

Introduction

1. We have been requested by Webber Wentzel, on behalf of the South African Poultry Association (“**SAPA**”), to assess the potential price impact of SAPA’s application to the International Trade Administration Commission of South Africa (“**ITAC**”) to increase ordinary customs duties on certain poultry products.¹ In particular, we have been directed to consider and respond to certain claims made by XA International Trade Advisors (“**XA**”) in its submission to ITAC regarding the likely impact on retail prices associated with this application.²
2. SAPA’s application to ITAC requests increases in ordinary customs duties for bone-in portions (“other”, tariff code 0207.14.9) and boneless cuts (tariff code 0207.14.1).^{3 4} This is summarised in the table below.

Table 1: Tariff headings and subheadings affected by SAPA’s application to ITAC

Tariff code	Product description	Rate of duty applicable (general, EFTA and MERCOSUR)	
		Prevailing	Proposed
0207.14.1 Boneless cuts			
0207.14.1 1	Breasts	12%	82%
0207.14.1 3	Thighs	12%	82%
0207.14.1 5	Other	12%	82%
0207.14.9 Other (bone-in portions)			
0207.14.9 1	Whole bird cut in half	37%	82%
0207.14.9 3	Leg quarters	37%	82%
0207.14.9 5	Wings	37%	82%
0207.14.9 6	Breasts	37%	82%
0207.14.9 7	Thighs	37%	82%
0207.14.9 8	Drumsticks	37%	82%

¹ Webber Wentzel (on behalf of SAPA) application to ITAC for customs tariff amendment: Increase in the rate of customs duty on Frozen Chicken (“**Webber Wentzel/SAPA application to ITAC**”)

² XA. 2019. AMIE comments on the application of an increase in the normal customs duties on bone-in and boneless chicken. 11 January 2019. The XA report was submitted on behalf of the Association of Meat Importers and Exporters of South Africa (“**AMIE**”).

³ Webber Wentzel/SAPA application to ITAC, pp. 12-15

⁴ In this note, those countries that attract no ordinary customs duties – the European Union (“**EU**”) and Southern African Development Community (“**SADC**”) – are termed countries with free trade agreements (“**FTAs**”). The rest – made up of the European Free Trade Association (“**EFTA**”), the trade bloc of South American countries known as Mercosur, and all other importers – are termed non-FTA countries. It is the non-FTA countries to which the proposed increases in ordinary duties will apply.

Tariff code	Product description	Rate of duty applicable (general, EFTA and MERCOSUR)	
		Prevailing	Proposed
0207.14.9 9	Other	37%	82%

Source: Webber Wentzel/SAPA application to ITAC, pp. 12-13

3. XA's submission advances the argument that an adjustment of ordinary duties as per SAPA's application will significantly increase the price of chicken to consumers.⁵ XA assumes that retail prices will increase by **4.7%** for every **10%** increase in tariffs, based on comments made by the Bureau for Food and Agricultural Policy ("**BFAP**") in previous matters.⁶ On this basis XA claims that the proposed tariff adjustment will increase consumer prices for (i) bone-in portions by **21.15%** (due to the shift in ordinary duties from 37% to 82%), and (ii) boneless cuts by **32.9%** (shift in ordinary duties from 12% to 82%)
4. Our brief is to assess the potential price impact of the duties being applied for by SAPA. We do so in three ways:
 - 4.1. We begin by contextualising XA's claims about consumer price increases and focus on the basis for these estimates. We find that these estimates relied on by XA are out of date and that neither XA nor BFAP have offered any substantiation or explanation as to how these estimates have been calculated. There is also no clarity as to exactly which products these estimates apply to nor whether the multitude of dynamics impacting the pass through to retail prices have been adequately accounted for. These shortcomings bring into question the validity of the conclusions reached by XA. This view is confirmed through a more detailed consideration of evidence relating to the likely retail price impact as undertaken in other parts of this note
 - 4.2. Next, we discuss the matrix of factors which determine the extent to which a tariff change may be passed on to consumers. A definitive view about the price impact flowing from a change in tariff level contains several assumptions, many of which are implicit. Without properly identifying and considering the validity of these assumptions, a definitive view of a retail price increase may not come to pass in reality.
 - 4.3. Lastly, we provide a range of upper-bound estimates for the potential impact higher tariffs may have on the retail prices of affected poultry products. This range of estimates takes account of the matrix of factors impacting on the import price. Even on the most conservative basis (i.e. assuming the maximum possible impact), this analysis suggests that the XA assumptions of retail price impact are exaggerated. Under more realistic estimates the pass-through to retail prices from the proposed tariff increases is predicted to be highly diluted and, in some cases, non-existent. These calculations, however, still only reflect upper-bound estimates as they do not account for the role of competition between domestic producers in limiting price increases or of the countervailing buyer power of retailers. Although it is difficult to quantify their magnitude, these factors would dilute any pass-through further still.

⁵ XA. 2019, p. 1

⁶ XA. 2019, p. 1

What is the basis for XA's claimed price increases from the tariff change?

5. The XA submission makes the claim that: (i) the price of chicken is already expensive; and (ii) the proposed tariff adjustments will significantly increase this price further for consumers.⁷
6. XA provides no basis to support the claim that chicken prices are currently expensive. Furthermore, this claim would appear to be inconsistent with general consensus that chicken is considered to be amongst the cheapest source of meat-based protein for South African consumers.⁸
7. In order to determine the price impact of the tariff increase, XA relies solely on a comment from an earlier BFAP note: essentially that a 10% increase in import tariffs will have a 4.7% increase in retail prices.⁹ XA applies this figure simplistically to the proposed tariff changes to conclude on retail price effects. There are a number of shortcomings with this approach:
 - 7.1. XA indicates that the quoted figures formed part of BFAP's comments on the proposed EU safeguard tariffs in 2016.¹⁰ The data used in the submission is also from circa 2016, and the underlying data for the transmission estimate is likely to be from further back in time than 2016. The estimate is therefore somewhat dated. There are questions of reliability for an outdated figure, particularly given that the structure of imports has changed significantly since 2016 with the avian influenza outbreak in the EU and a shift of imports to countries like Brazil and the United States of America ("**the US**").
 - 7.2. The quoted figure from the BFAP note is itself based on unpublished research and merely referenced by BFAP in its note.¹¹ Neither XA nor BFAP have offered any substantiation or explanation of how these estimates of pass-through have been calculated. As such, it remains unclear as to what data was used as well as what assumptions were made in this estimation. It is also unclear as to what estimation model and techniques were used to extract these figures – and indeed whether the parameters of the model adequately accounted for the multitude of dynamics impacting the pass-through to retail prices. The implication of this is that it is not possible for us or ITAC to verify and test the reliability of these estimates. Nor is it possible to ascertain whether the estimates are in any way relevant to the current proceedings. For this reason alone it is our view that these estimates should not be relied on by ITAC.
 - 7.3. In applying this figure, XA has treated all product categories affected by the SAPA application uniformly. This is despite the fact that each product category can have materially different free-on-board ("**FOB**") and retail prices, and therefore proportionally different price impacts depending on the product.

⁷ XA. 2091, p. 1

⁸ See, for example: Delpont, M., Louw, M., Davids, T., Vermeulen, H., and Meyer, F. 2017. Evaluating the demand for meat in South Africa: an econometric estimation of short term demand elasticities. *Agrekon*, Vol 56, No. 1, p. 20

⁹ See: BFAP. n.d. "Key fundamentals underlying the crisis in the South African poultry sector". Written submission to the National Assembly's public hearings on the poultry industry, 23 March 2017. (see <https://pmg.org.za/committee-meeting/24205/>)

¹⁰ XA. 2091, p. 8. (We also note that this BFAP report appears to from part of a 2017 submission by BFAP to the National Assembly during public hearings into the poultry industry see <https://pmg.org.za/committee-meeting/24205/>).

¹¹ Email communication with Dr Tracy Davids, 12 February 2018.

- 7.4. There is also a question about whether the manner in which XA has applied the 4.7% is correct. There is no indication from the BFAP note that its estimate will be linear for tariff increases larger than 10% or proportional when import and retail prices have changed.¹²
- 7.5. Finally, there is uncertainty whether the BFAP estimates can be applied to this situation given that they would seem to be based on an analysis of an increase in tariff for EU producers across all individually quick frozen (“IQF”) products.
8. Evidence of likely pass through to retail prices considered in later parts of this note confirm the inadequacy of these XA assumptions. For example even when we assume a full pass-through of the tariff increase to final retail prices (which is almost certainly likely to overstate the pass through effect), the resultant effective price effects are lower – sometimes by substantial amounts – in comparison to what XA presumes.

What impacts the extent to which a tariff change is passed on to consumers?

9. XA’s *a priori* position seems to be that the tariff increase will necessarily be passed on to end-consumers. It is obviously true that an increased tariff will have an effect on the underlying cost structures of the affected categories of imported product. However, the extent to which retail prices will then ultimately change in response to this cost shift for some importers cannot simply be assumed. Instead, these will depend on a range of other factors.
10. Any impact on retail prices from an increase in tariff will be diluted by the following factors:
- 10.1. *First*, a tariff is imposed on the FOB price of imports and not on the final retail price. The implication is that any tariff increase is diluted in the final retail price. For instance, if the FOB price is 50% of the final retail price then a 30% increase in the tariff can only increase the final retail price by a maximum of 15%.¹³ This is an important point in the current context as the FOB price typically makes up well less than half the prevailing retail price for chicken products impacted by this application (as shown in the table below).

Table 2: Comparison of non-FTA FOB prices with retail prices, Rands/kg

Category	Product	FOB price (excl. current duty)	Retail price (incl. VAT)	FOB price as % of retail price
Bone-in	Leg quarters (0207.14.93)	12.29	32.74	37.5%
	Wings (0207.14.95)	17.64	59.80	29.5%
	Thighs (0207.14.97)	8.55	39.56	21.6%
	Drumsticks (0207.14.98)	12.50	43.98	28.4%
Boneless	Breasts (0207.14.11)	25.87	52.17	49.6%
	Other (0207.14.15)	21.73	56.37	38.6%

Sources: Genesis calculations; SARS/WW import data; SAPA sample retail price data (February 2018)

Note: No retail price data was available for whole birds cut in half (0207.14.91), breasts (0207.14.96), other (0207.14.99), and thighs (0207.14.13).

- 10.2. *Second*, a change in tariff will typically only impact a portion of importing countries due to regional trade agreements. For example in this instance the application for a

¹² The BFAP authors appear to have estimated that a 10% tariff increases (likely using 2016 data) would raise import prices by R1.20 (i.e. by 10%) and that this absolute change of R1.20 would be effectively 4.7% of the then retail price. It is not clear that a linear relationship between these industry levels exists in terms of these percentage changes.

¹³ This illustrative example does not taken into account VAT.

tariff increase does not apply to the key import region of the EU (which has secured duty-free access to South Africa through the Trade Development and Cooperation Agreement)¹⁴ or to other SADC countries. Furthermore, it can be expected that imports will shift to some extent from countries where a tariff increase is applied to these free-trade regions. Thus, the existence of significant import sources which are unaffected by a given tariff increase serves to dilute any impact the tariffs may have on retail prices.

- 10.3. *Third*, foreign producers are often able to respond to higher tariffs by reducing their prices to compensate in some part for the new tariff which is imposed. This is particularly pertinent in the poultry industry where foreign countries are willing to export brown bone-in meat – which is typically seen as less desirable in higher-income markets – at significantly discounted prices to clear excess supply.¹⁵
- 10.4. *Fourth*, domestic producers will continue to face competition from each other in the domestic market. As these domestic producers compete for sale volumes this will restrain the incentive to increase prices as the price of imports rise and the competitive constraint from imports is somewhat relaxed.
- 10.5. *Fifth*, the countervailing power of larger buyers in the retail sector can also limit the pass-through of costs.¹⁶ Economic literature considers this buyer power to be an important force for limiting the ability of suppliers to pass through costs increases downstream.¹⁷ Put simply, “*strong buyer power constrains suppliers’ ability to raise prices, and in many cases obliges suppliers to lower prices...*”¹⁸ Once more this is a very pertinent consideration in this matter as South African retailers largely control access to the consumer, which provides these major retail groups with considerable countervailing power.
- 10.6. *Sixth*, competition also exists between the retailers themselves which can limit the extent to which they choose to raise price (even in the face of a cost increase from suppliers). Furthermore, from a retailer’s perspective the price elasticity of demand for consumers can also affect the extent to which cost increases are passed through. Retailers will carefully weigh up the decision to pass through cost increases for relatively elastic goods as the revenue gains from higher prices can be outweighed by lost revenue from lower sales volumes. Therefore, depending on the price elasticity of demand, it may not necessarily be profit maximizing for a retailer to fully pass through a cost increase.¹⁹

¹⁴ There are however currently safeguard duties in place for imports from the EU – these are however unaffected by the current application.

¹⁵ For example see BFAP. n.d. “Key fundamentals underlying the crisis in the South African poultry sector”. Written submission to the National Assembly’s public hearings on the poultry industry, 23 March 2017. (see <https://pmg.org.za/committee-meeting/24205/>).

¹⁶ Countervailing power or buyer power is defined as “*the ability of one or more buyers, based on their economic importance on the market in question, to obtain favourable purchasing terms from their suppliers*”. See: European Commission, 2002, Glossary of terms used in EU competition policy: Antitrust and control of concentrations.

¹⁷ For instance, the European Commission notes that “[b]uyer power is an important aspect in competition analysis, since powerful buyers may discipline the pricing policy of powerful sellers, thus creating a ‘balance of powers’ on the market concerned.” See: European Commission, 2002, Glossary of terms used in EU competition policy: Antitrust and control of concentrations, p.7. Available:

<http://ec.europa.eu/translation/spanish/documents/glossary_competition_archived_en.pdf> [Last available: 12 February 2018].

¹⁸ O’Donoghue, R. and Padilla, J. *The Law and Economics of Article 102 TFEU*, Hart Publishing, p. 167

¹⁹ For example, see: RBB Economics. 2014. Cost pass-through: theory, measurement and potential policy implications: A Report prepared for the Office of Fair Trading. February 2014, p. 4. Economic theory indicates that even a monopolist does not pass through the full extent of a cost increase if faced with linear demand. Instead, it is optimal for the monopolist to pass through half of the cost increase.

11. In the section that follows, we take account the above dynamics related to the cost of imported products to estimate the upper-bound range of likely retail price impact associated with the SAPA tariff application. We also discuss in more detail the role of domestic producer competition and the countervailing buyer power, although the impact of these factors is not quantified.

Estimated potential impact of the tariff increase on retail prices

12. Whilst it difficult to precisely calculate the likely retail price impact, a consideration of key influencing factors enables at least an upper bound range to be estimated. In the sections that follow we describe the methodology and data used and results obtained from this analysis.

Approach: Methodology and data

13. **Methodology:** The estimates we provide are calculated on three bases:

- 13.1. *Approach 1 – Calculate, in percentage terms, the maximum (i.e. upper bound) potential retail price increases from the tariff change.* In this first case, we assume that average FOB and retail prices will rise by the full extent of the tariff increase. This approach ignores the fact that imports from the EU and SADC will remain duty free due to their existing free trade agreements (“FTAs”) with South Africa.²⁰ Such an outcome would only occur if countries unaffected by the tariff increases and domestic producers were to raise their prices by the same amount as the tariff increase to affected countries.

- 13.2. *Approach 2 – Adjust the potential impact of tariff change downwards by taking into account other import sources.* In this second case, we account for the fact that the portion of imports from the EU and SADC will not attract the higher duty and estimate the weighted average increase in FOB and retail process based on the proportion of import source for each product. These estimates are likely to be more realistic, but are still likely to overstate potential price increases given that they do not include the possibility of trade diversion from non-FTA to FTA countries as well as potential reductions in FOB prices by non-FTA exporters.²¹

- 13.3. *Approach 3 – Further adjust the potential price impact by considering international trade dynamics.* In our third approach, we also try to account for two other key factors in estimating the potential price impacts: the ability of (i) exporters affected by tariff increases to absorb higher duties by lowering their prices and (ii) importers to shift volumes to unaffected trading partners.

14. *Assumptions regarding the response of domestic producers and retailers:* All three of these approaches are premised on the conservative assumption that domestic producers will raise prices in response to higher import prices (and this increase is to the same extent as the cost of importing has increased). In reality, competition between domestic producers and the countervailing power of retailers will dampen this incentive. Although the extent of this constraint is difficult to quantify it will certainly dampen the impact predicted in the above estimations.

²⁰ It also implies that domestic producers raise their prices in line with anticipated increases in import prices.

²¹ These too are predicated on the assumption that domestic producers will raise their prices in line with anticipated increases in import prices.

15. **Data:** We have been provided with the following data by Webber Wentzel, originally sourced from the South African Revenue Service (“**SARS**”):

15.1. *Volumes.* We have been provided with volume data and FOB prices by import country origin for the calendar years 2010-2018. This data has been categorised in various ways, including by import source country and region, and whether ordinary customs duties apply to the import source.

15.2. *Retail prices.* We use retail prices collected by SAPA representatives in February 2018.²² We have averaged the prices collected in this sample as the basis for our average retail prices.²³ (No retail prices were available in the sample for: bone-in portions of whole birds cut in half (0207.14.91), breasts (0207.14.96), and other (0207.14.99); and boneless cuts of thighs (0207.14.13).)

[Drafting note: The retail prices we have used are based on the sample collected by SAPA/Astral since 2018. Should 2019 prices arrive, we are happy our calculations and note to reflect these.]

Results

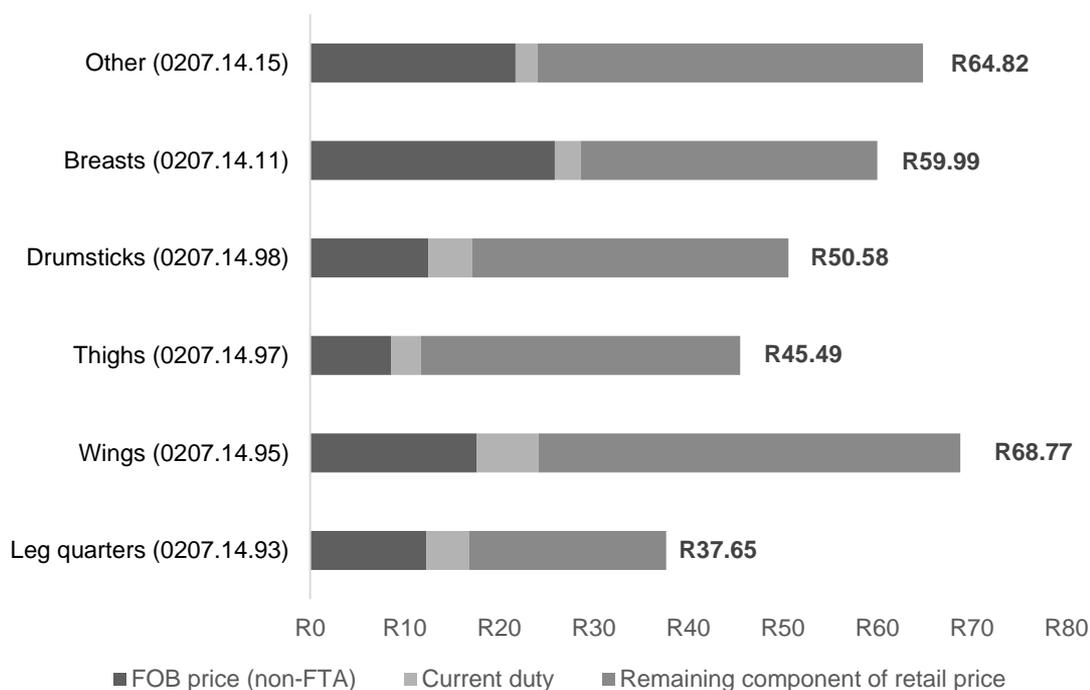
Approach 1: Maximum potential retail price increases

16. In all cases, a tariff is imposed on the FOB price of imports. Given that the FOB price constitutes only a portion of the retail prices (see figure below), the retail prices will increase by a lower percentage than the proposed tariff change. This is because the tariff is applied to the lower FOB price to generate a Rand increase, which even if passed through fully (as is assumed under this approach), will be a lower proportion of the higher retail price.

²² Statistics South Africa (“**Stats SA**”) has its consumer price index (“**CPI**”) for meat (including poultry) relatively stable during 2018, with the index declining by 0.3% from 116.3 in February 2018 to 115.9.

²³ These prices are inclusive of VAT, as we are interested ultimately in assessing the impact on consumers, who have to pay for products inclusive of VAT.

Figure 1: Relationship between non-FTA FOB price, tariff and retail price (2018)



Source: Genesis; SARS import data; SAPA sample retail price data (February 2018)

Note: Retail prices presented above are an average of sample prices collected by SAPA, inclusive of VAT.

17. Assuming that there is full pass-through of the tariff increase on average FOB prices for all dutiable imports into South Africa,²⁴ we can estimate the upper bound of potential retail price increases. Importantly, this upper-bound calculation ignores the fact that EU and SADC imports will continue to enter South Africa on a duty-free basis and instead assumes that these other importers respond with the same change in prices.
18. On the basis of average 2018 FOB price data and a sample of February 2018 retail prices provided by SAPA, the table below shows that for bone-in portions the anticipated range of maximum price increases is from 9.7% to 16.9%. At most, retail prices will increase by:
 - 18.1. 16.9% for leg quarters;
 - 18.2. 13.3% for wings;
 - 18.3. 9.7% for thighs; and
 - 18.4. 12.8% for drumsticks.
19. Even as an upper-bound, these potential increases are well below XA’s blanket increase presumption of 21.15%.

²⁴ I.e., those from non-EU and non-SADC countries.

Table 3: Upper-bound potential retail price increases for bone-in poultry products (R/kg), 2018

Tariff code	0207.14.91	0207.14.93	0207.14.95	0207.14.96	0207.14.97	0207.14.98	0207.14.99
Description	Whole, in 1/2	Leg quarters	Wings	Breasts	Thighs	Drumsticks	Other
FTA FOB price	13.50	12.29	17.64	9.68	8.55	12.50	9.27
Current duty	5.00	4.55	6.53	3.58	3.16	4.62	3.43
Proposed duty	11.07	10.08	14.47	7.94	7.01	10.25	7.60
<i>Effective increase in duty</i>	<i>6.08</i>	<i>5.53</i>	<i>7.94</i>	<i>4.36</i>	<i>3.85</i>	<i>5.62</i>	<i>4.17</i>
Current retail prices	N/A	37.65	68.77	N/A	45.49	50.58	N/A
Possible retail prices		44.01	77.90		49.92	57.05	
Potential price increase		16.9%	13.3%		9.7%	12.8%	

Source: Genesis calculations; SARS/WW and SAPA data

Notes: (1) Retail price samples were not available for whole birds cut in half (0207.14.91), breasts (0207.14.96), and other (0207.14.99). We do not show these products in further tables. (2) Future retail price estimates are inclusive of the increased duty as well as the additional VAT component on the higher duty.²⁵

20. For boneless cuts, the table below shows that the maximum price increases are 24.1% for “other” products and 31.0% for breasts. No imports are recorded from non-FTA countries for thighs, which indicates that there would be no impact from higher tariffs on this product.²⁶

21. These upper bounds – which are highly conservative – all lie below XA’s claim that prices can be expected to increase by 32.9%, with boneless thighs not affected at all (i.e. 0% change).

Table 4: Upper-bound potential retail price increases for boneless poultry cuts (R/kg), 2018

Tariff code	0207.14.11	0207.14.13	0207.14.15
Description	Breasts	Thighs	Other
FTA FOB price	23.10		19.40
Current duty	2.77		2.33
Proposed duty	18.94		15.91
<i>Effective increase in duty</i>	<i>16.17</i>		<i>13.58</i>
Current retail prices	59.99		64.82
Possible retail prices	78.58		80.44
Potential price increase	31.0%		24.1%

Source: Genesis calculations; SARS/WW and SAPA data

Notes: (1) No import are recorded for thighs (0207.14.13) from non-FTA countries. (2) Future retail price estimates are inclusive of the increased duty as well as the additional VAT component on the higher duty.

22. It is worth noting that boneless cuts of breast meat, which are anticipated to have the highest maximum potential prices increases, account for only a small portion of affected poultry product volumes (7.7% in 2018). These are also typically purchased by higher-income consumers (as indicated by their higher retail prices relative to bone-in portions currently).²⁷

Approach 2: Potential price increases adjusted for import origin

23. Imports from the EU and SADC will not be affected by the proposed tariff increase. This is because all EU and SADC imports currently enter into South African on a duty-free basis, in terms of (i) the Trade Development and Cooperation Agreement (“**TDCA**”) between the

²⁵ We note that on 1 April 2018, the VAT rate changed from 14% to 15%. Our workings use a VAT rate of 15% (even though retail prices were collected in February 2018). This is both for simplicity and because 15% is the current prevailing VAT rate.

²⁶ Volumes of boneless thigh imports are very low, relative to other products.

²⁷ Department of Trade and Industry. 2013. Media Statement by the Department of Trade and Industry on Tariff Increases with Respect to Certain Poultry Products. Available at: <<https://www.thedti.gov.za/editmedia.jsp?id=2842>> [last accessed 19 February 2019].

EU and the Southern African Customs Union (“SACU”) and (ii) the SADC FTA between SADC members.

24. It should be noted that safeguard duties were imposed on EU imports of bone-in portions (tariff code 0207.14.9) in September 2018. (Preliminary safeguard duties of 13.9% were imposed during December 2016, and in effect until 3 July 2017.) These will decrease over a period of three-and-a-half years to zero.²⁸ Importantly, this application does not impact the duties payable by the EU.
25. The degree to which total imports of the affected products are currently sourced from the EU and SADC will impact on the potential retail price increases from the proposed tariff change. The share of unaffected import volumes will have prices that are unaffected by the tariff change. These shares are outlined in Table 5 below. It should be noted that much of this prevailing trade pattern has been influenced by the 2017 avian influenza that affected EU producers, which saw more volumes sourced from non-FTA countries than would ordinarily be the case. This makes the estimates presented under this second approach conservative, as it overstates the likely impact. Over time, trade dynamics would likely see more imports sourced from the EU, which will not be impacted by the current tariff application.

Table 5: Share of bone-in and boneless poultry imports from FTA and non-FTA countries (2018)

Tariff Category	Tariff Code	Tariff Description	FTA	Non-FTA
Boneless Cuts	0207.14.1 Boneless cuts			
	0207.14.11	Breasts	0.0%	100.0%
	0207.14.13	Thighs	100.0%	0.0%
	0207.14.15	Other	0.1%	99.9%
Bone in	0207.14.9 Other (bone-in portions)			
	0207.14.91	Whole bird cut in half	55.3%	44.7%
	0207.14.93	Leg quarters	15.2%	84.8%
	0207.14.95	Wings	44.2%	55.8%
	0207.14.96	Breasts	0.0%	100.0%
	0207.14.97	Thighs	70.9%	29.1%
	0207.14.98	Drumsticks	8.5%	91.5%
	0207.14.99	Other	12.5%	87.5%

Source: Genesis calculations; SARS/WW data

26. Replicating our methodology under Approach 1, we can use the shares above as weightings for the degree to which prices of all imports will be affected by the tariff increase. Such an approach implicitly assumes no price increases by unaffected importers from the EU and SADC. (It also assumes no dynamic trade responses – i.e. (i) import diversion to other countries in response to changes in relative prices and (ii) no price decreases by exporters in non-EU countries. We deal with these aspects in the third approach.)
27. **Bone-in products:** On this basis, the impact on retail prices may be as low as 2.8% for thighs (0207.14.97) and up to a maximum of 14.3% for leg quarters (0207.14.93). These are substantially below the blanket increase indicated by XA.

²⁸ The schedule of safeguard duty rates on bone-in portions (0207.14.9) from the EU is as follows: (1) For the ITAC preliminary determination, the safeguard duty was 15% from December 2016 to 3 July 2017. (2) For the ITAC final determination, (a) from 28 September 2018 to 11 March 2019, the safeguard duty is 35.3%; (b) from 12 March 2019 to 11 March 2020, it is 30%; (c) from 12 March 2020 to 11 March 2021, it is 25%; (d) from 12 March 2021 to 11 March 2022, it is 15%; and (e) from 12 March 2022 onwards, it returns to 0%.

Table 6: Potential retail price increases in bone-in portions weighted by import source (R/kg), 2018

Tariff code	0207.14.93	0207.14.95	0207.14.97	0207.14.98
Description	Leg quarters	Wings	Thighs	Drumsticks
Current duty for non-FTA countries	4.55	6.53	3.16	4.62
Proposed duty for non-FTA countries	10.08	14.47	7.01	10.25
Change in non-FTA duty	5.53	7.94	3.85	5.62
Change in FTA duty	0.00	0.00	0.00	0.00
Non-FTA weighting (%)	85%	56%	29%	91%
FTA weighting (%)	15%	44%	71%	9%
<i>Effective trade-weighted increase in duty</i>	<i>4.69</i>	<i>4.43</i>	<i>1.12</i>	<i>5.15</i>
Current retail prices	37.65	68.77	45.49	50.58
Possible retail prices	43.04	73.86	46.78	56.50
Potential price increase	14.3%	7.4%	2.8%	11.7%

Source: Genesis calculations; SARS/WW and SAPA data

Notes: (1) Retail price samples were not available for whole birds cut in half (0207.14.91), breasts (0207.14.96), and other (0207.14.99). These products are therefore not included in the table above. (2) Future retail price estimates are inclusive of the increased duty as well as the additional VAT component on the higher duty.

28. **Boneless cuts:** For thighs, there is no anticipated impact given that there are currently no non-FTA imports of the product. There are no substantive differences in the anticipated price changes compared to the first approach for breasts and other boneless cuts for the opposite reason – effectively all imports for these products currently emanate from non-FTA countries. This is summarised in the table below.

Table 7: Potential retail price increases in boneless cuts accounting for import sources, 2018

Tariff code	0207.14.11	0207.14.13	0207.14.15
Description	Breasts	Thighs	Other
Current duty for non-FTA countries	2.77	0.00	2.33
Proposed duty for non-FTA countries	18.94	0.00	15.91
Change in non-FTA duty	16.17	0.00	13.58
Change in FTA duty	0.00	0.00	0.00
Non-FTA weighting (%)	100%	0%	100%
FTA weighting (%)	0%	100%	0%
<i>Effective trade-weighted increase in duty</i>	<i>16.17</i>	<i>0.00</i>	<i>13.57</i>
Current retail prices	59.99	-	64.82
Possible retail prices	78.58	-	80.43
Potential price increase	31.0%	0.0%	24.1%

Source: Genesis calculations; SARS/WW and SAPA data

Notes: (1) No import are recorded for thighs (0207.14.13) from non-FTA countries. (2) No retail prices were available for boneless thighs. (3) Future retail price estimates are inclusive of the increased duty as well as the additional VAT component on the higher duty.

Approach 3: Further adjustments to potential price increases based on trade diversion and exporter behaviour

29. The estimates presented so far do not take into account changes in the dynamic nature of international trade. In particular:

29.1. *Ability of exporting producers to reduce prices.* Exporters from non-FTA countries may reduce their FOB prices to defend their import shares under the higher tariffs. If exporters absorb some or all of the tariff increase, the potential retail price increases will be lower than those presented in Table 6 and Table 7.

29.2. *Import diversions in response to relative price changes.* As prices of non-FTA imports increase, one can expect a shift in imports to the EU and SADC regions. This

movement will reduce the potential price impact as a greater proportion of volumes will be duty-free.

Export price reductions

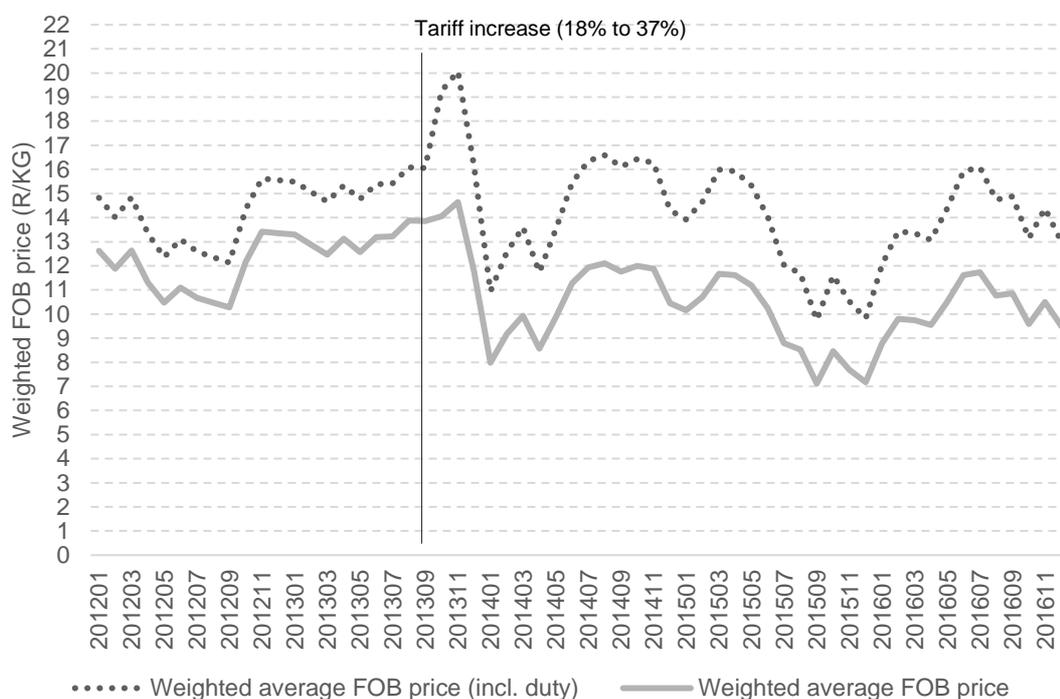
30. Poultry exporters are likely to be able to absorb, at least in part, an increase in tariffs. Foreign countries are willing to export brown bone-in meat (which is typically seen as less desirable in higher-income markets) at significantly discounted prices to clear excess supply.²⁹ This is particularly the case since boneless cuts of white meat typically sell at a premium in their respective domestic markets.³⁰ Therefore it is reasonable to expect that foreign suppliers may well be able to lower the prices of what they export to South Africa in response to a higher duty.
31. The potential for exporters to reduce FOB prices is illustrated in the example of South Africa's imposition of higher ordinary customs duties on non-FTA countries in 2013. In that instance ITAC made a final determination in August 2013 to increase ordinary customs duties on a range of poultry products, including bone-in portions and boneless cuts.³¹ This was implemented by SARS at the end of September 2013.
32. With specific reference to bone-in portions (i.e. the same products being considered here), duties increased from 18% (up to a maximum of R2.20/kg) to 37% as a result of ITAC's determination. The figure below shows the weighted average FOB price (excluding duties) for bone-in portions over time. It indicates that in the months subsequent to the tariff increase, weighted average FOB prices (excluding duties) for bone-in portions from non-FTA countries declined from R13.86/kg in September 2013 when the higher tariff became effective, to as low as R7.98/kg by January 2014, before recovering to R11.76/kg a year later in September 2014.

²⁹ For example see BFAP. n.d. "Key fundamentals underlying the crisis in the South African poultry sector". Written submission to the National Assembly's public hearings on the poultry industry, 23 March 2017. (see <https://pmg.org.za/committee-meeting/24205/>).

³⁰ See, for instance: BFAP. n.d. "Key fundamentals underlying the crisis in the South African poultry sector". Written submission to the National Assembly's public hearings on the poultry industry, 23 March 2017, p. 6

³¹ Affected poultry products were whole bird (0207.12.90), boneless cuts (027.14.10), bone-in portions (027.14.90), offal (0207.14.20) and carcasses (0207.12.20). See: ITAC Report 442. Increase in the rates of customs duty on frozen meat of fowls of the species *Gallus Domesticus*: Whole bird, boneless cuts, bone-in portions, carcasses and offal. 02 August 2013.

Figure 2: Non-FTA weighted FOB prices (excluding and including duties) for bone-in portions, 2012-2016



Source: Genesis calculations; SARS/WW data

33. In order to examine the degree to which export prices declined after higher tariffs were imposed, we have compared the weighted average FOB prices (excluding duties) for three, six and 12 months before and after the introduction of the 37% duty on bone-in portions. The results are shown in the table below. All three time periods point towards a decline in export prices, with the decline for the 12 months subsequent to the 19 percentage point increase in duties estimated at 11.9% as compared to the 12 months before. (Normalised to a 10 percentage point increase in tariffs, this equates to a 6.3% decline in weighted FOB prices.)

Table 8: Change in non-FTA weighted average FOB prices (excluding duties) for bone-in portions (R/kg), various time periods

Bone-in FOB price (R/kg)	3-month period	6-month period	12-month period
FOB prices pre-tariff increase	13.32	13.02	12.67
FOB prices post-tariff increase	13.62	11.13	11.16
Change in prices relative to tariff imposition	2.3%	-14.5%	-11.9%

Source: Genesis calculations; SARS/WW data

It should be noted that we have also considered other situations in which this effect might be seen, such as the introduction of safeguard duties on the EU at the end of 2016. However, this natural experiment is less helpful given that the safeguard coincides with the outbreak of avian influenza in Europe.

34. On the basis of this evidence, exporters may reduce FOB prices in a similar manner in response to future tariff changes such as those being applied for currently. By how much might export prices be expected to decline for a 45-percentage point tariff increase?

34.1. Whilst it is possible to extrapolate percentage changes on a linear basis, doing so may overstate the potential impact. A more appropriate (and conservative) approach in our view would be to use the decline from the previous example as a guide: export

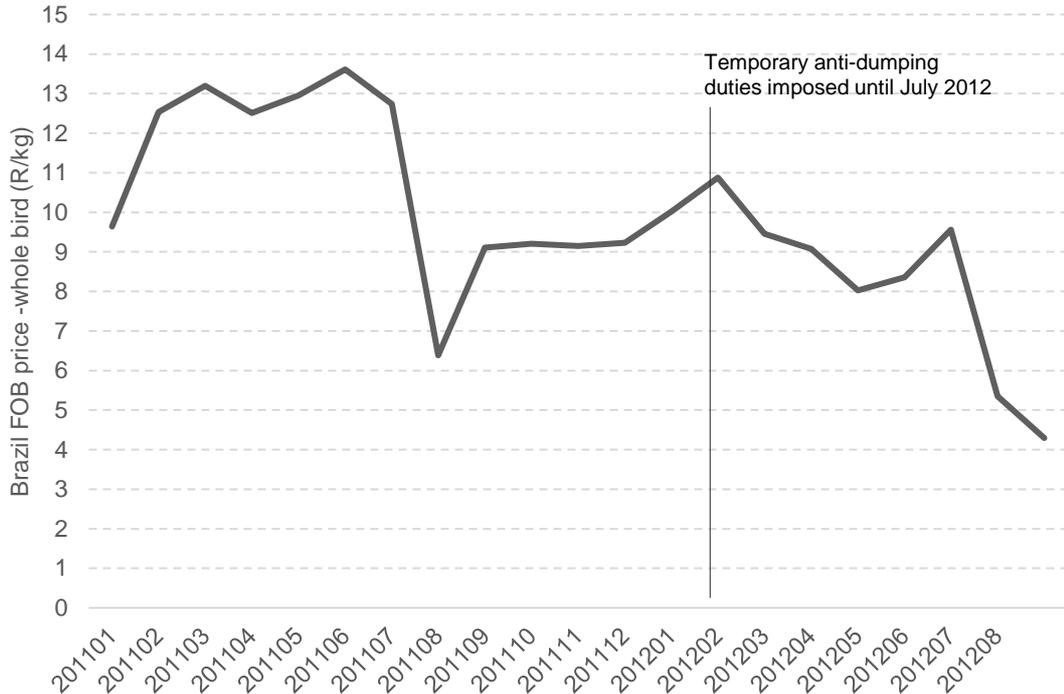
prices might be reduced by the same magnitude as they were following the November 2014 tariff increase, i.e. an **11.9%** reduction for an increase in duties from **37% to 82%**.

35. For boneless cuts, the 2013 ITAC determination only moved the ordinary customs duty from 7% to 12% (i.e. by 5 percentage points). This is a relatively small increase and there is no evident effect in the data of a response by exporters. In order to estimate what the impact a material tariff increase on boneless cuts might have on export prices, we focus on frozen whole birds, which are a similarly premium product as they are relatively expensive compared to other products.³² Temporary anti-dumping duties of 63% were placed on Brazilian exports of these products between February and July 2012.

35.1. Prices for this product are shown in the figure below. Following the imposition of duties on these products, weighed average FOB prices (excluding the duty) fell by approximately 13.5% in the six-month period that the temporary measure was in place as compared to the year prior to their introduction. This is a similar magnitude to the decrease in bone-in portions above. (Normalised to a 10 percentage point increase in tariffs, this equates to a 2.1% decline in weighted FOB prices.)

35.2. Using the same approach as for bone-in portions, we estimate that export prices for boneless cuts might be reduced by the same magnitude as was seen for the 63% increase in duties for frozen whole birds, i.e. a **13.5%** reduction in FOB prices following a 70-percentage point increase in tariffs, from 12% to 82%.

Figure 3: Brazil FOB prices on whole birds (0207.12.90), excluding anti-dumping duties (2011-2012)



Source: Genesis calculations; SARS/WW data ³³.

³² ITAC. 2013, p. 10

³³ It should be noted that we have also considered other situations in which this effect might be seen, such as the introduction of safeguard duties on the EU at the end of 2016. However, this natural experiment is less helpful given that the safeguard coincides with the outbreak of avian influenza in Europe.

Effect of export price reductions on price increase estimates

36. Taking into account only the potential reduction in export prices by non-FTA producers in response to higher tariffs, the potential price increase estimates for bone-in portions will lie between 2.4% and 12.3% depending on the product considered.

Table 9: Potential retail price increases in bone-in portions accounting for export price reductions and trade diversion, 2018

Tariff code	0207.14.93	0207.14.95	0207.14.97	0207.14.98
Description	Leg quarters	Wings	Thighs	Drumsticks
Current non-FTA FOB prices	12.29	17.64	8.55	12.50
Reduced non-FTA FOB prices	11.36	16.30	7.90	11.55
Current non-FTA duty	4.55	6.53	3.16	4.62
Proposed non-FTA duty	9.31	13.37	6.48	9.47
Change in non-FTA duty	4.76	6.84	3.32	4.85
<i>Effective trade-weighted increase in duty</i>	<i>4.04</i>	<i>3.81</i>	<i>0.97</i>	<i>4.43</i>
Current retail prices	37.65	68.77	45.49	50.58
Possible retail prices	42.29	73.15	46.60	55.68
Potential price increase	12.3%	6.4%	2.4%	10.1%

Source: Genesis calculations; SARS/WW and SAPA data

Notes: (1) Retail price samples were not available for whole birds cut in half (0207.14.91), breasts (0207.14.96), and other (0207.14.99). These products are therefore not included in the table above. (2) Future retail price estimates are inclusive of the increased duty as well as the additional VAT component on the higher duty. | (3) We have not included the EU safeguard duties in our weighted average FOB calculations, as these do not affect the ultimate potential price increase estimates.

37. For boneless cuts, the potential price increases will be 26.1% for breasts and 20.3% for “other” cuts.

Table 10: Potential retail price increases in boneless cuts accounting for import sources, 2018

Tariff code	0207.14.11	0207.14.13	0207.14.15
Description	Breasts	Thighs	Other
Current non-FTA FOB prices	23.10	0.00	19.40
Reduced non-FTA FOB prices	19.98	0.00	16.78
Current non-FTA duty	2.77	0.00	2.33
Proposed non-FTA duty	16.38	0.00	13.76
Change in non-FTA duty	13.61	0.00	11.43
<i>Effective trade-weighted increase in duty</i>	<i>13.61</i>	<i>0.00</i>	<i>11.43</i>
Current retail prices	59.99	-	64.82
Possible retail prices	75.64	-	77.96
Potential price increase	26.1%	0.0%	20.3%

Source: Genesis calculations; SARS/WW and SAPA data

Notes: (1) No import are recorded for thighs (0207.14.13) from non-FTA countries. We therefore do not present this product in the table above. | (2) No retail prices were available for boneless thighs. | (3) Future retail price estimates are inclusive of the increased duty as well as the additional VAT component on the higher duty. | (4) We have not included the EU safeguard duties in our weighted average FOB calculations, as these do not affect the ultimate potential price increase estimates.

Import diversions

38. It would be incorrect to assume that higher tariffs on non-FTA imports would necessarily divert non-FTA volumes to domestic producers. In recent years, there is evidence of the major shifts that can occur in import patterns, with substantial growth in non-EU imports (particularly from Brazil and the US) since the beginning of 2017. Pre-existing trade patterns, where the majority of bone-in portions came from the EU, were affected by the

avian influenza outbreak in Europe.³⁴ Over this same period, ITAC also instituted safeguard duties on EU members for bone-in portions (0207.14.9).

39. It is therefore evident that volumes do shift between importers, be it due to changes in relative prices such as those brought about by safeguard duties or from a binding constraint like health-related import restrictions. This is a point recognised by XA.³⁵
40. An increase in tariffs for non-FTA countries in the present case will raise FOB prices relative to those in FTA regions such as the EU and SADC. Relative prices between FTA and non-FTA import sources are therefore key to understanding the extent to which imports will divert from non-FTA to FTA sources after the introduction of the higher tariff. A decrease in the relative price ratio for FTA to non-FTA sources will likely divert trade towards FTA countries.
41. However, it remains difficult to estimate with a reasonable degree of precision the effect of changes in relative price ratios on trade patterns. This is largely because of the multiple variables that influence trade flows at any given point in time (such as exchange rate volatility, health-related production shocks such as avian influenza, and changes in exporter-based production costs and demand characteristics).
42. What are the implications of this for our purposes?
 - 42.1. **Bone-in portions:** The estimates presented in Table 9 above are likely to be overstated to the extent that they do not include the dynamic impact of import diversions away from relatively higher priced non-FTA countries to relatively cheaper FTA imports. Although we are not in a position to estimate this precisely, we note that for every 10% shift in import volumes to FTA countries would reduce potential price increases for leg quarters by 1.4%, wings by 1.2%, thighs by 0.8%, and drumsticks by 1.1%.³⁶
 - 42.2. **Boneless cuts:** Non-FTA imports account for essentially all imported boneless cuts.³⁷ Since 2012, the highest import share recorded for FTA countries in any one month is 10.25%. It is therefore apparent that FTA countries may offer a limited source of boneless cuts. It is therefore difficult to measure the extent to which higher FOB prices for non-FTA imports would divert trade to FTA imports. Again, for every 10% shift in import volumes that were to occur, the potential price increase would reduce by 2.6% for breasts and 2.1% for “other” cuts.

Response of domestic producers and retailers

43. All three of these approaches are premised on the conservative assumption that domestic producers will raise prices in response to higher tariffs (and by the same magnitude as the increase in import costs). In reality competition between domestic producers and the countervailing power of retailers will dampen this incentive. A dampening or even absence of price increases from domestic producers might occur due to one or more of the following reasons.

³⁴ See, for instance, <<http://epamonitoring.net/eu-poultry-exports-to-south-africa-in-the-face-of-avian-influenza-based-export-restrictions/>>.

³⁵ XA. 2019, p. 12

³⁶ These reductions are driven by the shift of volume share to FTA countries, which pay no ordinary duties. This lowers the effective trade-weighted duty, which has a differential reducing effect depending on each product and its current retail prices.

³⁷ As noted earlier, the only boneless cut that is sourced from the EU is thighs and these volumes are relatively small.

- 43.1. Domestic producers will continue to face competition from each other in the domestic market. The poultry industry contains a number of both large and smaller firms that compete for sales to retailers, wholesalers and food service providers. There are at least seven large producers, and these account for only approximately three-quarters of domestic production. The remaining 25% is made up of by scores of smaller players.³⁸ As these domestic producers compete for sales volumes this will restrain any incentive to raise prices. Additional volumes are sought by domestic producers given that they have invested in production capacity but are not currently filling it.
- 43.2. The retail sector is also concentrated and has a tight control over access to consumers. This gives the major retail groups considerable countervailing power over local producers. More than half of all chicken sales go through the retail channel, predominantly comprised of the four largest groups (Pick 'n Pay, Shoprite, Spar and Woolworths) and who source the majority of their chicken products from domestic producers.³⁹ For example, Shoprite Holdings – which is the largest food retailer in Africa⁴⁰ – holds 60% market share in frozen chicken sales according to Nielsen retail data.⁴¹ These retailers all represent crucial channels for domestic producers' products and they therefore likely hold considerable sway over bidding down the prices paid to domestic producers. This countervailing power is further enhanced through the use of competitive bidding for monthly volumes used by retailers and wholesalers where they continually play off the different producers against each other in order to obtain the best price. *[Drafting note: To be confirmed.]* Given the domestic producers' inability to change production in each month, this pushes poultry producers to be competitive or be left with unsold broiler stock.
- 43.3. Retailers themselves compete to sell volumes to consumers which could result in a further dilution of any impact on prices. South Africa's major retail groups have identified that they typically sell frozen chicken products at around cost, and they pay attention to rival retailers' prices.⁴²
44. Although the extent of these constraints is difficult to quantify it will certainly dampen the impact predicted in the above estimations. Therefore the above estimations can only be regarded as upper bound estimates of the likely retail price impacts.

³⁸ Davids, P. 2013. Playing chicken: The players, rules and future of South African broiler production. MSc (Agric) dissertation, University of Pretoria, p. 35; USDA Foreign Agricultural Service. 2013. South Africa Poultry Update: the supply and demand for broiler meat in South Africa. GAIN Report, 29 January 2013, p. 4; Department of Agriculture, Forestry and Fisheries. 2017. A profile of the South African broiler market value chain: 2017, p. 7

³⁹ For Pick 'n Pay and Shoprite, more than 97% is local product (Pick 'n Pay submission to National Assembly poultry industry public hearings, 09 May 2017, p. 5; Shoprite submission, p. 4). All of Woolworths chicken sold in store is locally sourced (Woolworths submission, p. 6). Spar estimates that approximately 80% of its chicken products sold are from domestic producers – see: Ensor, L. 2017. Retailers opt for local product. *Business Day* [online], 10 May 2017. Available at: <<https://www.businesslive.co.za/bd/companies/retail-and-consumer/2017-05-10-retailers-opt-for-local-poultry/>> [last accessed 20 February 2019].

⁴⁰ See: Shoprite Holdings. 2019. Information for Shareholders. Available at: <<https://www.shopriteholdings.co.za/investor-centre.html>> [last accessed 20 February 2019].

⁴¹ Shoprite submission, p. 8

⁴² See National Assembly submissions of Pick 'n Pay and Shoprite.