OECD Review of Agricultural Policies

South Africa

HIGHLIGHTS AND POLICY RECOMMENDATIONS

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Foreword

This publication presents the highlights form the OECD Review of Agricultural Policies in South Africa, *which was undertaken as part of an initiative to provide analyses of agricultural policies for four major agricultural economies outside the OECD area, the others being Brazil, China and India. It takes a thorough look at the situation of agriculture in South Africa and issues for the future. The study also measures the extent of support provided to agriculture using the same method that OECD employs to monitor agricultural policies in OECD countries. In addition, it focuses on key interactions between South Africa and OECD countries, including the impacts of trade and agricultural policy reforms. The country study aims at strengthening the policy dialogue with OECD members on the basis of consistent measurement and analysis, and to provide an objective assessment of the opportunities, constraints and trade-offs that confronts South Africa's policy makers.*

The study was carried out by the OECD Directorate for Food, Agriculture and Fisheries. The principal author was Václav Vojtech who received valuable contributions from Hsin Huang, Olga Melyukhina and Pete Liapis. Research and statistical support were provided by Laetitia Reille, technical and secretarial assistance by Stefanie Milowski and Anita Lari.

The study benefited from the substantive input of a range of South African experts. The following contributions were provided: contextual information to Chapter 1 by Jan Groenewald (retired Professor from Free State University); information on domestic policies by Mohamad Makhura, Ted Stilwell and Nico Meyer from the South African Development Bank (SADB), Johan von Schalkwyk from the Free State University (FSU), and Simphiwe Ngqangweni from the Pretoria University (PU); information on trade policies by André Jooste from the FSU; the data and information for the estimation of support to agriculture by André Jooste and David Spies (FSU) and Johan Kirsten (PU). The analysis of changes in incomes, poverty and inequality was prepared by Scott McDonald (University of Sheffield, UK) based on the Social Accounting Matrix data collected under the project PROVIDE and made available by the South African National and Provincial Departments of Agriculture. The study also benefited from inputs from the FAO and the World Bank.

The study benefited greatly from the support from the South African Ministry of Agriculture and Land Affairs, coordinated by Ben van Wyk, whose experts provided essential information on the functioning of agricultural programmes in South Africa as well as comments on the draft report.

The study was made possible through voluntary contributions from Germany, the Netherlands, New Zealand, Spain, Switzerland, United Kingdom, the Unites States, as well as funding from the European Union.

The study was reviewed in a roundtable with South African officials and experts in Pretoria in October 2005. Subsequently, South African agricultural policies were examined by the OECD's Committee for Agriculture at its 143rd session in December 2005, bringing together policy makers from South Africa, OECD member countries and some non-OECD countries. The report is published under the authority of the Secretary-General of the OECD.

Stefan Tangermann
Director
Directorate for Food, Agriculture and Fisheries

Table of Contents

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OECD Review of Agricultural Policies
South Africa

Highlights and Policy Recommendations

South Africa has undergone enormous economic, social and political change since the beginning of the democratisation process in 1994. The overall results have been positive with a stronger and stable macro economy, better integration into the global trading system, and progress in redressing past injustices and reducing poverty. There are still many challenges facing the government and South African society as a whole, including widespread unemployment and poverty, a large unskilled workforce excluded from the formal economy, weak social and educational systems, a significant level of crime and a high prevalence of HIV/Aids.

Agriculture contributes less than 4% to GDP but accounts for 10% of total reported employment. The sector is increasingly export oriented with about one-third of total production exported. The conditions for agricultural production are not favourable in most regions (with the notable exception of the winter rain area in Western Cape) due to poor land quality, highly variable climatic conditions and a scarcity of water.

South African agriculture is of a highly dualistic nature, where a developed commercial sector co-exists with large numbers of subsistence (communal) farms. Agriculture is well diversified with field crops, livestock and horticulture the main sectors. However, there can be large annual fluctuations in output due to weather conditions. Fruit production has seen the most dynamic development in the past ten years with a large share of total output exported, mainly to Europe.

Important and wide ranging reforms liberalising domestic and foreign trade and lowering support to agriculture were implemented in the 1990s. The current level of support (PSE of 5%) is low relative to the OECD average and is comparable to that in Australia, Brazil, Russia and China. Border protection has been significantly relaxed, which is consistent with an emphasis on new regional trade agreements. Market price support remains the largest component of producer support. The level of support is uneven across commodities and sugar is by far the most supported commodity. Budgetary payments have been reduced and there has been a shift in payments away from established commercial farms to development of the small farm sector that is emerging from the land reform. Almost one half of the budgetary expenditures are for the provision of general services, such as research, training, inspection and infrastructure development.

The commercial agricultural sector adapted well to the policy reforms and liberalisation efforts. However, economic and financial pressure on commercial agriculture is substantial, and as with other sectors, farmers must adapt their production and investment decisions to the market situation and overall economic developments. These market pressures need to be considered in the context of land reform and Black Economic Empowerment (BEE). The new entrants into commercial agriculture (and into agricultural based services) are at a considerable disadvantage relative to the more experienced operators in responding to these challenges.

Continued land reform is one of the most important agricultural policy challenges, in particular how to a) *improve the land acquisition and resettlement process; and* b) *create stakeholder consensus around the implementation strategy. Greater flexibility in land acquisition options and more decentralised community-driven decision-making would be positive steps. Moreover, adjustment assistance is required to ensure that land reform results in the emergence of viable farms. Development of the necessary technical and social infrastructure, as well as an effective service sector, are critical measures.*

Facilitating economic integration between small and large-scale commercial units is another policy challenge. The ability of the commercial sector to respond to increased market opportunities will ultimately determine any gains from global trade liberalisation. Farming policies need to be conducive to the adoption of quality and productivity improvements for this sector to become more internationally competitive and exploit its export potential.

1. Reforms and their impacts

South Africa is undergoing radical reforms towards market orientation and more equitable distribution of resources with all racial groups participating in the economy

The Republic of South Africa occupies the southern-most part of the African continent. With a surface area of 1.22 million km^2 and a population of 46.9 million, South Africa is one of the largest countries on the African continent. It is also the largest African economy, with a per capita GDP of USD 3 530 (USD 10 492 in PPP terms) more than four times the African average. However, the distribution of income is among the most unequal in the world, and high levels of unemployment, poverty and HIV/Aids are major concerns. Also, the potential of South African agriculture is limited by the relative scarcity of arable land and water resources.

South Africa has undergone immense social and economic change over the last 20 years, following the abolition of apartheid and fundamental reforms aimed at creating a more open and market-oriented economy. An underlying principle for virtually all government policy is to bring the previously excluded black community into the mainstream economy through job creation and entrepreneurship. Macroeconomic reforms have stabilised the economy, but serious problems of high unemployment and poverty remain.

Tight monetary and fiscal policies have kept inflation down and stabilised the economy, and more growth-oriented policies have prevailed since 2001

Over the past ten years, the South African government introduced important reforms throughout the whole economy. Since the start of the democratisation process in 1994, South Africa has made tremendous progress in stabilising macroeconomic fundamentals. From 2000, the South African Reserve Bank (SARB) has conducted monetary policy based on inflation targeting. It has allowed the exchange rate to float and there are no exchange rate targets. Inflation has been reduced to less than 5% and interest rates were reduced as well. However, real interest rates are higher than in the past periods with high inflation. Also, in the most recent years fluctuations in the South African Rand (ZAR) exchange rate influenced the economy which is more open to world markets than in the 1990s.

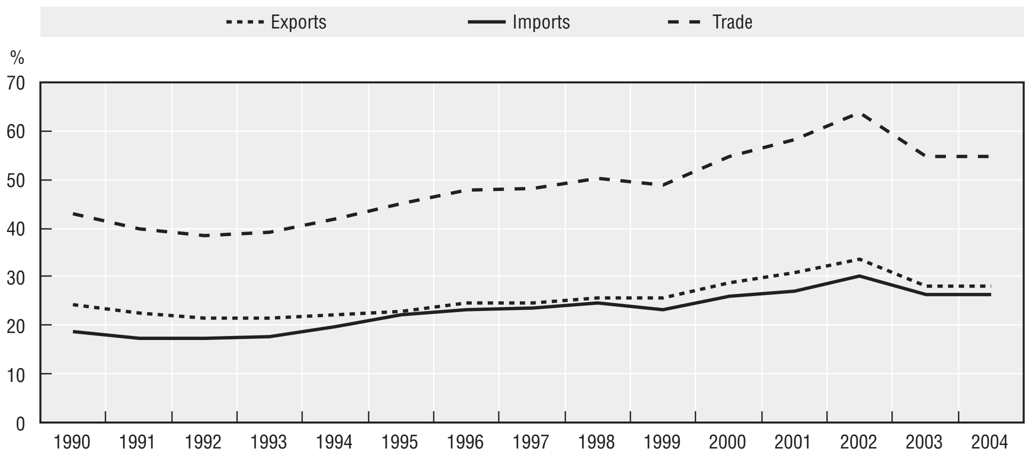
A gradual transition from fiscal austerity to a growth-oriented policy has taken place since 2001/02. However, despite a growing emphasis on poverty reduction and increased social spending, the impact on employment and poverty has been limited. Many social needs remain unmet with a large segment of the population excluded from the formal economy and having limited access to services. A high and rising rate of unemployment is a major concern. One crucial factor is the low skills level for a large part of the South African workforce. Moreover, the country faces major social challenges including the need to improve management of social and educational systems, a high prevalence of HIV/Aids infection, and a high level of crime.

Market liberalisation accelerated after 1994 and lead to increasing integration of the South African economy into global markets

The Marketing Act, in force since 1937, gave the government control over domestic markets and trade. Partial reforms, mainly concerning domestic markets, were implemented during the 1980s and early 1990s. However, it was in 1994-97 that the government introduced radical reforms, liberalising domestic markets, foreign trade, and prices in the whole economy.

Overall, the South African economy is increasingly oriented towards world markets both in terms of exports and imports. The share of exports of goods and services in total GDP increased from 22% in 1994 to 34% in 2002, while that of imports increased from 20% to 31% (Figure 1).

Figure 1. **South Africa: Total exports, imports and trade of goods as % of GDP, 1990-2004**



Source: World Development Indicators CD-ROM, World Bank, 2004.

South African agriculture is of a dualistic nature, with a well-developed commercial sector and large numbers of subsistence farms…

South African agriculture is highly dualistic with a small number of commercial operations run predominantly by the white farmers and large numbers of subsistence farms run by the black farmers. The problems and opportunities are quite different for each group. Agricultural reform continues with a series of measures to address past injustices including land redistribution, agricultural support programmes to disadvantaged farming communities, and a broad based programme of economic empowerment of the black population in the agricultural and food sector.

… and its potential for growth is constrained by availability of arable land and water

The importance of agriculture in the overall economy has been declining over the long term. Agriculture's share of GDP fell from around 6% in the 1980s to less than 4% in 2001-02. However, agriculture remains an important sector in terms of employment, accounting for around 10% of formal (officially reported) employment. Overall, the conditions for agricultural production are not favourable in most of the country. Only 16% of agricultural area is potentially arable and water resources are scarce in most regions. Natural pastures in desert and semi-desert areas represent 83% of total agricultural area, and the remaining area is used mostly for field crops and horticulture. The winter rain area in Western Cape is the only region with very favourable production conditions.

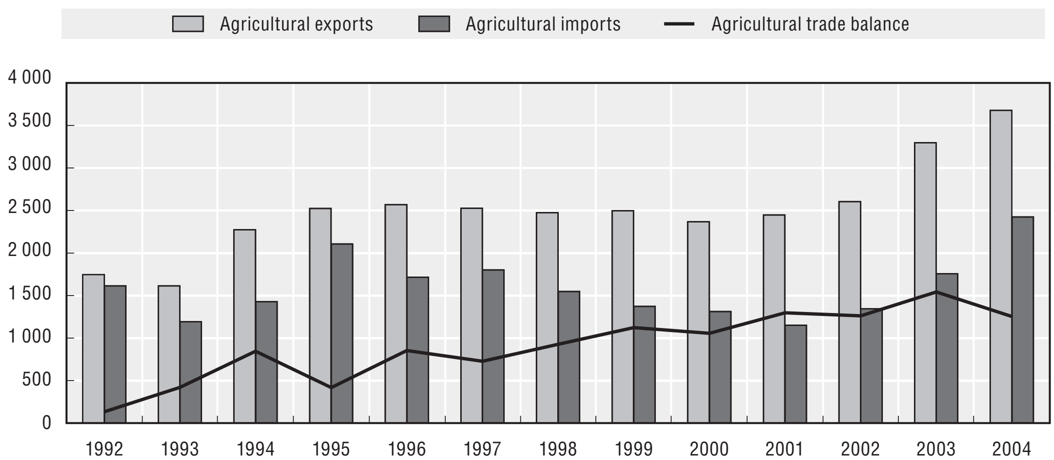
The three main sectors of agricultural production in South Africa are field crop production (33% of total agricultural output in 2001-03), livestock production (40%) and horticulture (27%). Overall, agricultural production is well diversified. However, due to adverse regional conditions, farmers in some regions have little scope to diversify. The southern and western interior (semi-arid area) is only suitable for extensive livestock production (sheep, cattle). Intensive livestock farming (dairy, poultry and pork production) is practised in the arable areas of the country, generally closer to the major metropolitan markets or on the coast where access to imported feed is easier. The country is a net importer of meat, most imports being from the neighbouring Botswana and Namibia.

The South African agro-food sector is increasingly integrated with world markets…

The South African economy, including agriculture, is increasingly integrated in world markets. Three major political and economic developments of the 1990s contributed to this process. The most important was the lifting of economic sanctions against South Africa following the accession in 1994 of a democratic government. The next radical change was the repeal of the Marketing Act of 1937, which led to establishment of a much freer economic and entrepreneurial environment with major reductions in government interventions in domestic production, marketing and trade. Finally, on the international front, the Uruguay Round Agreement of Agriculture (URAA) introduced new disciplines governing agricultural trade.

Figure 2. **South African agricultural exports and imports, 1992-2004**

Million USD



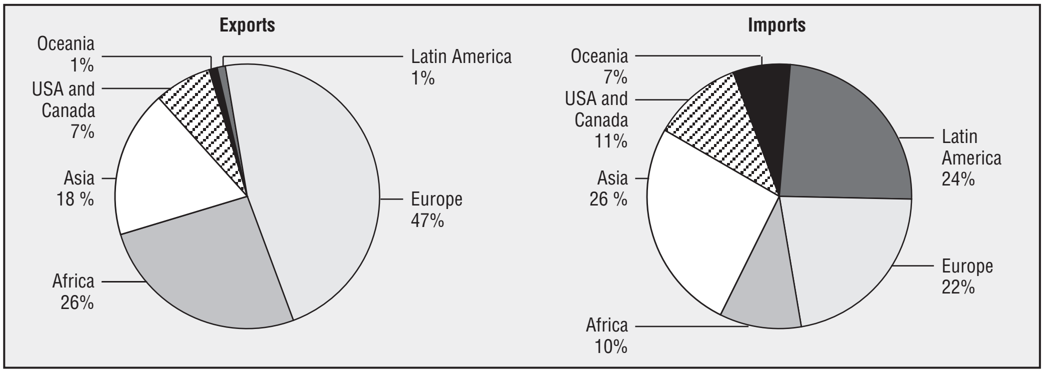
Source: Calculated from data of the Department of Trade and Industry.

… with a sharp growth in agricultural exports…

The opening of the agricultural sector placed South Africa among the world's leading exporters of such agro-food products as wine, fresh fruits and sugar. The country is also an important trader in the African region. The beginning of the current decade witnessed particularly strong agricultural export growth. South Africa's agricultural export revenues reached almost 9% of the total value of national exports. Europe is by far the largest importer, absorbing almost one-half of the country's agricultural exports. The African market is the second most important destination, accounting for around 26% of exports, with the Asian market slightly less important with an 18% share. North America (the United States and Canada) plays a relatively modest role as an export destination, absorbing only around 7%, while exports to Latin America and Oceania are marginal (Figure 3).

Figure 3. **South African agro-food exports by destination and imports by origin**

% of total



Source: Comtrade Database, 2005.

... and agricultural imports are also increasing somewhat

Agricultural imports are also growing but less rapidly than exports. Agricultural imports have accounted for 5% to 6% of total imports on an annual basis since 2000. They are distributed more evenly than exports with less emphasis on Europe. Europe, Latin America and Asia account for roughly equal shares (between 22% and 26%) (Figure 3). Combined, these three regions supply almost three-quarters of South Africa's agricultural imports. Most notable is the major role of Latin America as a supplier of agricultural products (24%), compared with its negligible role as an export destination (1%). Oceania and North America are also much more important as a source of imports than as export destinations. Conversely, Africa which is a major export destination is not a major supplier of agricultural imports.

Important and wide ranging reforms liberalising domestic and foreign trade and lowering support to agriculture were implemented in the 1990s...

Changes in South African agriculture in the past decade have been shaped by substantial macroeconomic and social reforms implemented from the mid-1900s, but reforms of agricultural policies were also initiated. Policy changes that impacted on agriculture included deregulation of the marketing of agricultural products; abolition of certain tax concessions favouring the sector; reductions in budgetary expenditure on the sector; land reform (restitution, redistribution and tenure reform); trade reform, including the tariffication of farm commodities; and the broadening/introduction of new labour legislation.

At the end of the 1980s and early 1990s there was increasing evidence that the continuation of highly interventionist policies was not economically sustainable due to their distorting effects. In addition to economic factors, globalisation and domestic social reforms contributed towards a relaxation of stringent interventionist measures. Market reforms implemented in 1996 (Marketing of Agricultural Products Act) liberalised prices and trade in large parts of the agro-food sector, including foreign trade (one notable exception is the sugar industry).

The main development in trade policies was the replacement of direct controls over imports by tariffs, which were set below the bound rates of the URAA, and elimination of state controls over exports. South Africa has also established a number of preferential trade arrangements with countries inside and outside the Southern African Development Community (SADC) region. These reforms resulted in the lowering of the average level of tariffs and simplification of the tariff structure while maintaining a tariff escalation profile. The new trade arrangements improved access to foreign markets for farmers but also exposed them more to external competition.

… and lead to a more market-oriented sector

Price liberalisation and market deregulation were accompanied by the development of trade and market institutions and an increase in the number of traders. Marketing reform has resulted in significant private sector response across the agro-food chain.

The withdrawal of most forms of support to commercial farmers created adjustment pressures for the sector, while deregulation of the input and services markets provided benefits. Effects on the sector were far reaching and included: *i)* shift of production out of grain to livestock in marginal production areas, and an increase in intensive farming in high potential areas, particularly horticultural production; *ii)* more farmer involvement in risk management by means of storage (especially in the case of maize, forcing the co-operatives which own the vast majority of grain silos to become more commercially oriented), forward contracts and diversification; *iii)* a strengthening of the role of organised markets (SAFEX, Auction markets) and producer responsiveness to price signals; and *iv)* an acceleration in the establishment of new enterprises in agriculture and downstream food processing sectors and foreign trade.

Less dependence on state support…

Although the deregulation of markets created some uncertainty, at the same time it opened opportunities for entrepreneurial farmers and led to a more efficient allocation of resources in agriculture. The net effect of these changes is that the South African agricultural industry has become less dependent on state support and internationally more competitive, although many sectors within the industry experienced a difficult period of adjustment.

… contributed to rationalisation of commercial farms

The structure of commercial farms in South Africa has been influenced by both deregulation and by the land reform programme. In response to deregulation, commercial farmers (especially in the field crop sector) adopted a wide variety of risk management strategies to cope with the declining and fluctuating producer prices that resulted from deregulation. These strategies included income diversification, *e.g.* on-farm agro-tourism, off-farm employment; farm diversification, *e.g.* different products, different regions; and farm consolidation and expansion. This latter trend has resulted in a smaller number of larger commercial farms, contrasting with a large number of very small subsistence farms.

Land reform is a fundamental element of agricultural reforms, aimed at redressing past injustices

After democratisation, the government introduced land reforms to redress past injustices, foster reconciliation and stability, support economic growth, improve household welfare and alleviate poverty in rural areas. The Land Reform Programme consists of three main programmes: restitution of land unjustly taken from people and communities; land redistribution; and land tenure reform.

Some of the components of land reform are well advanced…

The land restitution is well advanced (61% of claims settled). The beneficiaries had an option to be compensated in kind, with agricultural land and assets, or in cash. Some 65% of beneficiaries opted for the compensation in kind while the remaining 35% were compensated in cash. Cash restitution contributed directly to poverty alleviation. During the past ten years, about ZAR 1.6 billion (USD 200 million) have been spent by the government for financial compensation. Restitution beneficiaries tended to invest in home improvements, education and other livelihood projects. Concerning the restitutions in kind, around 916 500 hectares of agricultural land were restored to their former owners.

… while others are lagging behind expectations

Land redistribution is aimed at providing people with access to land for either settlement or agricultural purposes. The aim is, *inter alia,* to settle small and emerging farmers on viable farming operations in the commercial farming areas. The land redistribution programme aims to transfer 30% of all white-owned agricultural land to previously disadvantaged individuals within 15 years. In contrast with land restitution, the land redistribution programme in South Africa has performed below its expectations due to inadequate institutional capacity, financial resources, lack of appropriate agricultural support services, and co-ordination.

2. Current agricultural policies

Border protection has been significantly relaxed…

The trade liberalisation in South Africa after 1994 involved lowering the average tariff level by one-third by 1999. Licenses and quotas are restricted to tariff quota administration in respect of trade agreements, and non-tariff import controls consist of sanitary and phytosanitary measures in accordance with the WTO SPS Agreement. For a range of products, safeguard clauses exist but they have not been applied, mainly because of the substantial margin between bound and applied tariffs.

For most agro-food products, *ad valorem* tariffs or specific tariffs (or a combination of both) are applied. Formula tariffs exist for maize, wheat (replaced with and *ad valorem* tariff in July 2005) and sugar. Domestic market intervention has not been applied since the deregulation of markets in the mid-1990s. The exception is the sugar cane/sugar market where a price pooling system is maintained, and the South Africa Sugar Association is the only sugar exporter.

… and there is an emphasis on negotiating new regional trade agreements

Trade agreements have increasingly become an important tool for opening up markets for South African agricultural products. A general principle is that no agreement should exclude the negotiation of other agreements. South Africa is the most important member of the Southern African Customs Union (SACU), the others being Botswana, Lesotho, Namibia and Swaziland (BLNS countries). The customs union has been in existence since 1910 and was renegotiated in 2002. Within the African trade the most important development was the Southern African Development Community (SADC) Free Trade Agreement signed in 2000. Within this agreement the SACU tariffs were phased down in five years (by 2005). Other countries will do so in 12 years (by 2012).

South Africa is a beneficiary of several preferential trade agreements such as the US initiative African Growth and Opportunity Act (AGOA), and a Generalised System of Preferences (GSP) status with Canada, Norway, United States, Japan, Switzerland and the European Union. A Trade, Development and Co-operation Agreement (TDCA), between South Africa and the European Union was implemented from January 2000. On the other side, the European Union rejected South Africa's application to join the African Caribbean and Pacific (ACP) group. South Africa was accepted as a qualified member of the ACP which means that it can participate in/qualify for only tendering and procurement but not market access concessions to the European Union.

South Africa with other SACU partners is currently negotiating FTAs with the United States, the European Free Trade Association (EFTA) and Mercosur. Further negotiations with Africa's most populated country and second largest economy, Nigeria and the giant Asian markets of India and China have been planned but not yet started.

The budgetary support is increasingly targeted to the beneficiaries of the land reform aiming to develop their agricultural businesses and integrate with markets

An important share of public financial resources is devoted to the implementation of the land reform and especially land redistribution. To support this programme, Land Redistribution and Agricultural Development (LRAD) grants are given to the black disadvantaged population to acquire land or for other forms of on-farm participation. It allows farmers who can provide personal contributions (financial and/or own labour) to acquire more land. The implementation is demand led, and decentralised (applied by Provinces). Beneficiaries can access a range of grants depending on the amount of their own contribution in labour and/or cash. The programme is financially costly and budgets have become a constraint. Approval of the grant is based on the viability of the proposed project which takes into account project costs and expected profitability.

From 2005, new programmes are implemented to support the development of market oriented family farms emerging from the land reform process. The *Comprehensive Agricultural Support Programme* (CASP) is targeted to the beneficiaries of land reform willing to establish commercial farms. The support is to be provided mainly through investment grants allocated to viable projects. The CASP is complementary to the Micro-Agricultural Finance Schemes of South Africa (MAFISA), which is a newly established state-owned scheme to provide micro and retail financial services in rural areas.

The sector is also implicitly supported by tax relief schemes

The Diesel Refund System, introduced in 2000, provides a refund on the fuel and road accident fund levies paid on diesel. The concession applies to farming, mining and forestry. This is one of the few types of support which benefits the commercial farming sector.

Research and development, education and training, inspection and control, infrastructure are other major areas of public support

The publicly financed research and dissemination activities have been increasingly oriented towards the needs of the emerging small farming sector. The Agricultural Research Council in co-operation with the National Department of Agriculture and Departments of Agriculture in the Provinces are the main institutions involved. The inspection and control (regulatory) services of South Africa are relatively well developed. The Department of Agriculture programme, *National Regulatory System* (NRS), focuses on managing risks associated with animal and plant diseases; food safety, including the use of genetic resources and the importing and exporting of food; and bio-safety legislation pertaining to agricultural products entering South Africa and genetically modified products.

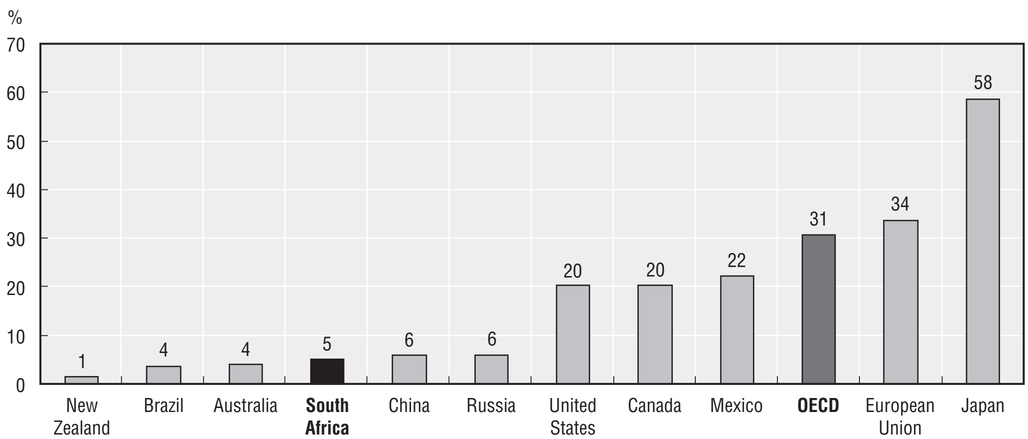
There are relatively low and declining levels of support to producers...

As part of the present review the OECD has for the first time calculated the Producer Support Estimate (PSE) for South Africa for the period 1994 to 2003. As measured by the aggregate percentage PSE, producer support in South Africa equalled on average 5% of gross farm receipts in 2000-03. A comparison of producer support in South Africa and the principal world agricultural players shows that the percentage PSE in South Africa is roughly at the level of such non-OECD economies as Brazil, China and Russia, and such OECD country as Australia and somewhat above that in New Zealand – the OECD country with the least policy interventions measured (Figure 4). The support level in South Africa is well below that in the United States and far below that in the European Union.

The measured average level of support in South Africa indicates a relatively moderate degree of policy interventions at the agricultural producer level and the overall trend shows some reduction of support since 1994. As is seen from Figure 5, the overwhelming share of producer support in South Africa is delivered in the form of Market Price Support (MPS). Budgetary transfers, although showing a tendency to increase in the current decade (mainly due to the introduction of the fuel tax rebate and spending on land reform), have less importance as a source of producer support.

Figure 4. **PSE by country, EU[1] and OECD averages, 2000-03 average**

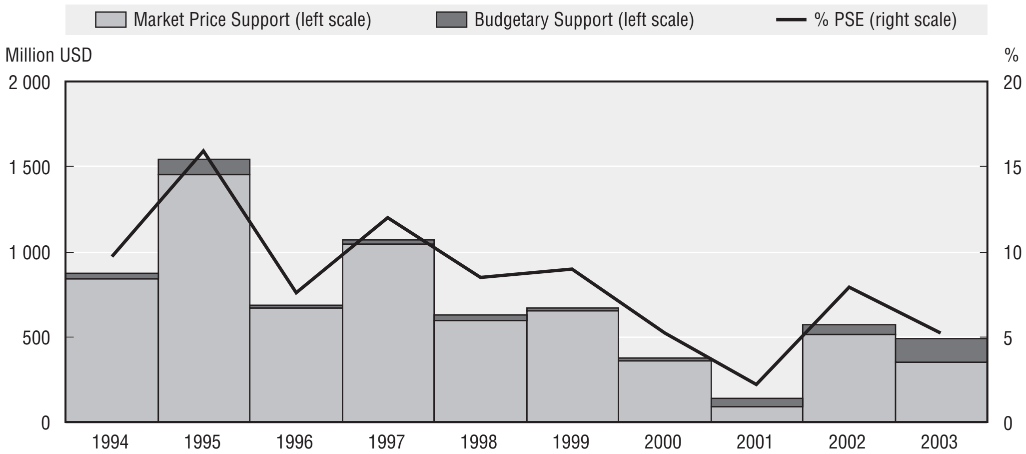
% of gross farm receipts



1. 2000-03: EU15.

Source: OECD PSE/CSE Database, 2005.

Figure 5. **Composition of Producer Support Estimate, 1994-2003**



Source: OECD PSE/CSE databases, 2005.

... but strong variations between the years...

The moderate average level of support in South Africa, however, goes along with marked year to year variations – especially in the initial and the most recent years over the analysed period – with the percentage PSE fluctuating between 2% and 16% (Figure 5). The strong variations in the support level are the result of diverse – and sometimes opposing – policy impacts. One major force was the progressive overall trade deregulation, with the reduction in border protection and elimination of export subsidies. This overall pressure towards lesser protection, and therefore, lesser producer support, was partly counter-balanced by the system of variable import tariffs, which was maintained for such principal commodities as maize, wheat and sugar. Over and above these specific policies, strong exchange rate fluctuations, without an immediate equivalent transmission to domestic agricultural prices, produced shifts in relative levels of domestic and external prices, thus strongly contributing to annual changes in the measured support.

... and uneven distribution of support among commodities

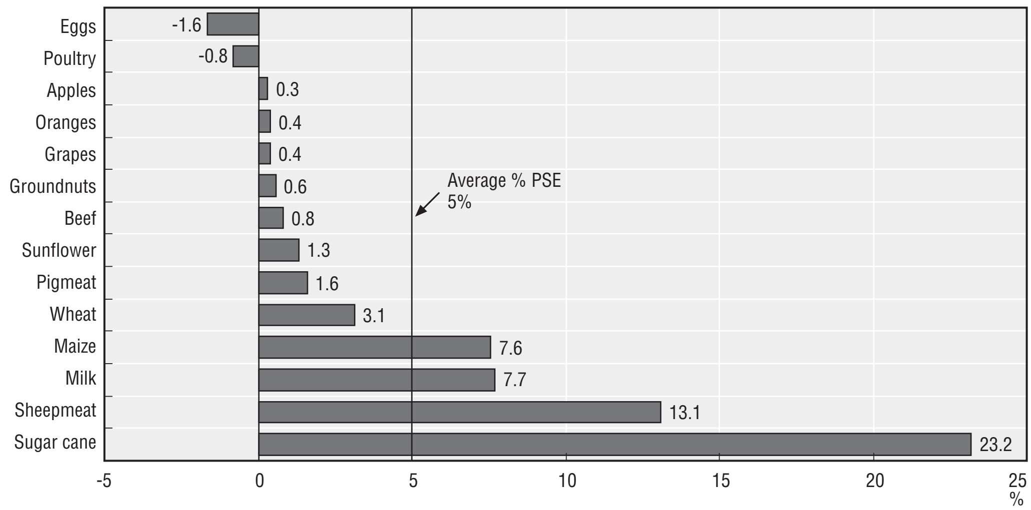
There are marked differences in the levels of support across individual commodities – with the average percentage PSE ranging from 23% for sugar to nearly zero for a range of other commodities (Figure 6). Sugar is the most supported commodity receiving support far above the average level. This is notable given that sugar is one of South Africa's key exports (around one-half of sugar production is exported). The high level of sugar support is maintained through high import tariffs and the pricing system under which South African sugar producers are effectively compensated for export losses by higher prices for domestic sales compared to that destined for exports.

Sheep meat, milk and maize are the other commodities receiving above-average support, though far below that for sugar and closer to the average level. Support for these commodities is based predominantly on border protection. It should be also noted that a relatively high average PSE for maize in 2000-03 largely reflects an abnormal price spike for white maize in 2002.

Figure 7 illustrates the relative importance of each component – the PSE and the General Services Support Estimate (GSSE) – in South Africa's Total Support Estimate (TSE).

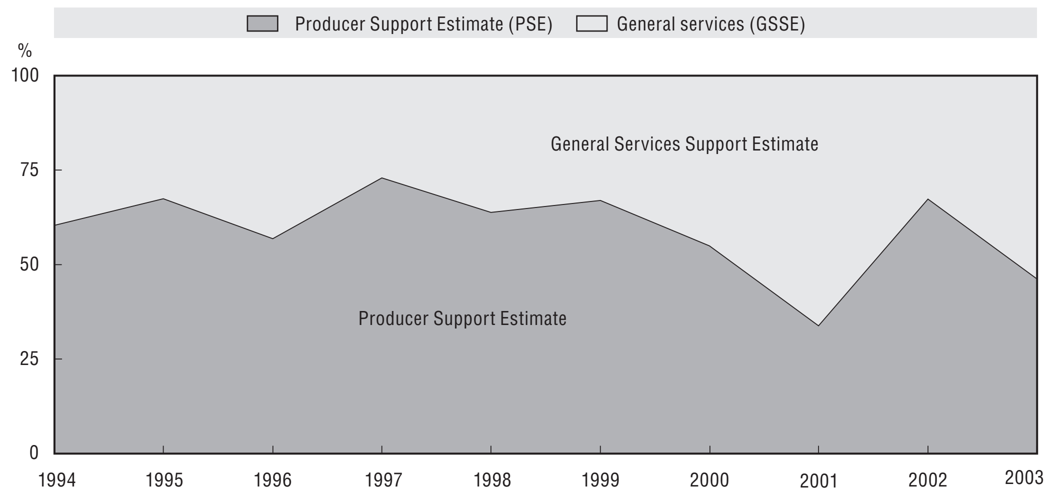
Figure 6. **South African PSEs by commodity, 2000-03 average**

% of gross farm receipts



Source: OECD PSE/CSE databases 2005.

Figure 7. **Composition of the Total Support Estimate in South Africa**



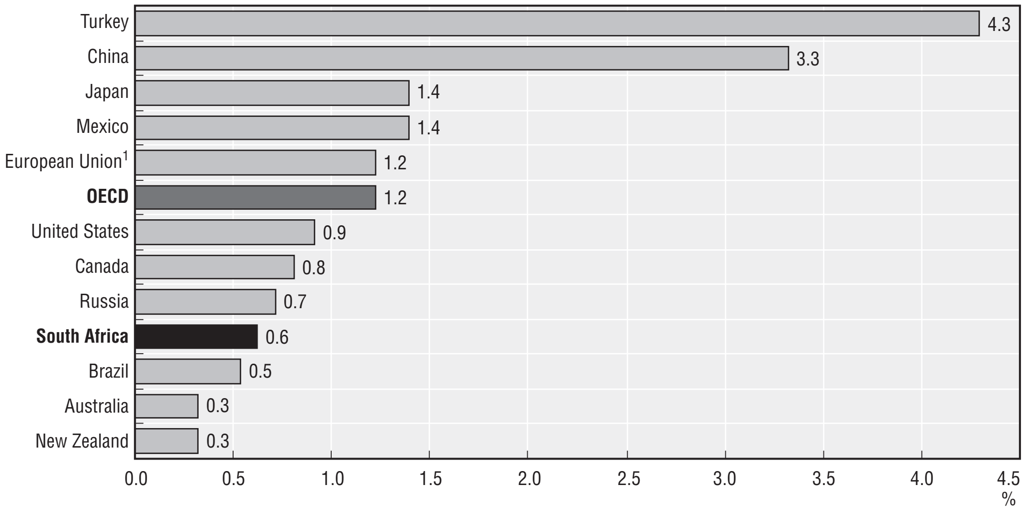
Source: OECD PSE/CSE databases, 2005.

Around 55% of total support to agriculture in 1994-2003 was delivered in the form of the transfers to producers (the PSE). The remaining assistance was provided through general services to the sector. The budgetary spending on general services finances mainly the research, development and training, the investments in infrastructure, inspection and control services, and administration of land reform. Most of the general services (training, infrastructure, *etc.*) are increasingly targeted to the emerging small farmers benefiting from the land reform.

The South African percentage TSE fluctuated over the analysed period, averaging 0.6% of GDP in 2000-03, which is slightly above one-half of the OECD level, and approximately between the percentage TSE in Russia and Brazil. The relative cost of total support in South

Figure 8. **Total Support Estimate in South Africa and selected countries, 2001-03 average**

% of GDP



1. 2001-03: EU15.

Source: OECD PSE/CSE databases, 2005.

Africa is however, far less than in China or Turkey – countries with significant weights of the agricultural sectors in their economies (Figure 8).

3. Effects of policy reforms

Improving market access is one of the priorities of South African policies

A major share of South African key exports is directed to just a few destinations, among which the OECD markets – in particular, the European Union – are the most important. In general, wine and fresh fruit exports face relatively low levels of border protection, in part due to bilateral and general tariff concessions to South Africa. However, these preferences do not exclude South Africa from the seasonal elevation of tariff barriers and from implicit constraints of the entry prices, built into the EU regime for fresh fruits. This is an important issue for South Africa as the seasonal elevation affects the possibility of exporting fruit production from provinces which have similar harvesting seasons to those in Europe, as these provinces have a potential to increase their production.

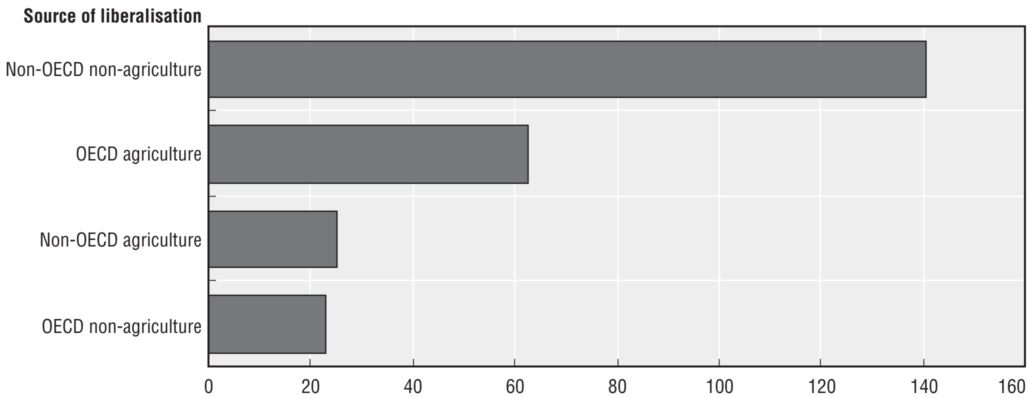
OECD sugar markets are effectively restricted to raw sugar exports from South Africa. Although reduction in protection of the sugar sector in the large OECD economies could provide important gains for the low-cost sugar producers, South Africa, with domestic prices higher than world levels, is unlikely to have the comparative advantage to reap those gains.

South Africa benefits from global trade liberalisation, mostly from reforms in non-agricultural sectors…

Quantitative scenario analysis shows that South Africa would benefit from global liberalisation and the expected effect is dominated by the reform in the manufacturing industry (Figure 9). Nevertheless, the gains from reform in agriculture are also important, accounting for one-third of total welfare gains. The most significant contribution to gains from the reform in agriculture is from liberalisation of OECD agricultural policies. Under

Figure 9. **Welfare gains in South Africa by source of liberalisation**

Million USD



Source: OECD Secretariat, GTAPPEM.

the standard assumption of full employment, scenario analysis suggests that agriculture factor returns would increase slightly more than non-agricultural returns. However, an alternative assumption of no constraints on the unskilled labour supply shows that factor income inequality would be increased, though the creation of new jobs for unskilled workers helps to reduce poverty.

... but liberalisation by South Africa itself is an important component of these gains

An analysis of the distributional implications of multilateral liberalisation suggests that there would be redistribution in welfare both between racial groups and provinces, with the coastal provinces and white households being subjected to some small declines in welfare while the inland provinces and non-white households experience some increase in welfare.

The overriding conclusion is that while global liberalisation may open up market opportunities to South Africa, the primary determinants of the welfare changes in South Africa are under the control of the South African government, namely South Africa's own tax rates. As such, these results are consistent with the trade theory argument of "no gain without pain"; in this case the "pain" being imposed through the need to replace lost tariff revenue through higher domestic taxes.

Effects of agricultural policy liberalisation on South African agro-food markets are offsetting and relatively small

Liberalising OECD and South African agricultural policies would, to some degree, have opposite and therefore partly offsetting effects on South African domestic markets for crops and livestock. For a number of commodities, the resulting effects of a partial multilateral liberalisation would therefore be rather small. The effects of OECD and South African policies individually are generally more pronounced in dairy markets.

A partial liberalisation in OECD countries would generally result in higher world and domestic prices for most agricultural products and would therefore not only benefit South African producers, but also negatively affect food consumers. However, given the rather marginal size of price changes, the impacts remain small overall. Unilateral South African liberalisation, on the other hand, will have minor effects on world and domestic prices. The relatively little impact of unilateral liberalisation on South Africa's agricultural markets is not surprising given that the binding overhang in South Africa's tariffs leads to relatively little change.

4. Policy challenges and recommendations

Achieving higher and sustained economic growth is crucial for improvements in rural areas…

Although the recent performance of South Africa's economy has been generally positive, both investment and output growth are still below the levels necessary to reduce unemployment and to achieve a more equitable income distribution. Despite growing emphasis on reducing poverty and increasing social spending, enormous social needs remain unmet and a large segment of the population is excluded from the formal economy – as indicated by very high unemployment rates – and has limited access to social services.

Agricultural and rural development in South Africa is not possible without broad economic growth and macroeconomic stability. This in turn calls for well gauged fiscal and monetary policies designed to achieve economic growth above the rates prevailing currently. However, in a country like South Africa, broad economic growth is inconceivable without resolving profound humanitarian problems, such as social divisions, illiteracy and low education levels, and HIV/Aids. These problems are largely rooted in rural South Africa, and agricultural development has an important role to play in their resolution. There is therefore a circular dependence between agricultural and economic growth and human development, which ultimately represents the most difficult challenge facing South Africa's policy makers.

Policies to increase participation in the rural economy and diversify incomes are key to addressing rural poverty…

Rural poverty in South Africa appears to differ from other countries in three ways: among the rural poor, income generated directly from agricultural activities and food consumed from own farm production are minor components of household resources (estimated at 10% to 20% of the total); many households continuously rotate between rural and urban base; and rural society is closely linked to the social and health problems of urban areas. The reorientation of safety net and social programmes in the late 1990s which addressed poverty issues in rural areas through general social security schemes was a move in the right direction.

However, the long-term solution requires involving a greater part of the rural poor in economic activities generating sufficient income. While recognising the important role of agricultural development in addressing poverty and inequalities, it should also be clear that the potential of agriculture and agricultural (land) reform itself to reduce poverty is limited. The current and prospective role of agriculture in the economy and South Africa's relatively scarce natural resources (arable land, water) suggest that only a limited number of people may secure fair living standards from agriculture only. The main potential to reduce rural poverty and inequity lies in the development of overall frameworks providing social security, education and training as well as health care, and in developing adequate infrastructures in rural areas. There is a need to examine how recent and ongoing sectoral and economy-wide policies contribute to poverty reduction by integrating poor population in broader economic activities.

… including development of rural and social infrastructure

Rural economic infrastructure, such as rural transport, telecommunication and information technologies, is crucial for the development of economic activities in rural areas, including commercially sustainable farming. Not all farmers in South Africa have access to the telecommunication and/or electricity networks. Equally important are the provision of social services and investments in infrastructure that will provide a knowledgeable, skilled, healthy, economically active society in rural areas. Just as transport and communication are the priority drivers for economic activity, education, skills development and health are the priority drivers for human capital development and welfare.

Land reform has a long way to go and is facing implementation challenges

Land reform is driven by the need to redress inequitable land allocation which emerged from the apartheid past. There is a broad consensus in South Africa that the land issue needs to be resolved as a matter of urgency, although there is much controversy about the ways this should be done. The key issues are how to *a)* create stakeholder consensus around the implementation strategy; and *b)* improve the procedures of land acquisition and resettlement. If agreement can be reached on a policy framework which allows a menu of options to be pursued, the results can then be monitored, evaluated and modified as the programme proceeds. Clarity is needed about the role and functions of institutions involved and better co-ordination between them. Land reform is a massive, complicated process and not everything can be done simultaneously. The identification of realistic objectives and careful sequencing of activities are conditions for success.

Budgets have become a constraint on the land reform programme. Provincial budget allocations have been overcommitted with the result that in some provinces, new projects cannot be approved and existing projects are jeopardised. Some provinces have put a moratorium on new projects. The costs to government of all the actions required, time scales involved, and fiscal responsibilities of specified government agencies need to be estimated well in advance. Land programme budgets should also be subject to macroeconomic constraints and government prioritising on public spending.

Some of the beneficiaries of land reform suffered defaults, as they were inadequately prepared for running commercial farming in a high risk environment, or were unable to raise sufficient capital for commercial production. The experience thus shows that the proper selection and follow-up of beneficiaries is crucial for land reform to develop sustainable commercial farming. At the same time, training is essential, not only in farm technologies, but also in marketing and financial management. Some retraining of extension personnel could provide this service but the largest potential rests with the current commercial farming sector, and its mentor approach appears a useful route to be supported and developed. Attention is needed to ensure the availability of appropriate support services at the right place, time and cost (*e.g.* financial services, market information and access, purchased inputs, research, and transportation infrastructure).

The overall policy objective would be to have a ready set of complementary land acquisition methods that have been tested and made operational. Governments should add variants, adapted to local circumstances. Legal mechanisms which transfer the ownership directly, or almost directly, from the former owner to the beneficiaries may be considered to avoid a lengthy transfer of ownership during which the State has to ensure the security of the asset "in transit". Land acquisition options need to include the acquisition of subdivisions, rather than whole farms.

… and a more decentralised approach offers promise

South Africa's experience with land redistribution since 1994 confirms the international lessons that underline the need to decentralise and make programmes more community-driven. South Africa's flagship redistribution programme, LRAD, made the important step of decentralising decision-making down to the provincial level, and reaped immediate benefits in terms of speed and the quantity of projects implemented. By bringing them closer to the local level redistribution decisions would become more adjusted with local conditions and the capacities and needs of the beneficiaries. As vertical accountability is relaxed, horizontal and downward accountability, and integration between programmes should be strengthened. The land reform programmes could then become an integral part of the local development plans which in South Africa are the basis for local development budgeting and implementation.

The government needs to keep stakeholders engaged in dialogue around policy implementation. Local government structures, farmers' associations, NGOs, and churches, can assist in a number of ways. They can identify programme priorities, support applicants in accessing the various land reform programmes, and provide follow-up technical assistance to successful beneficiaries. NGOs and research institutions can provide valuable monitoring and evaluation services, and assist in policy development.

Developing a viable small-scale commercial agriculture requires well targeted support services

The dismantling of apartheid implied a strong commitment to develop a new class of black farmers and to integrate them into a market economy. This objective requires considerable investment in human capital and progress in this area has been slow. Smallholder farming, still located mostly in the former homelands, is an impoverished sector, dominated by low-input, labour-intensive production. Low productivity is a major handicap, coupled with tenure insecurity, very small size of land holdings and lack of support services (*e.g.* extension, finance and marketing). The black population in rural areas is the target of the land reform policies, but it is clear that adequate supporting infrastructure must also be in place if these new entrepreneurs are to survive.

The new entrants into commercial agriculture (and into agricultural based services) are at a considerable disadvantage relative to the more experienced operators in facing the challenges of the liberalised market. The government may address these issues by implementing well targeted support programmes and services, including research and development programmes tailored to the needs of the emerging commercial farms. The emerging commercial farmers may also benefit from the experience of commercial farmers, and the government (at different administration level) has a role to play in facilitating the exchange of information and promoting tutorial partnerships.

It is essential for the development of small-scale farms and for the less developed regions of South Africa, to have a financial system able to mobilise savings, allocate capital and monitor farmers, business firms and micro-enterprises. The Micro-Agricultural Finance Schemes of South Africa (MAFISA) was established to provide micro credit and related services to the rural poor. In principle, MAFISA is targeting those who, with the help of the loan, are able to establish a viable business and escape poverty. In this respect, careful client targeting and development/application of transparent selection criteria are of utmost importance to secure longer term financial viability of the programme.

Liberalisation of market and trade policies provide both challenges and opportunities, mainly to commercial farms

During the 1990s, South Africa liberalised its economy including the wide liberalisation of agricultural markets and agro-food trade. Although many sectors experienced a difficult period of adjustment, the deregulation of markets opened opportunities for entrepreneurial farmers and led to a more efficient allocation of resources in agriculture. The net effect of these changes is that the South African agricultural industry has become less dependent on state support and more competitive internationally.

The South African agro-food trade is increasingly integrated with world markets and South Africa is exporting around a third of its agricultural production. In general, the tariffs regime has been simplified and the level of tariffs reduced during the 1900s. In most cases the applied tariffs are well below the bound rates. However, for some products (maize, wheat, sugar) the tariff schedule remains complex (formula tariffs), and applied tariffs are changing frequently. This may create uncertainty for businesses that frequently import goods and isolate the domestic markets from price changes on world markets. A simplification of the tariff structure (as was done for wheat in July 2005) may be considered also for the other products.

Although there is no direct state intervention on the markets, the sugar market is still regulated by the South African Sugar Association (SASA). The sugar producers are subject to quotas when selling on domestic markets and a price pooling system is in place. SASA is also the only exporter of sugar. As a result sugar is the most highly supported commodity in South Africa and the system applied is implicitly taxing domestic consumers. The deregulation of the sugar market may bring benefit to consumers but also may lead to a better allocation of scarce resource in agriculture (arable land and water).

Conclusion

Within the past ten years, wide-ranging reforms created a good base for continuation of efforts to address further, often profound, economic and social challenges facing South Africa. While important progress has been made, there is much more to be done in South Africa to redress social inequalities, reduce poverty, and increase equitable access to economic opportunities for all segments of the population. Balancing more inclusive social policy with a stable and open macroeconomic environment, in which both the role of further agricultural development and the limits of agriculture's contribution are clearly recognised, is the fundamental challenge.

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