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NEVA MAKGETLA: Managing rents in local commodity value chains

Should policymakers try to secure a more developmental and fair allocation among SA producers

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Picture: 123RF/SOLAR SEVEN

International prices for staple foods and industrial inputs — wheat and maize, coal and steel — have been driven by wild speculation in the past three years.

In theory, when global prices surge SA producers should expand their production, ultimately bringing them back to their theoretical competitive level, which is the local cost of production plus a normal rate of profit. In practice, consumer prices for maize and wheat are both up 30% in the past year, while domestic prices for coal rose 13% and basic steel more than 60%.

By definition, in these circumstances local producers are making rents. True, if global prices stayed high for longer, new investors might ultimately step up and domestic prices would fall. The process could take decades, though, and as John Maynard Keynes pointed out, in the long run we're all dead. So that's not a lot of comfort.

In these conditions the question is whether policymakers should try to secure a more developmental and fair allocation of rents. Instruments to that end include taxes on exports or on superprofits, price ceilings and clawback of revenues from import tariffs when domestic prices soar or at least their elimination.

Rents persist for commodity producers for different reasons in different value chains. The poorest 60% of households spend nearly a tenth of their income on maize and wheat products, so the extraordinary increase in 2022 was a blow to working-class communities.

However, on the face of it, the value chain looks reasonably competitive. There are 30,000 commercial farms, though milling and retail are concentrated. Nonetheless, domestic prices track international trends (import parity for wheat and export parity for maize), apparently for two main reasons.

First, farmer associations and the SA grain exchange only communicate international prices, with no comparable index for domestic costs. Second, large-scale millers and retailers avoid smaller producers, which in effect suppresses competition with established producers. Moreover, the government enforces a tariff to protect wheat producers when international prices are low, without an analogous cap when they spike. In the mid-2010s, low international wheat prices pushed the tariff above 50%.

In the steel value chain rents shifted to the ore mines and then back to the refineries over the past decade. Neither allocation benefited the more innovative, diverse and labour-intensive downstream manufacturers. In both cases they paid close to the import parity price.

Speculative increases in international steel prices started with the Covid-19 pandemic in early 2020 and then jumped again when Russia invaded Ukraine. In addition, for much of this period SA imposed a tariff on imports of basic steel goods. In this context increases in domestic steel prices far exceeded those for downstream manufacturers and machinery. Producer prices for metal products and machinery rose 30% in 2022, only half as fast as basic steel.

In coal, through the 2010s the mines increased their share in the rents at the cost of Eskom. The resulting rise in coal prices contributed to the crisis in the national electricity system. In the past decade the international market was mostly flat, but the mines raised the price to domestic users — dominated by Eskom — from about a quarter to more than half of the export price. As a result, in constant rand the average price of coal sold in SA more than doubled from 2005 to 2021, even before the jump in 2022.

The first-best response to higher international prices would be increased domestic investment and production, in effect delinking local prices from global markets. In practice, that takes time. Moreover, it is not viable in steel, where the economies of scale for mining and refineries far outstrip domestic demand.

That leaves it to the government to ensure more competitive prices for downstream consumers, for instance through export taxes on commodities with significant foreign sales, clawback provisions where tariffs protect domestic consumers when world prices are low, or higher taxes on rents.

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