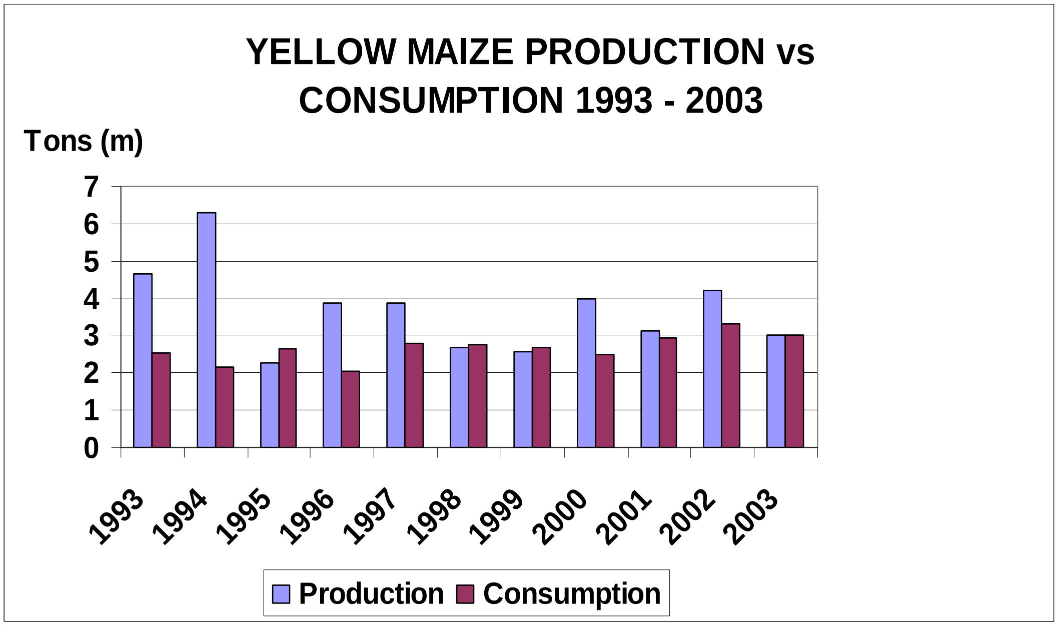
The core of the presentation will revolve around the latest developments in South Africa and give you a perspective on the global situation from our point of view.

2. SOUTH AFRICA: SCOPE OF THE INDUSTRY

The core staple food of South Africans is white maize (annual consumption 4 mmt), followed by wheat (annual consumption 2,5 mmt). Yellow maize in our country is mainly consumed as animal feeds (annual consumption 2,4 mmt) as well as industrial usage for wet milling purposes (annual consumption 0,6 mmt). South Africa is a net importer of wheat with a self-sufficiency index around 80 – 85%. We produce a surplus of white maize annually and are both importers and exporters of yellow maize on an annual basis.


Wheat Production & Consumption
Tons (m)
3.0
2.5
2.0
1.5
1.0
0.5
0.0
1993
1995
1997
1999
2001
2003 e
Production
Consumption


WHITE MAIZE PRODUCTION vs CONSUMPTION
1993 - 2003
Tons (m)
7
6
5
4
3
2
1
0
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
Production
Consumption



3. DEREGULATION PROCESS: 1991 – 1997

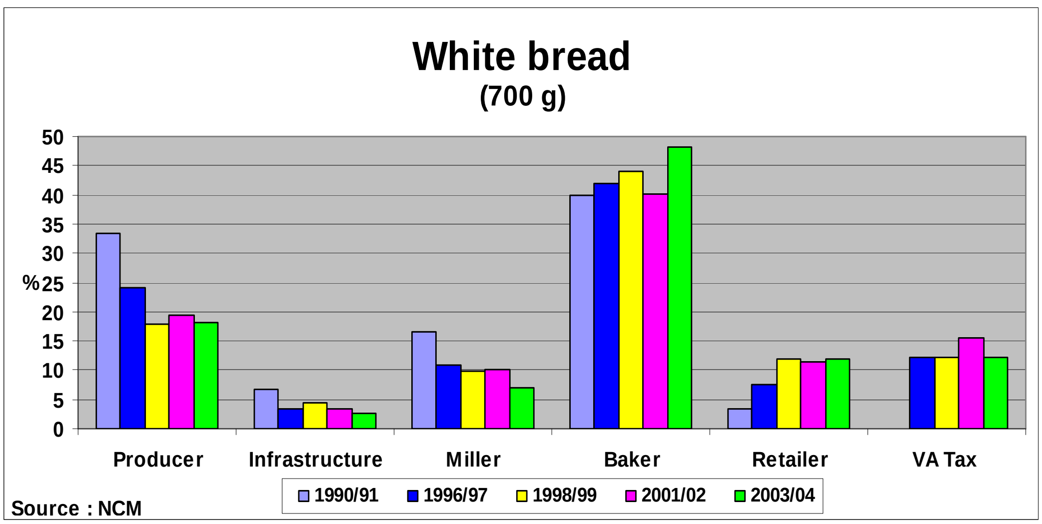
The grain industry was highly controlled by Government during the period 1936 to 1991. These included the fixing of wheat and maize prices, storage costs, transportation arrangements, registration of mills and bakeries and silo owners, as well as control over wheat flour and maize meal prices, together with the wholesale and retail prices of bread. Bakeries were forced to deliver bread only within particular areas and there was a tight quantitative control on imports and exports via the Wheat and Maize Boards. The whole value chain was production-driven with the majority of the members of the Wheat and Maize Boards consisting of farmers.

In 1991 Government decided to deregulate the milling and baking industries and to only keep control over the raw materials. Pressure mounted in the value chain as consumers started to dictate their preferences to the market in terms of what they want, where they want it and how much they are prepared to pay for their products. These pressures eventually ended up as being Government's decision to totally deregulate the whole value chain in 1997. The Wheat and Maize Boards were closed and the control over the prices of raw materials was abolished. Quantitative restrictions were replaced with a tariffication system and there are no longer any buyers of last resort. The current import duties are zero on both maize and wheat.

This period was the time when the value chain actually realised that in order to function properly it has to be pulled and not pushed.

4. POST DEREGULATION

The market adapted very well in a very short space of time after the deregulation announcements. A futures market for grains was developed which currently trades up to 10 times the annual crop. This provides high liquidity to all role-players. Some of the functions previously performed by the Wheat and Maize Boards were constituted into small public benefit companies that are jointly controlled by the industry role-players. This ensures that the market receives enough information to function properly. We have established a South African Grain Information Service (www.sagis.org.za) to provide the market with supply and demand information. The Southern African Grain Laboratory (www.sagl.co.za) was also established as a reference laboratory to act as an independent referee for all quality issues. I would like to point out a few positive aspects which stems from the deregulation process and that justifies the theory that the market is far more capable of performing the function of the allocation of resources than are central planners.



The graph above illustrates the proportions of the value of a loaf of bread allocated to the various role-players in the wheat to bread value chain. It clearly indicates the difference between what the Government in the past perceived each role-player should receive, compared to what the market finally decided.

Immediately after deregulation in 1997 we saw an improvement in the co-operation between the value chain role-players via both formal and informal structures. The quality of our products improved substantially and there was a huge increase in the product ranges, which are now available to the consumer. It, however, brought about a huge increase in the volatility of our raw material prices, which we are still battling with at the moment. Over and above the changes in the international market we also have to deal with exchange rate differences, variances in freight cost (which were experienced during the last year), as well as the high unpredictability of the weather in Southern Africa. We saw a substantial increase in the number of new entrants entering the market, but typical of an immature market, we also saw a large number of participants failing and closing their businesses. In general, the competition has increased and that, with innovation, benefited the consumers.

On the downside (from a processor's perspective) we saw a decrease in product prices coupled with a decrease in the profits of the companies participating in the value chain. The capacity utilisation also diminished. Unfortunately the services provided by Government deteriorated over time, especially the funds allocated for vital research to keep the industry competitive. We also saw a substantial decline in employment numbers in the industry.

Chairperson, we are still overall confident that we took the right decision to deregulate the market and are today, as South Africans, really thriving on the adrenaline that the free market is providing every day to stay alive and to supply food to the nations of Southern Africa.

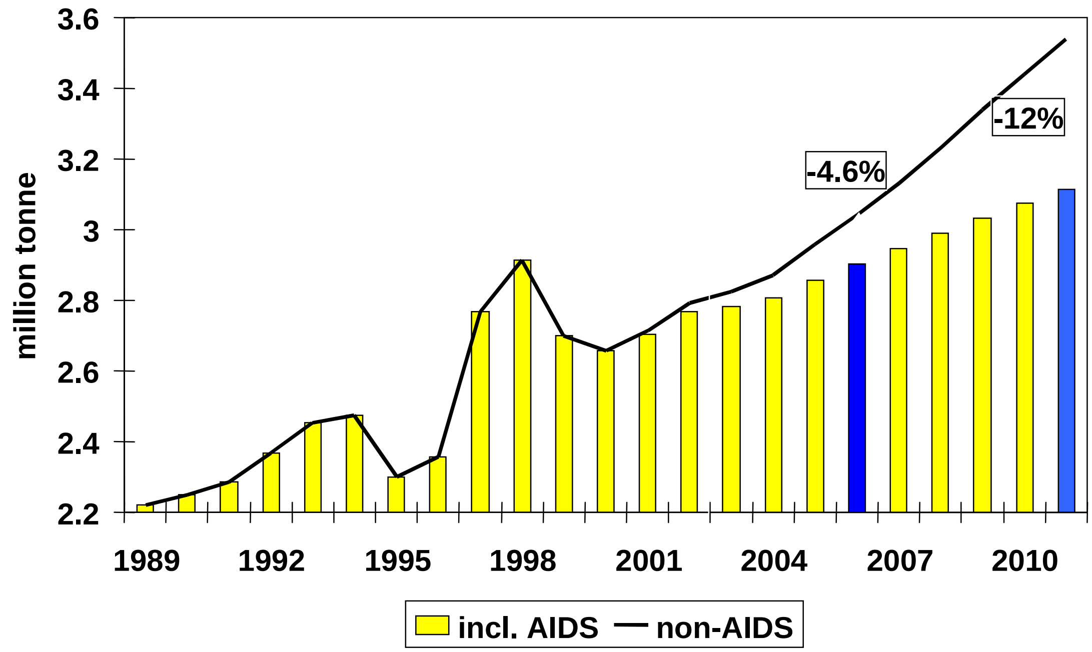
5. LATEST DEVELOPMENTS IN SOUTH AFRICA

5.1 Focus locally

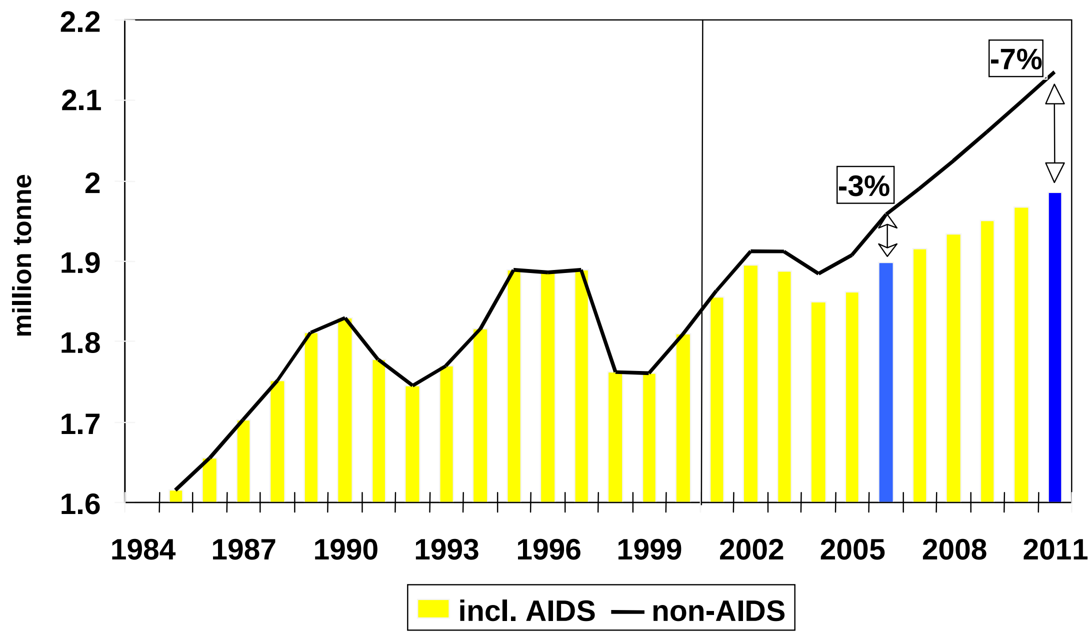
The South African Government embarked on a ***food fortification*** programme towards the end of 2002, which is focussed on seriously addressing malnutrition in South Africa. Wheat flour and maize meal were chosen as the most appropriate vehicles for the premix that was agreed to between Government and the private sector. The cost of the premix that is added to the products is just less than US $4 per ton. The initial indications are that this programme is very successful. However, we are experiencing some problems in getting the smaller processors in rural areas to participate. The monitoring capacity to ensure compliance is also lacking from Government's side. The high concentration of larger processors in the industry, however, is probably the factor that will ensure the success of this programme.

It would be very difficult not to mention the ***HIV Aids*** epidemic in Southern Africa when one looks at the latest developments concerning staple food consumption in our region. We did some studies to evaluate the impact of Aids on the sales of maize meal and wheat flour. We are continually in the process of revising our predictions, given the recent improvement of information about this epidemic.

Maize meal sales volumes



Wheat flour sales volumes



From the above graphs it is clear that the growth in sales will be much slower because of the Aids epidemic than what it would have been under normal circumstances. The predicted gap for wheat flour sales is 7% in 2011, whereas the gap for maize meal sales in 2011 is 12%. This is more than half a million tonnes of maize meal that we stand to lose in sales per annum (as predicted for 2011). This will probably cause the industry to reconsider its capacity, especially as some regions in South Africa are more highly affected than others.

One of the positive aspects in the grain industry in South Africa today is the development around ***cultivar selection*** at the beginning of the value chain, in order to ensure compliance with end-consumer requirements. We have successfully implemented a voluntary system amongst role-players in the wheat to bread value chain, whereby no new variety gets released onto the market if it does not meet the requirements from the milling and baking industries. Any variety that does not meet the specifications as agreed upon, may be grown and sold but will not fetch a proper market price in the system. Thereby no sensible seed company is actually investing in any variety that does not meet the requirements of the market. We have agreed to a specific set of release criteria to achieve this goal. This has substantially narrowed the standard deviation for the end quality of our raw material and is also very friendly towards the mechanical dough-mixing systems in our baking industry.

We have also embarked upon a project to evaluate certain quality characteristics in our white maize varieties, in order to ensure hardness, whiteness and a certain minimum kernel size. The milling industry is expecting a far better yield from our white maize varieties once all the softer cultivars have been eliminated from the production system. In similar vein, we have commenced with a project to identify yellow maize cultivars with characteristics that meets the specific needs from the animal feed sector. The grain ***grading rules*** have also been adjusted, after deregulation, to be more consumer friendly.

The decrease in the services that are rendered by certain Government departments caused the industry role-players to embark upon a system of ***self-regulation*** with regard to some aspects. The industry annually collects samples of all grains and sends it to the Southern African Grain Laboratory (an independent internationally accredited laboratory) to analyse our ***crop quality.*** We also collect samples of all imported grain to be analysed by the Southern African Grain Laboratory. These analyses are published to ensure that South African consumers are satisfied that the products are safe and that the quality thereof is certified. The producers and plant breeders can also compare the ***quality of the imported products*** against the release criteria that are set by the industry for local grains. The industry, through the Chamber of Milling, is also collecting samples of wheat flour and maize meal to ensure a proper set of ***quality benchmarking*** for industry role-players and to satisfy consumers that the products traded in the market place are safe.

A development that is receiving a lot of attention in South Africa is ***Black Economic Empowerment,*** which requires specific action plans to allow the previously disadvantaged members of our population to become part of the mainstream economy. The relevant statute seeks proactive equity participation of black business partners in the ownership of our food companies and the proactive appointment of black executives on the boards of companies. As is probably the case everywhere else, we are spending a lot of time in organised industry to improve on our ***food safety*** measures, paying particular attention to traceability aspects of food safety. Research is also focussed on matters such as mycotoxins.

The industry associations are playing an important role in formulating good manufacturing practice protocols to ensure that the food safety and traceability concerns of our consumers are attended to.

It would be amiss not to mention the matters concerning ***genetically modified organisms.*** It seems that South Africa is currently seen as a fairly liberal country where the Government has approved numerous genetically modified traits, and that these are widely used in the production of maize. We estimate that the yellow maize crop in South Africa is probably just short of 50% genetically modified and the best number that I have for genetically modified white maize is around 8% of our production. We have not yet experienced any resistance from consumers since genetically modified maize was introduced. Coming from a region where we frequently see people in real life suffering from hunger, (as opposed to only seeing this plight on CNN or BBC), we believe that biotechnology is a part of the solution to alleviate poverty on our continent. Food security, therefore, remains a very important point of discussion between industry and Government.

I would like to highlight one of the issues that we have not been able to resolve yet. This has to do with the registration and approval of the GMO traits throughout the world. South Africa, like many other countries, has a system whereby all new GMO traits have to be approved before it could be imported. Currently, as soon as we approve a new GMO trait to allow maize to be imported, a new one is registered in the country of origin, which disqualifies that country as a potential supplier to our market. As it is at the moment, South Africa is not in a position to import any yellow maize from the United States because of this approval gap. Should Argentina follow the same route, we will probably be in a position where we will not be able to import maize at all, unless it is certify GMO free. This will create an unnecessary premium on the cost of feed and related products. I would like to call on the seed companies to apply timeously for the approval of GMO traits in potential markets. This, I believe, is a huge challenge to especially the smaller markets in order to be allowed to import genetically modified grains from all origins.

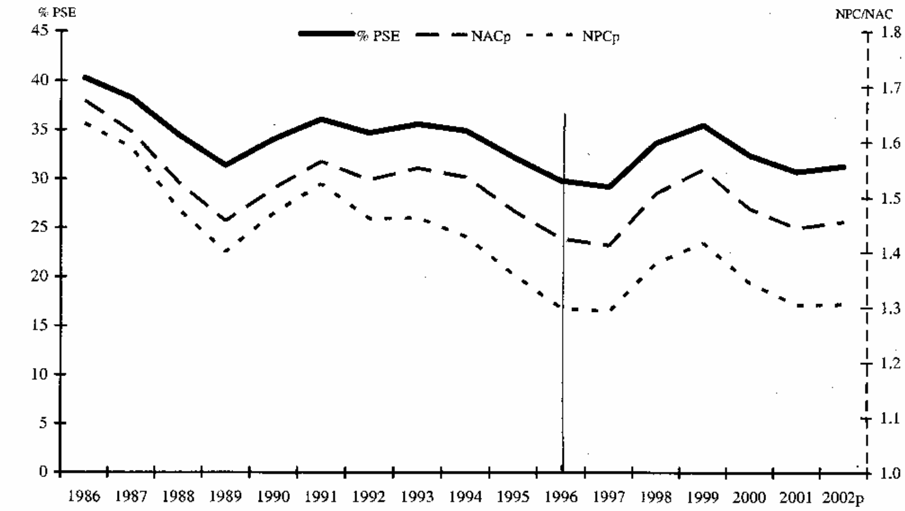
5.2 International perspective

Ladies and Gentlemen, I would like to dedicate this last part of my paper to the realities of agriculture under the World Trade Organisation, following the conclusion of the Uruguay Round, and how this has panned out from a South African perspective.

At Uruguay we accepted the Developed World's offer in promising lower ***subsidies.*** What in fact happened was an increase in subsidies. Last year at this same meeting the Organisation for Economic Co-operation and Development presented a graph in their report on agricultural policies in the OECD countries, which actually showed an increase in producer support since 1996.

Graph I.1. Evolution of Producer Support Estimate (%PSE), Producer Nominal Coefficient (NPCp) and Producer Nominal Assistance Coefficient (NACp)

1986-2002



p: provisional.
Source: OECD PSE/CSE database, 2003

At Uruguay we also accepted the offer of the Developed World for lower ***import duties,*** which was to increase wealth. South Africa conformed to this request and decreased our import duties, but it did not lower the levels of poverty as was promised. I would like to read to you a quote from a United Nations report that was released on 27 May 2004:

'Globalisation is having little effect on persistent mass poverty and may even worsen the trade balance in the world's poorest countries. The notion that it's enough to integrate into the world's trading system and liberalise your economy, is not working.' Carlos Fortin (Deputy Secretary General, Trade and Development: United Nations).

The underlying current within this notion is reflected in even stronger terms by South Africa's President, Thabo Mbeki:

'Let me mention some of the matters that will be discussed in the Doha Development Round. One of these concerns the international trade in agricultural products. Critical in this regard is access of our products into the food markets of the developed countries, some of which continue to subsidise their own agriculture in a context that verges on intellectual, economic and social obscenity and brutal selfishness.'

Another promise that we found hard to believe, is the promise that ***food aid*** won't disrupt commercial business. Following the drought in Southern Africa in 2002, together with the political instability in countries like Zimbabwe, we – for the first time since deregulation – faced large volumes of food aid entering our markets. We experienced huge upward pressure on our local food prices due to an over-estimation of demand by the food aid community, as a tool to attract sufficient donor interest.

Milling companies in receiving countries like Lesotho and Swaziland complained that the over-supply of food in their markets forced them to focus their sales on South Africa to ensure that their businesses remained viable. This disrupted our market. The milling industry in South Africa further formed part of the supply chain to process some of the genetically modified maize that was donated by the United States into a product format, to make it acceptable to countries like Zimbabwe and Zambia who were afraid of allowing live GMO seed which could potentially be propagated into their countries. Having to mill these donated products we were very much aware of the quality of those grains, which appeared highly suspect at times. This being said, South Africa realises that it has a leading role to play in fostering food security in Southern Africa. To this end South Africa recently made a modest but firm contribution of US$ 15 million towards a regional food security and aid initiative. Our industry retains the maxim 'Feed Africa from Africa First' when it comes to food aid.

At Uruguay we also bought into the notion that ***free trade agreements*** are equal to more market access. From the milling industry's perspective, all free trade agreements that South Africa entered into or is still entering into, seem to improve market access for non-agricultural products but create more opposition (than markets) for our agricultural products. Just to give you an example, the percentage of agricultural trade included in the free trade agreement with the European Union is as follows:

South Africa:	81% access granted to EU agricultural products
European Union	61% access granted to SA agricultural products

These are a few examples of the reality that hit South Africa following the Uruguay Round.

6. CONCLUSION

The grain market in South Africa is probably one of the freest markets in the world today and we are very proud of what we have achieved thus far. We are still striving to become increasingly competitive as we improve on our productivity, whilst dealing with the challenges that are unique to our region. We are, however, looking forward to the results of the Doha Round of the World Trade Organisation negotiations. We hope to be allowed not only to level the proverbial 'playing field', but also to plough that field, in order for our industry to become a global player to a much larger extent than is currently possible.

Once again, thank you for the opportunity to address you today and I trust that the challenges that we in South Africa have faced over the last 10 years will also encourage you to embrace changes in the future with enthusiasm and expectation. In this vein we hope to see you all enjoying our cereal products when you visit South Africa for the Soccer World Cup in 2010!

Thank you Chair, and my compliments to the IGC for a fine conference!

Jannie de Villiers
Executive Director
Chamber of Milling
South Africa

E-mail: jannie@grainmilling.org.za
Web: www.grainmilling.org.za
Tel: +27 12 663 1660
Fax: +27 12 663 3109