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**THE TPP AND JAPAN'S AGRICULTURAL
POLICY CHANGE**

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PROCEEDINGS

DR. SOLIS: Everybody is very, very hungry to engage in this conversation with you, but please, everybody, do continue with your lunch. It's such a pleasure to welcome back Yamashita-san. He was here last year and now, of course, a lot has happened since and he's going to give us an update. And the big development is that the TPP negotiations have concluded and we actually now have text, we have market access schedules, we can actually gauge the impact that this will have on Japan, the United States, and the other participating countries.

Yamashita-san is based at the Canon Institute for Global Studies. He also has an affiliation with RIETI and he spent I think 30 years in the Ministry of Agriculture. I consider Yamashita-san the most insightful analyst of Japanese agricultural policy. I learned a lot from his writings and he has addressed a wide range of issues, the modernization, the reform of Japanese agriculture, Japan's position in TPP negotiations, and other trade agreements, and the way forward when we think about the future of Japan's farming. He is a very prolific writer. He puts me to shame because every year when I see him, almost every year he gives me a new book that he has just published. And he also is very active in the debate in Japan, appearing in media, writing op-eds, and so forth.

I think we're very fortunate that he's going to share his views. I asked him if he could cover the following issues, one is an assessment of the outcomes of TPP for Japanese agriculture, two would be a discussion of the TPP countermeasures that the government has revealed, whether it's just déjà vu pork barrel all over again or there is actually a hint of some genuine reform somewhere there, and if TPP is not the final solution obviously for Japan's agriculture, what should be the next steps when we think about reforming the policy regime for Japan's agriculture?

I should also note that Mr. Yamashita-san's remarks are on the record, but when we have the back and forth with all of you that will be off the record so you can be very candid. Maybe we'll have more than we wished for by saying that, but, Yamashita-san, thank you so much.

DR. KAZUHITO: Well, thank you very much. And thank you very much (audio interruption) -- I guess my arguments from the Japanese embassy to the United States and some other corners from the agriculture industry. So, having said that, first of all, I would like to discuss the basic agriculture policy structure and basic agriculture tariff structure in Japan.

As you know, rice is a very important agriculture product in Japanese agriculture and industry as well as Japanese politics. And in order to protect the Japanese farmers, the Japanese government increased the rice price for farmers. Until 1995 there was a system called the Food Control Law. Under the Food Control Law the Japanese government purchased rice directly from farmers. So the Japanese government increased the rice price in order to protect the farmers' income because most of the Japanese farmers are producing rice. But increasing the rice price caused the glut of rice, because the increase of the rice price would cause the increase of the rice supply and decrease the demand for the rice. So we have a huge amount of surplus. So in order to cope with the surplus, the government introduced the acreage reduction or set-aside program in 1970 by giving farmers subsidies for reducing rice production. And right now—the Food Control Law was abolished in 1995, so this acreage reduction or set-aside program is the only policy by which the Japanese government keeps the Japanese rice price high. So the set-aside program is very important for the Japanese agriculture industry, but it's not very important

for the Japanese consumers because the Japanese consumers are forced to pay higher price than the equilibrium rice price.

So by keeping the Japanese rice price very high we remained the inefficient, small-scale part-time farmers in the rice industry. So 64 percent of farmers are producing rice, but those farmers are producing only 21 percent of the total agriculture production in Japan. That means there remain a lot of inefficient small-scale farmers in the rice industry. And those rice farmers—this is the farmer's income and in different categories. In the case of dairy farmers, broiler farmers, or pig farmers, the farmers are getting income mostly from the farming. But on the other hand, when it comes to the rice farmers, most of the farmers' income comes from the earned income working from factories, municipal government, or schools and hospitals, or somewhere else than the farms. Also, the pension is a very important source of income. That means, when it comes to the rice farming in Japan, part-time farmers or retired workers are producing rice in the Japanese rice industry. This is the share of the different incomes among the farmers' incomes. So most of the Japanese farmers are rice farmers and most of them are part-time farmers or retired workers. So then agriculture income used to share more than 60 percent in the total farmers' income, now it's reduced to less than 20 percent, about 15 percent of the total farmers' income. And the non-agriculture income and pensions are playing a more important role in the farmers' income.

There is a cooperative called the JA (Japan Agricultural Cooperatives). And actually the JA is a very unique entity in Japan and it can make any kind of business, including the sales of farm inputs and products, insurance, and banking. And this is the only institution which can do the banking as well as other activities.

So by pegging the rice price very high, JA could not only get high commission in proportion to price, but maintain a lot of small-scale part-time farmers. So the small-scale farmers could deposit their earned income in JA. So now JA turned out to be the second largest bank in Japan. So the high rice price, coupled with the omnipotent capabilities of the JA, makes the JA prosper, although the Japanese rice industry declines.

So that's the reason why JA has made a very vehement opposition to the TPP negotiations, because without any tariffs on rice the Japanese rice price would go down. And then, if most of the part-time farmers get out of the rice industry, they will lose lots of members, so they would lose lots of deposits in their deposits. So that's why they gathered more than 10 million signatures against TPP negotiations. So still they remain opposed to the TPP negotiations.

This is the structure of the tariffs on agriculture products. The tariffs on most of the Japanese agriculture products are very low, but the tariffs on some agriculture products are extremely high because that is the result of the Uruguay Round negotiation. In the Uruguay Round negotiation, according to the modality of the Uruguay Round negotiation, we tariffed the non-tariff measures, mostly import quota systems, and we replaced import quota with tariff, which is equivalent to the difference between the domestic price and the international prices during the base period of 1986 to 1988. During that period, the price differential between the domestic price and the international price was the largest among the major countries, including Japan, the United States, and the European Union. So we introduced very high tariffs and at the time it was called the "dirty tariffication," because the tariff rate is so high, so prohibitive, that no importation could take place.

This is the comparison of agriculture policies. The United States and the European Union have shifted from price support to the direct payment scheme. On the other hand, the Japanese agriculture policy depends on price support policy backed by the huge amount of tariffs. So it is very difficult for the Japanese government to get rid of the tariffs. And if you shift from the price support to the direct payment scheme, we can eliminate tariffs and that means that we can eliminate a huge amount of consumer burden. So eliminating tariff would be beneficial to the Japanese consumers, but as you know the consumers' interests are hardly reflected in any trade negotiations. It's a shame, but that is the reality of the politics.

So having said that, TPP negotiations, the Diet Committees on Agriculture, Forestry and Fisheries made a resolution that the five basic agriculture products—rice, wheat, beef and pork, dairy products, and sugar—must be completely excluded from the TPP negotiations. And the Japanese government was constrained by this resolution. So the outcome of the TPP negotiations is that tariffs on rice, wheat, sugar, beef, butter, and skim milk powder are maintained. On the other hand, tariff-quotas of rice, wheat, butter, and skim milk powder expand and surcharge on wheat within tariff-quota decreased by 45 percent, and tariffs on beef and pork decreased, but it is accompanied by the safeguard. And tariffs on whey and cheese are limited. So some of the tariffs on the basic five agriculture products are eliminated. So still there are lots of arguments against the TPP negotiations saying that the Japanese government could not fulfill the objectives of the Diet's Agriculture Committee's resolutions. So the Japanese government is facing strong opposition from the agriculture sector.

So when it comes to beef, actually, we liberalized our import quota systems in 1991 and at the time we introduced a 70 percent tariff rate. Through the Uruguay Round negotiation, now we have a 38.5 percent tariff rate on beef. But actually the production of *wagyu* beef has increased. And actually there is a shift from the Holstein beef, milk cow beef, to the *wagyu* beef. And what is happening is that Japanese dairy farmers transplant fertilized *wagyu* eggs in milking cows, so we can get a *wagyu* calf out of Holstein milking cows. So the Japanese beef production has shifted to *wagyu*, which is less affected by imported beef. Now the Japanese beef price is record high. And thanks to the increase of the imported beef price from the United States and from Australia, well thanks to the current exchange rates, imported beef price increased. So the domestic beef price increased too.

Actually, there is an argument about currency manipulations, but 10 years ago Japanese exchange rate is almost the same as right now. And the Japanese currency appreciated 50 percent about 2 years ago. And I don't know that there is a currency manipulation by the United States or not, but Japanese currency appreciated. But recently it devalued 50 percent. So if the Japanese beef industry survived the current exchange rate two years ago, then the Japanese beef industry couldn't survive right now without 38.5 percent tariff rate because the currency devalued 50 percent from 2 years ago.

So this is a very complicated import tariff system on pork. Below the gate price, that is 524 yen per kilogram, high tariffs are imposed on low quality pork but above the 524 yen per kilogram, ad valorem tariff rate, which is currently 4.3 percent, is levied on imports. But actually what kind of imports is taking place is that trading companies combine high quality, high priced pork and low quality pork and make the average price exactly at the price of the gate price, 524. And by doing so they can pay the least tariffs. So actually what they are paying is nothing but 4.3 percent. So they are not paying very high tariff rates on low quality pork. And what is going to happen after the TPP negotiation is that specific duty, 482 yen per kilogram,

would be reduced to 50 yen per kilogram and the ad valorem tariff rate, 4.3 percent, would be abolished, would be eliminated. But the actual way of importation will not change very much. So the importers would continue to import at the price of gate price. So they would mix high quality pork and low quality meat and import exactly at the price of 524 yen per kilogram. So that means actually the tariff would be reduced from 4.3 percent to 0 percent. What makes so much difference between the 4.3 percent and 0 percent? Actually, that doesn't affect the Japanese pork industry very much.

The Japanese government, the Ministry of Agriculture, Forest and Fisheries, announced that it would strengthen the deficiency payment program for beef and pork. First of all, the amount of deficiency payment for beef and pork would be increased from 80 percent of the difference between the guaranteed price and the market price to 90 percent of it. And also this deficiency payment is made from the fund which the government and producers make contributions to it. Now in the case of pork, 50 percent of the fund is born by the government. So now the Japanese government is trying to increase the 50 percent to 75 percent, just like beef fund. These deficiency payments would become permanent measures by being stipulated in the law. I understand that there is some criticism from the pork industry in the United States that this would diminish the effect of the reduction of the tariffs on pork. I think I'm the last person to defend the Japanese agriculture policy, but I'd like to point out three things.

This is a kind of a defensive policy. If the price goes down from the guaranteed price, then the Japanese government would pay part of the price difference. So it does not try to increase, stimulate pork production, it is trying to maintain the pork production. Secondly, this deficiency payment has been put in place for a long time and it does not affect U.S. export of beef or pork to the United States. Lastly, the Japanese Agriculture Minister and the Japanese Ambassador to the United States made an argument that this deficiency payment subsidy is well within the limit which is allowed in the Agreement on Agriculture of the WTO that is—this is Amber Box policy, but it is within the limit of AMS, called aggregate measurement of support. So the Japanese government is free to give such kind of subsidies to domestic farmers.

But this argument is completely wrong. I strongly disagree with them because if you read the articles in the Agreement on Agriculture, then there is an article, Article 1F, which means that the peace clause in the Agreement on Agriculture has already been expired. That means that rules and disciplines on agriculture subsidies in the Agreement on Agriculture do not apply to agriculture subsidies at all. That means subsidy and countermeasure agreements directly apply to the agriculture subsidies. So there is a very famous case, U.S. cotton case, and according to the appellate body's judgment, price contingent subsidies are subject to countermeasures. So if U.S. pork industry or beef industry are affected by these subsidies, then USTR could be free to take those subsidies to the WTO's dispute settlement bodies. So you don't have to argue against it right now. If there is damage after the implementation of the TPP agreements, then you can take this subsidy to the WTO dispute settlement and you can eliminate this kind of subsidy.

This is the schedule of tariff reduction on beef. This is the case when TPP goes into effect in 2017. But if you delayed the ratification of the TPP—actually, the longer the delay of the ratification of the TPP, the more disadvantaged the U.S. beef industry is than Australian beef industry, because Australia could get a better position by the Japan-Australia new free trade agreement. The dotted line is the tariff reduction line by the Japan-Australia free trade agreement.

So rice and TPP agreement set a new country specific tariff quota, 70,000 tonnes TRQ (tariff-rate quote) for U.S. Actually, right now, there is a tariff-rate quota, 100,000 tonnes tariff-rate quota for direct human consumption. And if there is a price differential between the domestic rice price and the Californian rice price, this tariff-rate quota would be filled completely. So actually in normal cases the fill rate of this TRQ used to be 100 percent, but in the fiscal year 2014 the fill rate reduced to 12 percent. The reason why the fill rate dropped so sharply is that the price differential between the Japanese domestic rice price and the Californian rice was actually eliminated and reversed. So last year I met with a person from the Japanese trading company and he said that the Japanese rice price is less expensive than California rice, so they are thinking about exporting Japanese rice to California. Well, things have changed very much, but because the Japanese rice price dropped, due to the declining demand for rice, and the California rice price increased, thanks to the depreciation of the Japanese yen, the fill rate dropped to 12 percent.

This year Japanese rice price goes up thanks to the Japanese set-aside policy. What happened to the set-aside policy is that Japanese government increased the set-aside subsidy for producing rice for feed use. So now for the Japanese farmers to produce rice for feed use is much more profitable than producing rice for direct human consumption use. So the production of rice for feed use increased. That means that the supply of rice for direct human consumption use declines, that means the price for direct human consumption uses increases. So the price differential was eliminated, but the price differential re-emerged. So U.S. rice producers could export more rice to the Japanese market, taking advantage of the newly created country specific tariff-rate quota. But I don't think that's the end of the story. Increase of the rice production for feed use could replace imports of corn for feed use from the United States. And then it could damage the U.S. corn industry. If I were a public official of the USTR, I would take this subsidy to WTO and the United States is sure to win the case. Then the United States could retaliate on Japan by imposing high tariffs on automobiles from Japan. That is the very worst scenario, but legally speaking, it can happen. So, I don't know. I'm not forecasting the future very well, but if such kinds of subsidies damaged the interest of the U.S. corn industry, I think there may be such a kind of solution to it.

Lastly, I'd like to talk about the dairy sector. Lots of people say that the U.S. dairy industry are not satisfied with the outcome of the TPP negotiation. But in my opinion there is only one industry in Japanese agriculture which may be affected by the outcome of the TPP negotiations, that is the dairy industry, because we are going to eliminate tariffs on cheese. For cheese production more than 10 percent of the raw milk is destined for the cheese production, out of the milk for processed products: butter and skim milk powder and cheese. And we are going to eliminate tariffs on whey. Whey is a strong substitute of the skim milk powder, and skim milk powder is a major dairy processed product in Japanese agriculture. That means if U.S. whey completely replaced the Japanese skim milk powder production, 3.5 million tons of milk out of total 7.3 million tons of milk production would be wiped out. So the Japanese milk production would get a very hard time by the TPP negotiations. That's a possibility. But I don't know what is going to happen to the Japanese dairy industry, but this is what I think about the outcome of the TPP negotiations.

Thank you very much.

DR. SOLIS: Thank you very much, Yamashita-san. That was very insightful and very interesting.