

Reform Is Vital for Survival of Japanese Agriculture



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Japanese Agriculture in Decline

Agricultural groups in Japan argue that Japan's participation in the Trans-Pacific Partnership (TPP) talks would lead to the destruction of Japanese agriculture. As in past trade negotiations, agriculture seems to be a big impediment for Japan in the TPP talks.

A lot of Japanese Diet members believe that five items — rice, wheat, beef and pork, dairy products, and sugar — should be considered as exceptions to tariff eliminations and if not, Japan should not hesitate to leave the negotiating table. If the other countries involved in the TPP negotiations do not approve so many items as exceptions, then Japan would eventually ask for approval of just rice as an exception to tariff elimination, since rice is regarded as the most important and sacrosanct part of Japanese agriculture.

But whether or not Japan joins the TPP, Japanese agriculture is in decline.

Total agricultural production, having peaked in 1984 at 11.7 trillion yen, has continued to decline and is now around two-thirds of that amount, namely 8.2 trillion yen. Agricultural income declined by almost half from 6.1 trillion yen in 1990 to 3.2 trillion yen in 2010. It is notable that the decline in rice farming is the most significant, as shown by the fact that the share of rice production to total agricultural production has fallen from around 50% in 1960 to less than 20% in 2010. By contrast, the share of agricultural workers aged over 65 rose from 10% in 1960 to 60% in 2010.

Farmland, considered to be indispensable for food security, totaled around 6.1 million hectares in 1961. With an additional 1.1 million ha developed by public works since then, total land should have reached 7.2 million ha. But there remains in fact only 4.6 million ha, as around 2.6 million ha have disappeared, more than all the existing rice fields and the 1.9 million ha released to tenant farmers on the occasion of agricultural land reform in 1947. Of the 2.6 million ha which have disappeared, half have been abandoned and half converted to other uses.

In 2010, the amount of abandoned agricultural land expanded to 0.4 million ha, due to a decline in agricultural income. If agriculture does not pay well, the amount of abandoned land will increase. When agricultural income declines, the children of farmers do not want to succeed to their parents' business and so the parents have to continue working, pushing up the farming population age.

Thus both the increase in abandoned land and aging farming population proceed simultaneously due to the decline in agricultural income.

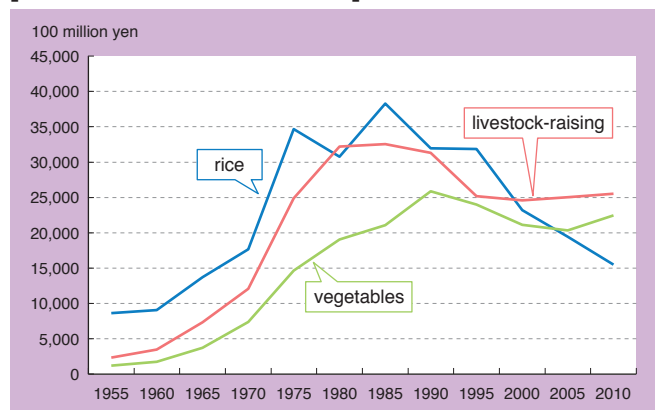
Why Is Rice Considered a Sacrosanct Item in Japanese Agriculture?

Rice used to be the principal food of the nation and at the center of Japanese agriculture. However, compared to 50 years ago, the proportion of rice production to total agricultural production, which used to be 50%, has now fallen to less than 20% and consumption per capita has declined by half over the same period. Its importance as a food is decreasing not only in Japanese agriculture but also in daily life. In spite of this, rice is considered a sacrosanct item to be protected in trade negotiations. Japanese agricultural cooperatives seem to be playing an important role in pushing for protectionist measures in trade negotiations.

Looking back at the history of agricultural cooperatives in Japan, during the era immediately after the end of World War II when Japanese people found it difficult to obtain food supplies, farmers sold their rice crops on the black market rather than to the government, since prices on the black market were higher. But if this were allowed to continue, the governmental rice rationing system for the benefit of poor people would not work well. So in order to avoid this, the government transformed the war-time organizations which during the war conducted and operated all such agricultural business — including sales of farm products, purchases of related materials, and finance for farmers in villages — into agricultural cooperatives and attempted to use them as organizations for forcing farmers to sell rice to the government. This is why Japanese agricultural cooperatives work so closely with rice farmers. They also maintain a monopolistic status in their villages, symbolized by the fact

CHART 1

Changes in Japanese agricultural production amount per item



Source: Ministry of Agriculture, Forestry and Fisheries

that their sales share of fertilizers is 80%, partly due to the traditional village management systems that originated from the rice farming business such as joint management of water supplies.

One of the biggest reforms ever undertaken in postwar Japan was reform of agricultural land. The government purchased a piece of land at a very low price from the landowner and sold it to tenant farmers. By endowing tenant farmers with the ownership of agricultural land, the government successfully eliminated the socialist or communist groups that supported the interests of peasants before the war from villages, and the village farmers all became conservative. The agricultural cooperatives organized farmers and began to support conservative political parties in elections. The Liberal Democratic Party (LDP), the most powerful conservative party in Japan, began to support Japanese farmers led and organized by cooperatives by raising the price of rice and providing subsidies.

Reasons for Decline of Japanese Agriculture

Until 1995, the Japanese government had continued to purchase rice from farmers and then sell it to wholesalers, thereby ensuring revenues for the rice producers. This had been implemented on the basis of the Food Control Law, though the law had lost its original objective of providing food evenly to the nation including the poor in the event of food shortages.

In this system, agricultural cooperatives obtained sales transaction fees in proportion to the sales of the products. They would keep the high profits achieved through the higher price of rice under this law than on the black market, since the farmers would find it less profitable to sell rice on the black market than to sell it to the government through the agricultural cooperatives. With the high price of rice, the cooperatives could also sell fertilizers or agriculture machinery to the farmers at a high price, raising their revenues even further. Even after the law was abolished, a price of rice higher than the international level or the equilibrium price has been maintained by the set-aside program which reduces rice supplies.

As the scale of production increases, costs decline and incomes (equal to sales minus costs) rise. But due to this set-aside program, small farmers facing high production costs that should have pushed them to exit from the market have continued to produce rice thanks to the high rice price maintained by this policy.

Since such small farmers remained in the market, their farmland was not leased to relatively large-scale full-time farmers whose principal revenue sources came from agriculture, with the result that those full-time farmers could not expand their farm size and reduce their costs.

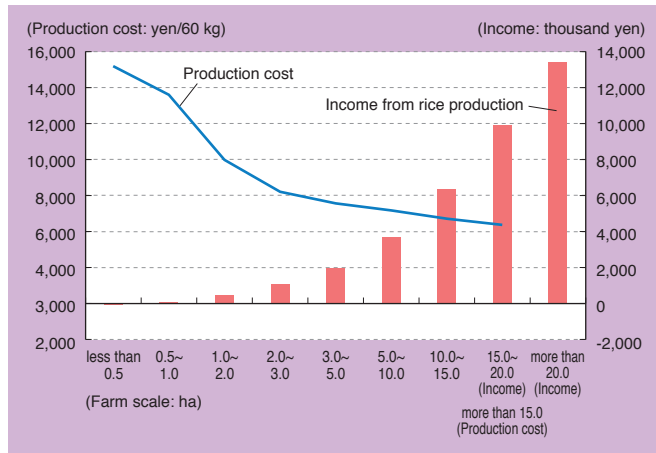
Therefore, the share of the sales of full-time farmers whose primary income came from agriculture to that of all rice farmers is only 38%, an extremely low figure, whereas the same figure in dairy farming is 95% and that of vegetable farming is 82%.

Expansion of Agricultural Cooperatives

A large majority of rice producers are small part-time farmers who work in other businesses than agriculture on weekdays and work in their

CHART 2

Production cost of rice & income per scale of farming



Source: Ministry of Agriculture, Forestry and Fisheries

rice fields only on weekends. They are not eager to continue farming and are willing to sell their land for non-agricultural use such as residential use at a much higher price than for agricultural use. The sale of land amounts to several trillion yen each year. They put their earned income or revenue from other businesses and the sale of their land in the agricultural cooperatives' accounts. The deposits in these accounts totaled 88 trillion yen in FY2012, effectively making them the second-largest megabank in Japan.

The policy of a high price of rice which led to maintaining the number of part-time farmers worked in favor of the cooperatives' management, since they made a lot of profits by engaging in financial business, as well as life and casualty insurance, sales of agricultural products, provision of farm-related materials or daily goods, wedding and funeral services, and hospital and medicare business, covering a wide range of business activities from cradle to grave.

In addition, in their membership system, whoever lives in an agricultural cooperative's territory can join the association as a semi-member and take full advantage of its operations, though they cannot participate in its decision-making process. A large part of agricultural cooperatives' deposits have been used for such semi-members' housing loans or those for their children's education.

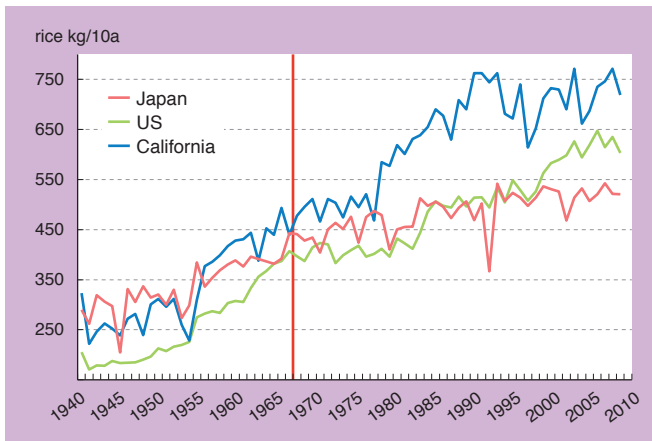
Agricultural cooperatives with a large number of part-time farmers as members, thanks largely to the policy of keeping the price of rice high, have been able to maintain their political clout by influencing a large number of votes in rural communities.

Introduction of Set-aside Program to Reduce Acreage under Cultivation & Its Impact

Due to this high rice price policy, rice production increased and consumption declined. We had a surplus of rice. Then, since 1970, in order to reduce government expenditures on its purchase of excess rice supplies, a policy of reducing acreage under cultivation, that is a set-aside program, has been introduced. Since the abolition of the policy of purchasing rice supplies by the Japanese government in 1995, the policy

CHART 3

Changes of unit revenue of rice



Source: US Department of Agriculture, National Agricultural Statistics Service, Quick Stats

of reducing rice production is the only method to maintain the high price of rice. Farmers joining this set-aside program are also subsidized and the government's costs in such subsidies exceed 500 billion yen a year. When added to the burden on consumers due to the higher price than the equilibrium price resulting from this program, this totals more than 1 trillion yen annually, compared to the total value of rice production of 1.8 trillion yen. The reduced acreage under this policy has now reached 1 million ha, equivalent to 40 % of the total rice fields.

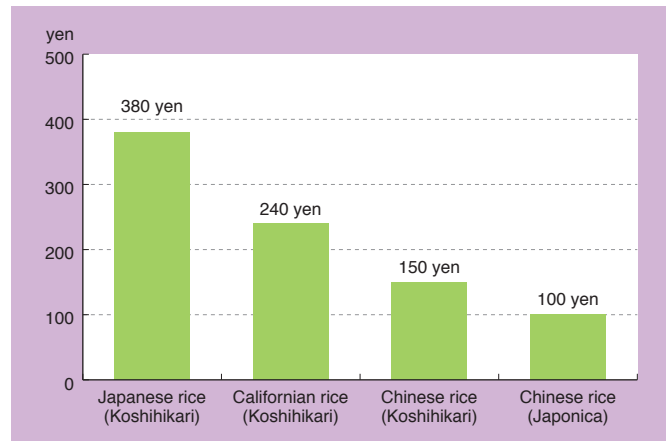
This policy affected each farmer's efforts to reduce production costs. The cost per unit of production is equivalent to the cost per unit of area divided by the yield per unit of area. Thus, if the yield per unit of area increases, the cost will decrease. However, assuming that total consumption or production of rice remains unchanged, an increase in rice yield per unit of area would reduce the paddy fields necessary for rice production and expand the acreage to be covered by this set-aside program. This would increase subsidies for the program. The Ministry of Finance demanded that the Ministry of Agriculture, Forestry and Fisheries not develop any varieties which increase rice yield per unit of area. Now Japan's average yield per unit of area is 40% less than that in California.

Are Tariffs on Rice Necessary?

High quality is a distinctive characteristic of Japanese rice. In Hong Kong, Koshihikari, a Japanese variety of rice produced in Japan, is sold at a price 1.6 times higher than Koshihikari produced in California and 2.5 times higher than that produced in China. Furthermore, the price difference between Japanese rice and Chinese rice has now been reduced to around only 30%. In *Chart 5*, the pink line shows the price of imported Chinese rice, and the purple line shows the price of the Chinese rice sold in the Japanese market. The gap between the price of Japanese rice (shown in the green line) and the price of Chinese rice sold in the Japanese market would be considered as the quality gap reflected in the price. Furthermore, the price of

CHART 4

Prices of rice in Hong Kong



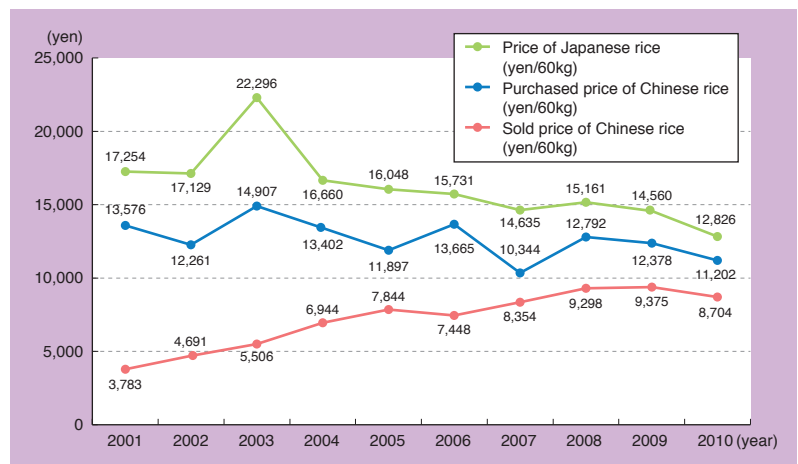
Source: Compiled by the author based on the data of Maruya Corporation, Inc.

Japanese rice is realized by the set-aside program, as already described. Therefore, if this policy was abolished the price would fall to around 8,000 yen per 60 kilograms, and the price of Japanese rice would be lower than that of Chinese rice and thus tariffs would not be necessary anymore.

Without tariffs it would be impossible to keep the rice price higher than the international price by the set-aside program. With the abolition of the set-aside program, the price of rice would be lowered and part-time farmers would be ready to lend their land to full-time farmers whose main source of income is rice farming. If the government directly subsidizes farmers whose principal work is rice farming, their ability to pay the rent will be raised and the farmland will be consolidated to such farmers, and their farm size will expand and production costs will fall. Assuming that the production cost for rice farmers with more than 15 ha of rice fields in Japan is 6,378 yen per 60 kg, with the abolition of the set-aside program they can expect yield per unit of area to reach the level of Californian rice yield, and their production cost will drop to 4,556 yen, which is less than

CHART 5

Price difference between Japanese rice & Chinese rice



Source: Ministry of Agriculture, Forestry and Fisheries

half of the average cost in Japan of 9,478 yen.

Trade Liberalization Is Key to Restoration of Japanese Agriculture

Rice production in Japan has declined from 12 million tons in 1994 to 8 million tons now. The domestic rice market, which has been protected by high tariffs, will shrink further due to aging and decreasing population. To restore or preserve Japanese agriculture, there will be no other way than to develop the export market.

However, no matter how much Japan may try to reduce its production costs, it cannot export its products if its trading partners protect their own markets with high tariffs on imports. This means that unless Japan is actively involved in trade negotiations for the TPP or any other FTAs to achieve free trade by eliminating high tariffs, Japanese agriculture may not be able to survive.

For example, China is a promising market for Japanese agriculture. Although Japan can export rice to China without paying tariffs, Japanese rice is sold at 1,300 yen per kg in Shanghai while it is 500 yen per kg in Japan. This is because the Chinese state-owned enterprise, a distribution monopoly, takes a great margin. With such *de facto* tariffs, Japan cannot export rice freely to China. In the TPP negotiations, the US is trying to introduce rules and disciplines on such state-owned enterprises. This means joining the TPP negotiations could lead to Japan's developing the Chinese market.

What About Other Agriculture Products?

Some 250 billion yen would be needed in direct payments to replace tariffs. About 200 billion yen of this should be allocated for the livestock industry. The existing corn-importing system obliges farmers to undertake a particular process for feeding livestock to avoid having this duty-free corn for feed use switched to a high-tariff starch use. With this particular process, the price of corn for feeding livestock rises by 20%. If the tariff on starch is eliminated, such special operations would be unnecessary. The cost of corn is a major part of the production cost of raising livestock, so if the price of corn falls, the livestock industry's price competitiveness would be improved substantially and the amount of direct payments necessary for eliminating tariffs be reduced.

The gains from trade are mainly gains for consumers. Currently, we have high tariffs on imported agricultural products in order to keep the domestic prices of agricultural products higher than international prices. Take wheat, for example. There are high tariffs close to 200% on imported wheat that accounts for 84% of total national consumption in order to maintain the high price of domestic wheat, which accounts for only 16%, and this ultimately increases the burden on consumers.

If, instead, the domestic wheat industry received direct subsidies from the national budget and lowered its prices, such tariffs would not be necessary and the burden on consumers would disappear. In this way, both farmers and consumers would benefit from this new policy. However, agricultural cooperatives would lose their vested interests, such as possible reductions in their sales transaction fees due to lower prices and also a possible decline in their membership due to a fall in the

number of part-time farmers.

How Can "Abenomics" Work to Reform Agriculture?

Among a wide range of strategies to consolidate Japanese growth proposed by "Abenomics", it is recommended to transform agriculture into a new industry by recommending that farmers engage in the processing and distribution of agricultural products as well. Doubling exports of agricultural products or having a banking system for integrating agricultural land by leasing the land to farmers are other recommendations. With these policies, the strategy aims at doubling farmers' income in the next 10 years. Since agricultural income is equal to sales (quantity sold multiplied by price) minus costs, the policy aims at raising prices by adding value, increasing quantities by encouraging exports, and reducing costs by expanding the size of farming through concentration and integration of agricultural land.

In order to achieve the goal of doubling farmers' income, the most important policies will be structural reform and lowering production costs and prices, and thereby raising competitiveness, not merely pursuing high product quality.

But farmers may not be experts on processing and distribution, and the concentration and integration of agricultural land may not be easy either. Under the lenient Japanese regulations on the utilization or zoning of land, it is not difficult to sell farmland for non-agricultural use such as residential use. If an owner leases a piece of land to a farmer, however, it becomes difficult for the owner to regain the land when there is a ready buyer. Thinking about this, the owner would refrain from leasing his or her land. It is much better to keep it abandoned rather than to lease it and miss the golden opportunity to sell it at an unreasonably high price for residential use. They do not have to pay any real estate tax even after ceasing to cultivate it.

With the existing policy of the set-aside program and keeping the price of rice high, even farmers with high production costs tend to continue to be engaged in farming. For those reasons, additional land for farming is unlikely to be available for farmers whose primary income is from agriculture.

In order to achieve a concentration and integration of agricultural land, reforms of the current policies are recommended. In particular, assuming that exporting agricultural products is the only way to achieve a doubling of farmers' income, given depopulation and the shrinking domestic market, it is important to lower the price of rice, the most important Japanese agricultural item, exports of which are even now steadily increasing, by abolishing the policy of the set-aside program. This would also make it possible to eliminate the existing restrictions on expanding the scale of production and increase yield per unit of area, thereby enhancing the export competitiveness of rice farming through overall cost reductions.

Such regulatory reforms would pave the way to a brighter future for Japanese agriculture. **JS**

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