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SOUTH AFRICA'S NEW AGRIBUSINESS AND LAND REFORM POLICY REGIME: A CASE STUDY OF THE WINE INDUSTRY

Norma Tregurtha*

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* Norma Tregurtha is currently employed by the ComMark Trust.

1. INTRODUCTION

Agriculture is an important part of the South African economy and while it contributes less than 4% to the country's GDP, it provides almost 10% of the country's formal sector employment. The sector has, by all measures, relatively large linkage effects with the rest of the economy, and is a major earner of foreign exchange - currently more than 20% of the country's merchandised non-gold exports are primary agricultural products.

Over the past decade far-reaching agricultural policy reforms have been introduced into the sector affecting its structure and performance. Paradoxically, these reforms include both market liberalization and market regulation policies. The deregulation of the marketing of agricultural products coupled with external trade reforms contributed to freeing-up of output markets. At the same time increased labour legislation and the implementation of the country's land reform programme raised the cost of doing business. While the jury is still out, on balance it appears as if the agricultural sector as a whole has gained from these policy shifts. However, as with any policy change there have been both 'winners' and 'losers'. The review presented here will analyze the operational response of the South African wine industry to these changes.

The paper begins by describing the main agricultural policy reforms that have been implemented in recent years and then goes further to document their impact on South Africa's wine industry. The analysis is concluded with the list of recommendations as to how the industry can best be supported to amplify or ameliorate, if necessary, the business impact of these changes.

2. SOUTH AFRICA'S CHANGING AGRIBUSINESS POLICY REGIME

2.1. Opening up of international markets

Until early in 1998, the marketing of agricultural products in South Africa was extensively regulated. Products were either controlled under the one of the 22 different marketing schemes or under separate, industry-specific legislation. The main characteristic of this control was isolation or protection from world market forces. Deregulation occurred in two phases. The first phase took place in the 1980s and was aimed at liberalizing the domestic market while foreign trade still largely consisted of either managing imports and exports to indirectly manipulate domestic prices (e.g. maize, wheat), or of monopoly export schemes (e.g. for fruit). The second phase took place in the 1990s as all restrictive export legislation was systematically repealed and the various industry control boards were dissolved.

The 1993 signing of the Marrakech Agreement at the WTO's predecessor the GATT introduced widespread external trade reforms. The first effect was the conversion of all existing quantitative controls over imports of agricultural goods into tariffs, and followed by the scaling down of those tariffs according to an agreed schedule. Despite the terms of that Agreement, however, South Africa's tariffs in agriculture are now considerably lower than the bound rates agreed in terms of the WTO. The country has also affirmed its position on liberalized international trade by assuming membership of the Cairns Group, thereby signaling its intention to lower tariffs even further regardless of the progress made by the developed countries in reducing farming subsidies and other forms of state support (Vink *et al*, 2002; Vink and Tregurtha 2003).

It must be noted South Africa's own domestic support levels are comparatively low. State resources committed to agriculture have declined significantly over the past 15 years. This is illustrated by the fact that budget support to the sector in the FY 2001/02 was approximately R2.0bn - a 50% reduction compared to 1988 (Tregurtha and Vink, 2002).

2.2. Democratising the agricultural economy

Prior to 1993, South African farm workers were not covered by any labour protection or collective bargaining legislation. Farm life was regulated by paternalism and a set of informal "farm rules" dictated by each farmer - often to the detriment of farm workers. This changed in 1993 when basic employment rights and minimum labour standards were extended to agricultural workers. The rights of farm workers were further strengthened when the Extension of Security of Tenure Act was ratified in 1997. As a result of this act, landowners who wish to evict those living and working on farms can only terminate these rights under relatively strict conditions (Ewert *et al.,* 1998).

Lastly, minimum wages in most South African sectors of the economy are set by industry bargaining councils. However, given that the agricultural sector has never been significantly unionized and could not establish such a bargaining council, the Department of Labour established a minimum wage for the sector, which it implemented in 2003. The regulation of the agricultural labour market described here has impacted on the flexibility and unit cost of farm employment, and as will be shown by the wine industry case study, employees have responded accordingly (Conradie 2004).

Aside from changes in labour policy, South Africa's agribusiness policy landscape has been transformed by the country's land reform program. Briefly, this land reform programme consists of three components: namely restitution, tenure reform, and redistribution. Restitution deals with historical land rights and the return thereof; tenure reform examines forms of land holding; redistribution is focused on the transformation of existing racial biased land ownership patterns.

With respect to redistribution, from 1994 to 1999 this was implemented by means of a Settlement/Land Access Grant (SLAG). SLAG was a small grant (R16,000 was eventually increased to R 20,000) made available to poor households, usually organized in groups, to buy land on the open market. In 2001, the Department of Land Affairs (DLA) revised this programme and launched, Land Redistribution for Agricultural Development (LRAD). The aim of LRAD is to provide financial assistance to black South Africans who wish to farm. It is implemented via a sliding scale grant system ranging from R20 000 to R100 000 per person depending on own contribution (Jacobs et al, 2003).

Between 1994 and 2005, total amount of land delivered through the redistribution program was 1,35 million hectares. This amounts to less than 2,5% of the total agricultural land in South African, and it falls short of its stated target of 30% or 25 million hectares the sector has committed itself to redistribute by 2014. The slow place of land reform has been ascribed to a number of factors including budget constraints of the Department of Land Affairs (DLA), the government department charged with implementation of the land reform. For example, in December 2002 the Western Cape office of the DLA had accumulated LRAD commitments worth over R100 million. However, only R48 million was available from current budgets, and as a result, this office could not accept any new applications for that period ((Jacobs et al, 2003).

The pace of land reform is not only constrained by the budget of the DLA but also by the supply of land. Current policy primarily rests on the open market acquisition of land by beneficiaries and is thus dependent on private owner's willingness to sell. Anecdotal evidence points to a general lack of willingness on the part of these owners to sell their properties, often deterred by the lengthy and bureaucratic process involved in a land reform transaction (Jacobs et al, 2003). The far-reaching political and economic implications of this slow pace of transformation should not be underestimated especially in light of Zimbabwe's recent experience.

3. SOUTH AFRICAN WINE INDUSTRY: RESPONDING TO CHANGE

3.1. From a domestic, insular industry to a world-class exporter

The wine industry serves as a useful case-study that offers insights into the response of South Africa's agribusiness sector to these far-reaching policy changes. South Africa is the world's tenth largest wine producer, accounting for 2.5% of global production (SAWIS 2004). In 2003, the industry produced more than 714 million liters of wine with a market value of R10,675 million. Within the agricultural economy of South Africa, viticulture[1] is the second biggest sector and includes 4 435 wine grape farmers and 505 wine cellars. Large farmer-owned co-operatives dominate wine processing with 66 wine co-operatives responsible for 87% of all white wine and 62% of all red wine production. These co-operatives are supported by 440 smaller private cellars and a limited number of producer wholesalers.

The late 1990s saw considerable foreign investment in South Africa's vineyards, large-scale replanting and quality improvements, leading to a boom in exports. There was an explosion in the number of wineries and wines produced – over 100 new wineries were established between 1999 and 2001. There was also substantial industry investment in information technology, export infrastructure, and distribution facilities. Finally, low production costs have sustained competitiveness of the industry, particularly those wineries producing quality wines for premium price. Consequently, the South African wine industry over the past decade has emerged as a large, dynamic and increasingly export-orientated sector.

This view should be contrasted with the state of the sector in the early 1990s. From 1970-1991 the expansion of the industry was controlled by a wine production quota scheme. This scheme prescribed the total area under vine per producer, and set standard industry prices, which were unrelated to cultivar and quality. Furthermore, with the exception of a few private estates, the majority of wine grape producers belonged to a co-operative and were required to sell all of their output through this government entity that managed the scheme. While the objective of this regulation was to manage surplus production and to maintain artificially high producer prices, it resulted in a domestic-orientated industry, which

[1] Viticulture products includes wine as well as brandy production (rebate and distilling wine), grape juice and grape juice concentrate

encouraged high volume production and rewarded poor quality (Ewert *et al* 1998, Wood and Kaplan 2004).

In 1992, largely as a result of the actions of a group of estate producers, these quota regulations were suspended and over a period of 1992-1997 all remaining industry controls were systematically dismantled. This deregulation allowed domestic producers to begin supplying international wine markets, which had opened up after the sanctions were lifted. The outcome of these positive developments on the industry included:

- The opening up of new growing areas with the potential for quality wine production;
- New entrants brought into industry have displayed a strong sense of entrepreneurship, renewal and innovation;
- A significant number of wine co-operatives beginning to incorporate and initiating marketing and export programmes;
- Shift of the production profile towards higher value red wine cultivars, bringing the industry more in-line with export market demand.

Much of the growth in the South African wine industry has been due to its stellar export performance. From 1992-2003 exports grew at an average rate of 24,4% per annum, and the current export propensity of the industry is 30%. With respect to destination, South Africa's wine exports are heavily concentrated in the European Union, with the United Kingdom absorbing 44% of exports, followed by the Netherlands (18%) and Germany (8%). Focusing on the UK market, for the first time in 2004, South African wines captured more than 10% of the market .

Profitability of export sales has recently come under scrutiny as the industry has had to contend with a depreciating domestic currency. At the end of 2001, the Rand had depreciated to an average of R 12 to the US dollar while the average for 2005 has been R 6.50 – this volatility has made export planning and management highly complex (Conningarth Economists 2004), and has made the industry vulnerable to imports. Current import penetration of wine products into the South African market is very low - estimated at 3.4%. It must be noted that wine imports into South Africa are fairly erratic as imports are typically used as a mechanism to balance production, domestic sales and exports. Furthermore, the local wine industry is well protected from import competition via a MFN duty of 25%, which is significantly higher than the 1.8% weighted average tariff for all South African agricultural products. The implication of this is that the industry is vulnerable to existing and new trade agreements (NAMC 2002).

The transformation of the South African wine industry from a domestic, insular industry to a world-class exporter was not a seamless process, nor has it been completed. In the first half of the 1990s wine grape farmers struggled to adapt to changing international consumer demands which included a move away from table or basic wines in favour of premium wines, and a shift from Old World wines styles towards New World, lighter, more accessible wines. Between 1993-1996, while industry stock levels were at an all time high inflation-adjusted producers income declined for the period. It was only from 1996 that farmers started to significantly increase their plantings of cultivars such as shiraz and merlot (SAWIS, 2004).

Despite on-going investment in new vineyards, the industry's ratio between red and white varieties, and between noble and standard cultivars is too low, given international trends.

Additional problem facing the industry is the increase in the number of wineries, which led to a concomitant increase in the number of South African wine brands. This resulted in a fragmented industry with a limited ability to accrue significant marketing and branding capacity. These challenges have been compounded by the absence of a South African global wine brand such as Australia's Jacobs Creek or France's Mouton Cadet.

3.2. Managing the impact of labour market regulation

Wine industry directly employs 126,000 people while an additional 140,000 people are employed by support industries (Conningarth Economists, 2004). From 1993 to 2002 the South African agricultural sector shed approximately 150,000 jobs primarily in response to the introduction of labour and tenure security legislation. In the wine industry no such contraction was discernable; farm employment remained relatively unchanged increasing from 42,000 in 1993 to 43,712 in 2002. At primary level, wages paid in the wine industry are very low when compared to other sectors. It was thought that the introduction of minimum wage legislation in 2003 to address this situation would lead to job losses. Six months after minimum wages had been implemented, a survey in the wine industry found the net employment effect to be less than 1% (Conradie 2004). The most important consequence of the implementation of minimum wages was not the loss of wholesale labour but rather the slow down in job creation for permanent workers, which took place at the same time when output was expanding.

For the wine industry, the regulation of the labour market has not only affected the rate of job creation but also the flexibility and unit cost of farm employment, and this has led to a number of structural changes in the labour market. Firstly there has been a substitution of permanent labour with temporary and seasonal labour. Two separate surveys found a marked shift away from the employment of permanent workers towards the employment of temporary workers. Reasons cited by farmers as factors inducing this shift include the Extension of Security of Tenure (ESTA) legislation, rising labour costs due to compliance with conditions of employment, and minimum wage regulation (Sunde and Kleinbooi, 1999; Du Toit and Ally, 2002).

Secondly, there has also been an increase in the use of labour contractors. One survey in the fruit and wine sector found that more than 53% of farmers interviewed indicated that they use an agricultural labour contractor. Under these circumstances an employment relationship is no longer directly between a farmer and a worker. Rather, a farmer concludes an arrangement with a broker who then supplies a team of workers. While this externalization of labour offers farmers certain operational advantages such as the ability to control costs and risks, farm workers are adversely affected in terms of their livelihoods and incomes. Rather than being "part of the farm" the relationship between workers and farmers is increasingly an indirect one- limited to cash payment for particular tasks completed. Finally, from a gender perspective the introduction of labour legislation has lead to a relative increase in the number of women farm workers employed. The main reasons cited for this are employers' attempts to maximise the utilization of existing on-farm labour pool and thereby to control housing

costs (Du Toit and Ally, 2002).
The South African wine industry has thus managed to internalize some of the costs and negative impacts of labour regulation by adjusting their employment strategy. It is still too early to assess the overall impact of these changes on the development status of farm workers.

3.3. Struggling to bring about land reform

The wine industry, as is the case with tree crops, is characterized by high barriers to entry in terms of capital, market information and skills requirements. These barriers effectively exclude the majority of black South Africans from participation as entrepreneurs, and have inhibited the pace of land reform in the sector. A survey conducted at the end of 2003 found that from 1995-2003 a total of 425 people had benefited from the South African land reform process and approximately 511 ha of wine grapes had been brought under the control of previously disadvantaged South Africans. In aggregate terms this represents less than 0,5% of all agricultural land under wine grapes (Vinpro, 2004).

Land reform beneficiaries have entered the industry either as groups who collectively own a property or as a joint-venture with an existing industry partner. Joint ventures have proved successful as beneficiaries have been able to leverage-off their partners' capital and industry experience. In recent years innovative solutions to deal with the high capital requirements of the wine industry have come to the fore. These include preferential access to municipal land via long term leases and capitalization of water rights.

The industry has recognized the importance of increasing the pace of land reform, and in 2002 formed the South African Wine and Brandy Company. The mandate of this company is not only to shift the quality profile of the industry by also to assume responsibility for the transformation of the industry. The soon to be legislated AgriBEE charter will give further impetus to this process.

It is unfortunate that the focus of the transformation process in the wine industry has been focused on land ownership. Land makes up less than 10% of the industry's assets and that production of wine grapes produces less value-added than almost every other part of the supply chain.

4. Conclusions and Recommendations

The first democratic government of South Africa committed itself to realizing the twin goals of efficiency and equity. The introduction of policy reforms and regulations into the agricultural sector was an attempt to bring about these goals. In the case of the wine industry, market liberalization led to an increase in efficiency while various labour market regulations did not paralyze the industry. With respect to the pace of land reform, hardly any progress has been made since 1994 and this remains the industry's single biggest obstacle.

Efficiency and equity are not mutually exclusive; a major factor influencing South Africa's ability to grow its international market share is the increasing emphasis developed-country consumers are placing on the origin of products and production processes. For the South African wine industry this translates into concerns about the traceability of its products, employment conditions of farm workers, success of the land reform programme, and other transformation issues.

Aside from its regulatory role, the South African government is tasked with creating an enabling environment for the agribusiness sector so that it can deliver on its growth and equity mandate. Examples of interventions relevant to the wine industry include:

- **Domestic Support**: High levels of domestic support currently enjoyed by South Africa's competitors should be recognized and worked against. Furthermore cognizance should be taken of the potential vulnerability of the industry to existing and new trade agreements.
- **Research and Development**: With respect to research and development, the capacity of the industry has been eroded in recent years due to lack of funds. The government should increase funding available for R&D and technology transfers, and ensure that benefits continue to flow back to the industry, with priority given to emerging producers.
- **Empowerment via Public Private Partnerships**: Where innovative solutions to empowerment have been developed these need to be championed and supported. Access to municipal land via long term leases, capitalization of water rights are all viable policy instruments the government can use to promote such empowerment initiatives throughout the wine industry

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About the Author

Norma Tregurtha is currently employed by the ComMark Trust. She was previously with the Department of Agricultural Economics at Stellenbosch University, where she was responsible for implementing its industry and community-outreach progammes. Norma's research expertise covers e-commerce, trade in natural products, agricultural labour issues and public sector support for agriculture.

Norma is responsible for ComMark's livestock programme and is working in South Africa with the National Wool Growers Association, with TEBA in Lesotho and with the Eastern Cape red meat industry.

Norma has a Masters Degree in agricultural economics from Stellenbosch University.