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C O L U M B I A U N I V E R S I T Y I N T H E C I T Y O F N E W Y O R K

Rethinking the Growth Strategy: Competition is the Way toward Strengthening Agriculture¹

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Abstract

Japan's dairy industry is under heavy governmental regulation. This has serious consequences; for instance, controls on the imports of butter leads to periodic butter shortages. The collection of raw milk from farmers is monopolized by agricultural cooperatives in the region, which blend the raw milk from many farmers and sell it to dairy processing firms. Therefore, there is no opportunity for farmers to save money, increase quality and reap the benefits of a higher quality product. Regarding pork, Japan's tariffs are highly irregular. Japan imposes a specific tariff of ¥482 per kilogram on inexpensive pork parts imported at a CIF price less than ¥64.53 per kg. For imported pork at the CIF import price, which is between ¥64.53 and ¥524 per kg, Japan uses a "gate price system" in which the tariff equals the difference between the benchmark price of ¥546.53 and the CIF import price. Imported pork products that are more expensive than the ¥524 per kg (expensive pork parts) are subject to a conventional ad valorem tariff of 4.3%. This system maintains a domestic price of at least ¥524/kg regardless of quality. It also produces a huge incentive to lie about the true import price. Another incentive is to mix expensive and cheap pork parts to reduce the average import price to ¥524 per kg in order to minimize tariffs to be paid. This system discourages Japanese farmers from producing high quality pork, since expensive imports may be sold cheaper as part of the mixed pork shipment. Agricultural reform should be fundamental, not cosmetic, since the whole system needs to be overhauled. The realization of "Strengthening Agriculture" through Abenomics depends on the success or failure of these reforms.

¹ This article is a translation, with some addition and modification of an article which appeared in the Nihon Keizai newspaper (Japanese) on January 23, 2015.

Rethinking the Growth Strategy: Competition is the Way toward Strengthening Agriculture

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1. Dairy products

Japan continues to face a butter shortage and this is not the first time such a predicament has happened. In 2008, there was a severe lack of supply of butter and emergency imports were necessarily conducted in 2010. Why does Japan face this dilemma time and time again? Many readers may think that the simple solution to this butter shortage would be to import more butter.

In actuality, the imports of butter are de facto monopolized by an independent administrative agency called the “Agriculture & Livestock Industries Corporation.” The supply and demand of many manufacturing products, resource commodities, and agricultural products are adjusted due to the price changes in the international market, and a supply shortage in the long term will not occur. The attempt to control the production volume, the distribution system, and imports in order to balance domestic demand and supply of dairy products often demonstrate the cracks in the system, as this tight quantity control fails to adjust with the dynamic nature of supply and demand.

Raw milk production in Japan is regulated by the Ministry of Agriculture, Forestry and Fishery, which divides the production in Japan into 10 regions. For each region, an upper limit is set as ordained by the “Regulation by the Designated Raw Milk Producer’s Groups”, which keep monthly tabs on the production of raw milk. Essentially, they are regional federations for agricultural cooperatives. A dairy farm is, in principle, required to sell all raw milk to the agricultural cooperative to which each farmer belongs to. The agricultural cooperative negotiates with dairy processors and sells raw milk at varying prices depending on its final use (for drinking milk, powdered milk, butter, cheese, etc.).

Raw milk producers with low-priced processed milk products, such as butter, receive subsidies that supposedly make up the difference between the price for milk drinking use and for butter use. However, dairy farmers are not eligible for

subsidies if they exceed the upper production limit. The price of raw milk to be sold to processors is revised annually, which is affected by the changes in the cost of production in previous years.

The agricultural cooperatives are monopolizing raw milk distribution between dairy farmers and dairy processing companies. This means that the dairy farmers cannot innovate their products through branding the quality or taste of the milk because their products are ultimately pooled together with other farmers at the hands of the agricultural cooperatives. From this current stance, where the dairy market is controlled by the strict surveillance of supply and import regulations, milk producers do not have the means and incentive to differentiate their products through high quality branding, to plan exporting, or to generate new and creative ideas for their products. The only choice for the raw milk producers to brand their products is to leave the designated organizations system, and become the so-called “outsiders.”

If we think of the history of rice de-regulation as analogous to the raw milk, the current state of raw milk fits the times before 1969, the year when rice distribution was opened to non-government channels. The serious shortage of butter has deep roots in the “economic planning” system à la socialism.

In order to prevent a butter shortage and allow for production of high-quality dairy products, a systematic deregulation of the dairy industry is necessary. Especially important in this process is the introduction of competition in the raw milk distribution. The origins of the current system lie in the old practice where dairy processing firms refused to buy raw milk. But this can be prevented by the use of advanced information technology in supply and demand, introduction of long-term contracts between dairy farmers and processing firms, and, in general, efforts to secure a competitive environment and price mechanism for the dairy industry.

In China, milk is imported from Australia using expensive airplane tankers, and sold at a price four to five times more expensive than the locally produced milk. It is obvious that the high quality and safety levels of Japanese dairy products will have a high demand from the Asian middle class. Therefore, efforts to brand Japanese products as such and to find foreign markets, is essential for the prosperity of this industry.

In order to promote exports, deregulation regarding imports of dairy products is also necessary. The ideal image is to discard the current system of the state-controlled imports of dairy products, and shift to a straight tariff system, while also gradually lowering the tariff rates. Products such as butter could be provided to the consumer with competitive international price, and the efforts should be placed in revitalizing the dairy market by improving the quality of domestically-produced cheese and drinking milk with selective high quality.

In the case of dairy products, the key to “Strengthening Agriculture” as professed in Abenomics, is to dismantle the monopoly of agricultural cooperatives in the raw milk distribution process, as well as introduce competition in the production and distribution of processed dairy products. If we can transform the dairy market from the current socialistic economic planning system to one with an environment of competition through innovation and product quality, the dairy market can emerge as an export industry for Japan.

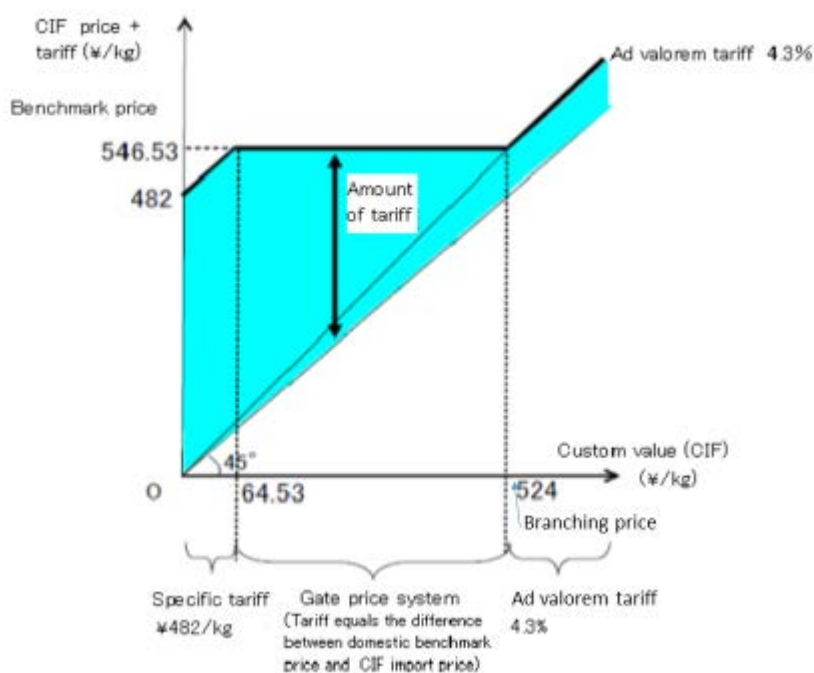
The import barrier for beef underwent tariffication from a quota system in 1991 after the “Beef-Orange War” in the 80s, when the customs duty rate was initially 70% and then dropped to a staggering 38.5% (The conventional tariff rate is 50%). The initial reaction to this lowered tariff rate was that the domestic beef cattle farms would sustain a destructive blow. This, however, did not happen. In reality, the domestic beef market was revitalized through competition, and price diversification developed according to their production location, quality, and the cut of the beef. The beef market is moving in a direction in which cheaper beef parts are imported, and domestically produced high-quality brand beef are exported.

In the past, moments of crisis such as the BSE problem in Japan and the United States were managed by acquiring supply internationally, and a diversified source of beef suppliers for the Japanese market was bountiful. In the future, the advantages seen in the domestic high quality brand beef will not only stand firm in the face of FTA and TPP agreements, but will also create increasing export opportunities.

2. Pork Tariff

Although pork is in the same livestock industry, it has not advanced as much as beef in terms of production innovation as well as branding. One large reason is because of the pork-specific tariff system.

Japan's tariffs on pork are highly irregular (nearing violation of the World Trade Organization's (WTO) principles). Japan imposes a specific tariff of ¥482 per kilogram on imported pork (sub-primal) of CIF import price, which is less than ¥64.53 per kg for cheap pork. For imported pork (middle-priced pork) of CIF import price, which is between ¥64.53 and ¥524 per kg, it uses a "gate price system" in which the tariff equals the difference between the benchmark price of ¥546.53 and the CIF import price. Imported pork products that are more expensive than the branching point of ¥524 per kg (expensive pork) are subject to a conventional ad valorem tariff of 4.3%.



The intended purpose of this system, according to the Ministry of Agriculture, Forestry, and Fisheries (MAFF), is to prevent cheaply priced foreign pork products from being widely circulated domestically, and to protect domestic producers.

Within this system, there is a large incentive to falsely state the import price higher

than the actual price, in order to illegally avoid paying the high tariff. The system of the gate price system, as opposed to the ad valorem tariff, is problematic in that it creates large incentives for the importers/exporters to evade the tariff. If the import price is below the benchmark price, falsifying the import price by 100 yen higher, this will result in profits of 100 yen. Tariff evasion in pork imports have been reported quite frequently and it has taken a deep root in the nature of this system.

In addition, methods called “Combination Importation” have been commonly adopted, in which expensive and cheap parts of pork are mixed together in order to bring the product price closer to the benchmark price. This is a legal way of minimizing tax payments. Those who suffer from this are the domestic producers of high-quality pork, since the high price parts will be “dumped” to the high-quality pork market. A crucial drawback of this system is that it is not protecting the producers in which the system is supposed to protect.

The chaotic situation of this system can be improved if the “Gate Price System” is replaced by ordinary ad valorem tariff rates for different pork parts, regardless of how cheap or expensive the price is. It would further be ideal if the tariff rates can then be removed. Then an efficient production will be achieved combined with a new system of stipends for domestic producers to ensure minimum income. The Japanese government must not gear their political power and economic resources around the concept of “protection” concerning agricultural products, but must devise policies that promote exports through branding and securing distribution.

3. Conclusion

Thus far, the problems and solutions introduced have been mainly about the dairy product and livestock industry (especially pork), but the same problem exists in all agricultural products that are protected by high tariffs.

Even if certain products and farmers are to remain protected for political reasons, it is extremely important that for the mid to long-term, policies should be formed to strengthen domestic agriculture through the promotion of efforts for innovation and production efficiency. Instead of tariffs, protection of the producers through direct income support will lead to similar benefits for farmers yet decrease the burden of the tax payers. As a byproduct, these will have positive influences for FTA and TPP

negotiations as well.

This new system of changing the shape of protection, allowing growth for the creativity of the agricultural producers, and promoting competition is an aspect of the new agricultural reform set out by the government.

The role of the local agricultural cooperative is to support the members with their efforts showing the local originality and advantage depending on the varying situations of the regions and focus on further developing innovation for local agriculture. This can transpire through the freeing of local agricultural cooperatives from the power of national and systematic regulation through the Central Union of Agricultural Cooperatives, and by departing from a management system that relies on finance and insurance businesses. The federations for raw milk distribution are in principle made up of members from the local agricultural cooperatives. Management is currently conducted in the same manner nationwide, and reform is necessary in order to take advantage of regional strength and differences, both in its products and nature of production.

Agricultural reform should not be cosmetic, but more at a fundamental level so that there is change in the nature of the whole system. The realization of “Strengthening Agriculture” through Abenomics depends on the success or failure of this reform.
