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Grain and Feed

Japan's Proposed Rice Reforms

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Report Highlights: Japan is proposing broad reforms in its rice policies which would end government controls for rice production by fiscal 2008, and increase subsidies to large-scale farmers. The number of farming households is expected to fall 17-29% as smaller, less inefficient farmers transfer their land to larger farmers. Rice prices could fall by an addtitional 50% due to continued oversupplies, as the Government gives up its role in limiting production. Japan is expected to reduce "blue box" expenditures by shifting production linked subsidies to direct payments and loan-rate type measures.

Includes PSD changes: No
Includes Trade Matrix: No
Unscheduled Report
Tokyo [JA1], JA

SUMMARY

Despite declining consumption, rice continues to be Japan's most important crop. Fifty-four percent of commercial farmers produce rice as their main crop, and rice occupies nearly 40% of Japan's cultivated land area. However, there are uncertainties about the future of Japanese rice production since 60% of Japanese farmers are 60 years of age or older, and Japan's rice farms average just 1.05 hectares.

The Japanese government has controlled rice production and distribution since World War II because of its social and economic importance. However, rice consumption has fallen by nearly 50% since the early l960's and Japan has had to spend 5.85 trillion yen ($48.75 billion at 120 yen/dollar) since 1971 in crop diversion programs to control chronic surpluses. Despite these large subsidies, rice prices have fallen consistently for the past 10 years.

In December, after two years of debate, the Ministry of Agriculture, Forestry and Fisheries (MAFF) announced a new framework for Japan's rice policy which calls for the abolition of government control of rice production by fiscal 2008, and subsidy reforms to help develop large-scale farmers. MAFF intends to make Japanese rice production more market-oriented by turning responsibility for managing supplies over to co-ops.

As subsidies shift to larger producers, older, less efficient producers are expected to retire, facilitating larger scale production. MAFF forecasts that by 2010 the number of farming households will decline by 17-29%, and that 60% of riceland will be farmed by farmers with an average of 14 hectares. Regional development plans could lead to increased production of wheat, soybeans, and rice for industrial uses such as *sake* production.

In the short-term, the reforms could result in more surplus rice as the Government turns supply management over to the private sector. Most observers therefore expect rice prices to fall to about half of their current level.

The new plan is expected to have little direct impact on rice trade and border policies. However, over the long term, demand for imported wheat and soybeans might be reduced slightly if wheat and soybean production continues to increase. Japan is expected to remain well within its WTO ceiling for domestic supports, and it will reduce "blue box" expenditures by shifting production linked subsidies to direct payments and loan-rate type measures.

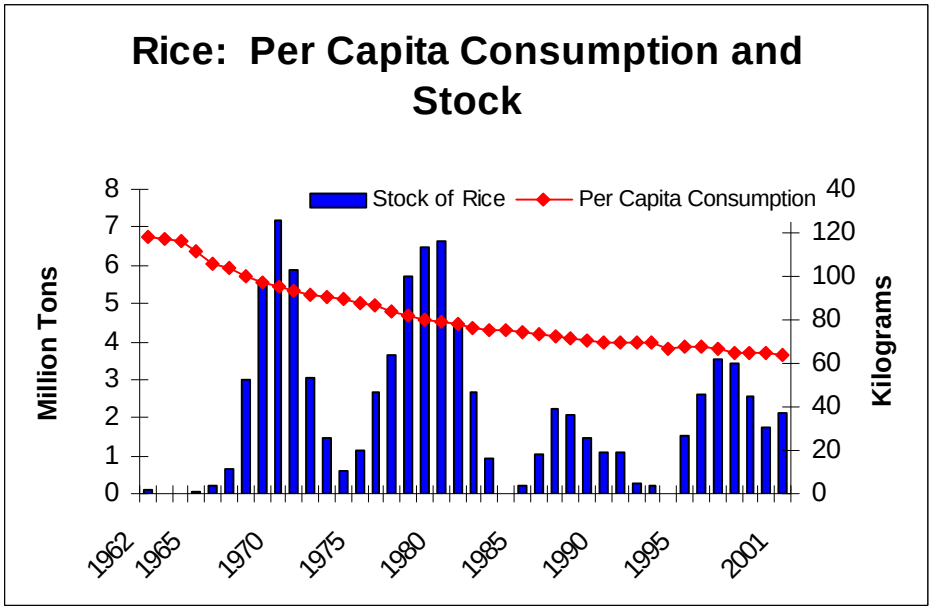
The Diet will have various opportunities in the coming years to re-evaluate and amend the reform program, and some observers feel that the reforms will not be fully implemented. However, budget pressures are likely to continue encourage reforms in Japan's rice program.

WHAT'S BEHIND THE REFORMS?

Background on Past Policies

In Japan, rice has long been the main food staple for consumers, and the major crop for farmers. Recognizing both its nutritional and economic importance, the government, between 1942 and

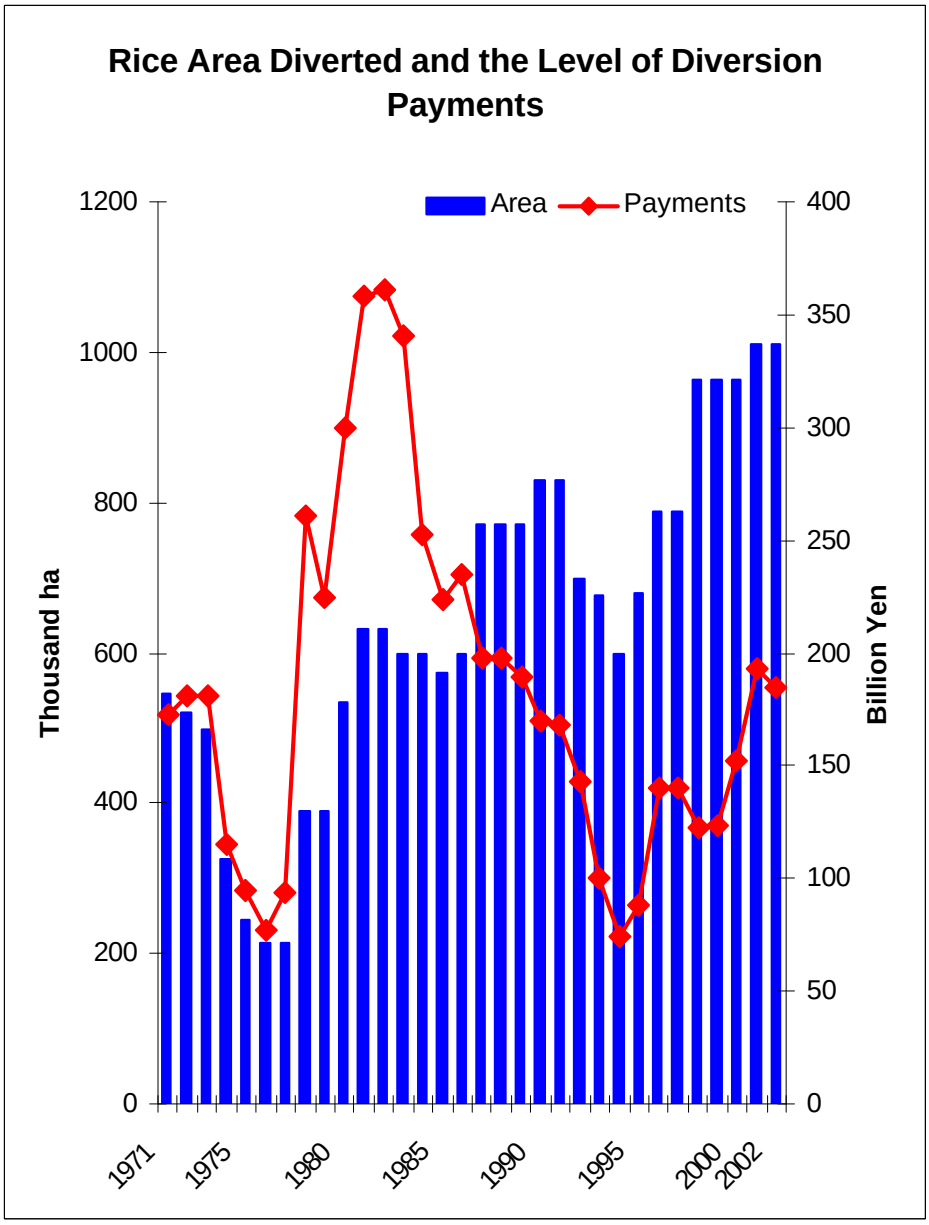
1996, controlled rice production and marketing under the Food Control Law. Under this law, the Food Agency (FA) of MAFF guaranteed a minimum producer price, and it bought, sold and stored all rice. As Japan grew economically, the Japanese diet became more westernized and, after peaking at 118.3 kilograms (KG) in 1962, per capita rice consumption began falling to its current level of 63.6 KG, a 46% decline. Meanwhile, the guaranteed price support system, generous subsides, and advances in farming technology and infrastructure resulted in large surpluses.



Source: Ministry of Agriculture, Forestry and Fisheries

Programs to Reduce Planted Area

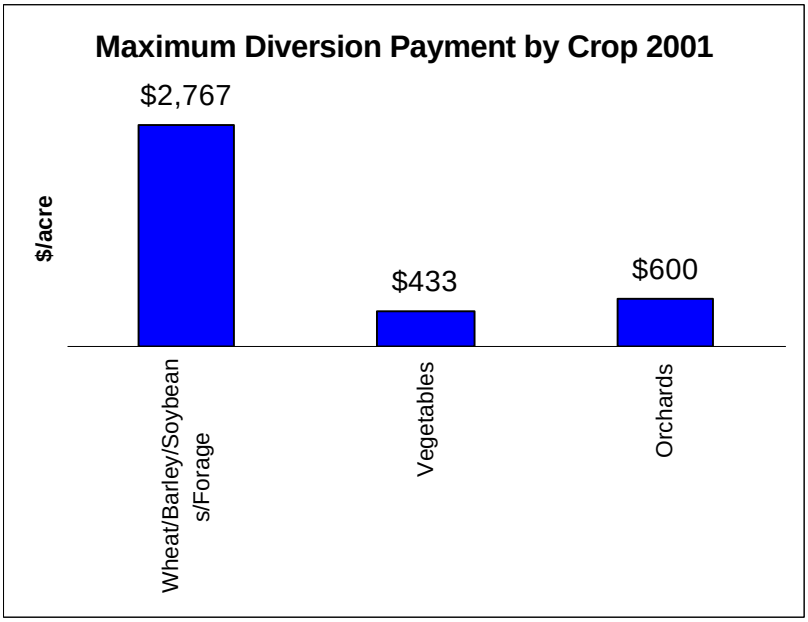
In 1971, in order to cope with chronic surplus production, Japan initiated a program to take land out of rice production called the "*gentan*" program. This program, which is still in effect, has been changed slightly over the years. The initial plan primarily focused on controlling rice output by paying rice farmers not to plant rice. However, in the mid 1970's, the program was revised in an attempt to improve Japan's self sufficiency by encouraging farmers to grow crops like wheat and soybeans on diverted rice paddies. Under the current plan, the Production Adjustment Promotion Program (which still includes crop diversion provisions), MAFF offers payments to farmers who switch from rice production, based on forecasts of how much rice paddy area needs to be reduced to bring supply and demand into balance. The per-hectare payments from the government are revised annually and vary according to the use made of the diverted land. While farmers can receive payments for simply leaving paddies uncultivated, the largest payments are currently being provided to those converting rice land to wheat or soybeans.



Source: Ministry of Agriculture, Forestry and Fisheries

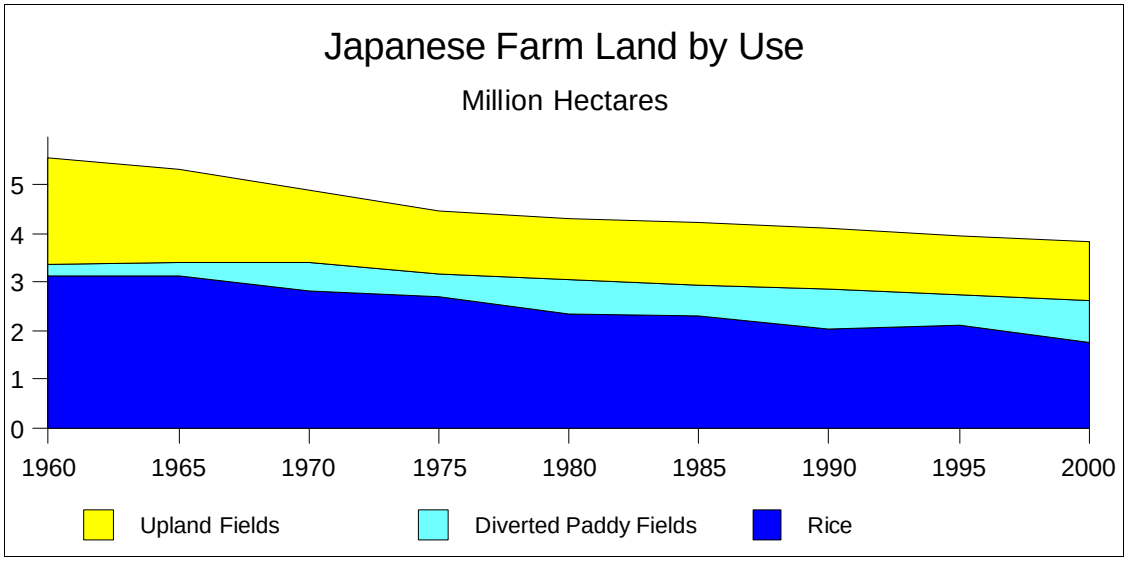
Because the diversion program is based on planted area, if yeilds are higher-than-expected, surplus rice often floods the market. In 2002, Japan diverted a record 1.01 million hectares (about 2.5 million acres), or 40% of its potential paddy land at a cost of 184.6 billion yen (about 1.5 billion dollars). However, favorable weather conditions resulted in a surplus of over 2.1 million metric tons. Since 1971, Japan has spent a total of 5.85 trillion yen (about 48.75 billion

dollars) on this program. This is considered to be a "green box" program under WTO rules, which is not subject to any limitations.

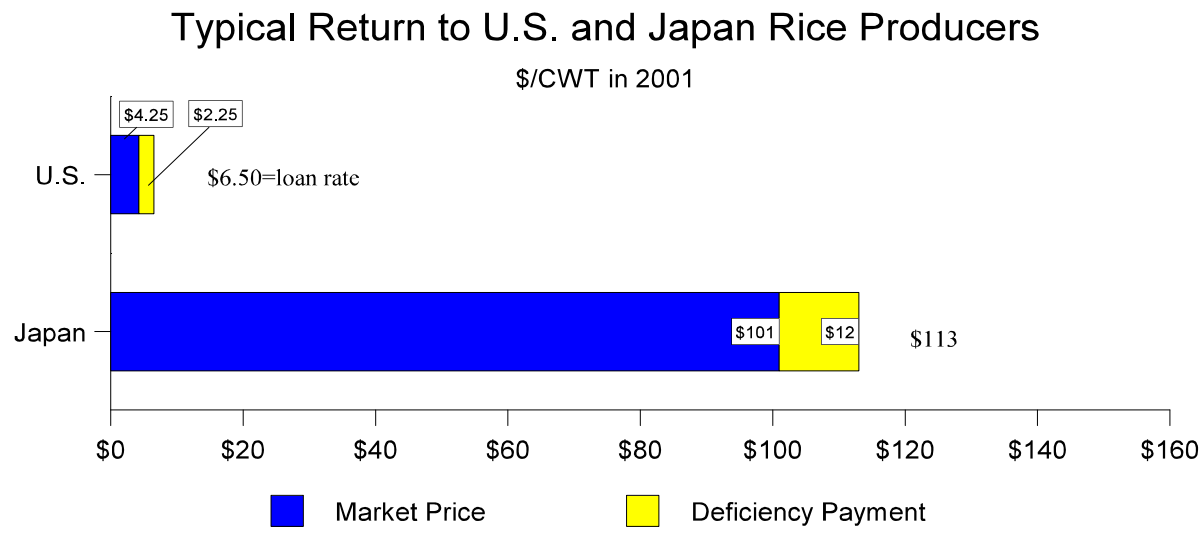


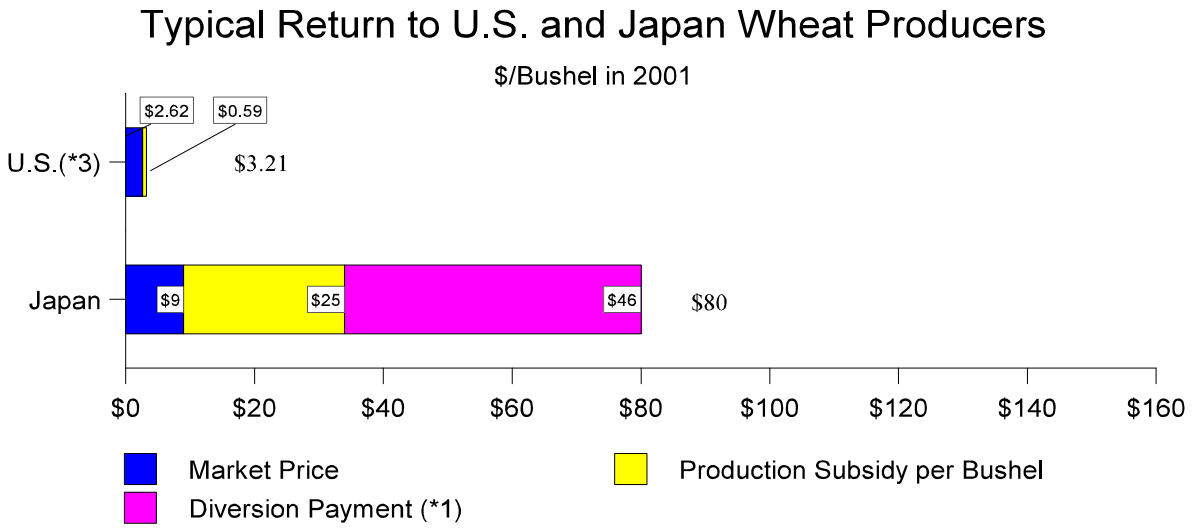
Source: FAS/Tokyo

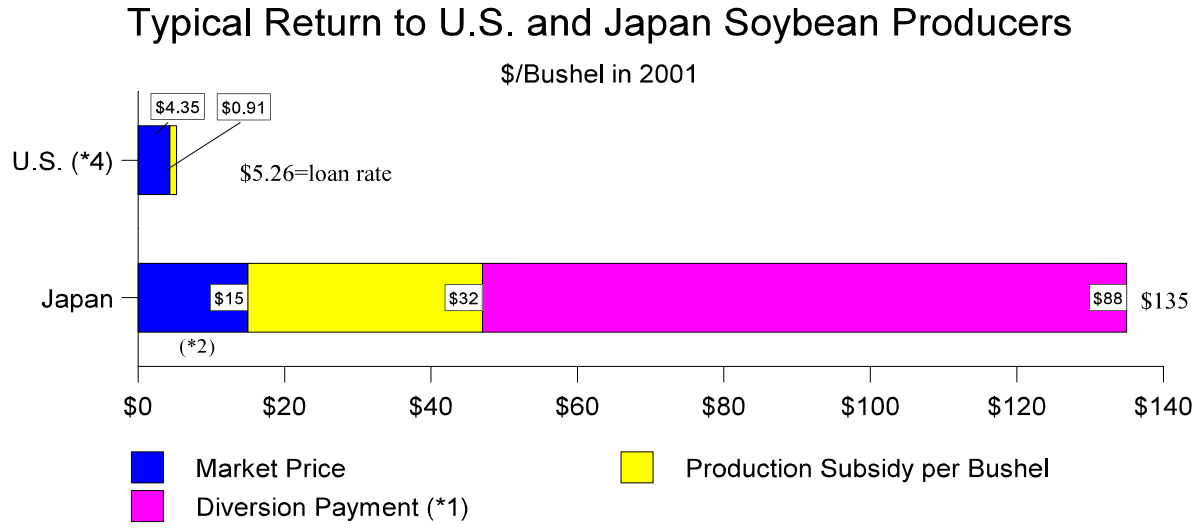
Note: Converted to US$/acre using the exhcange rate of Yen120/dollar and 2.5 acres/hectare.



Source: Ministry of Agriculture, Forestry and Fisheries







Source: FAS Tokyo
Note 1: The diversion payment represents the standard amount payable to the rice farmer for diverting rice paddies to wheat or soybean

production. It is converted to U.S. dollar/bushel basis by using the average yearly yield and an exchange rate of 120 yen/dollar.

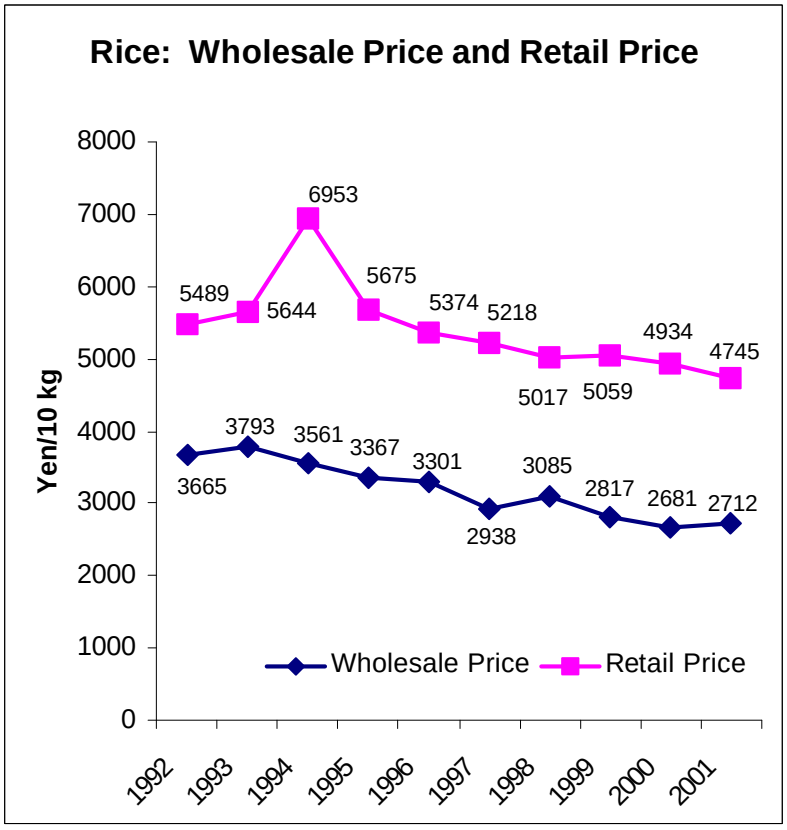
Note 2: The market price for soybeans includes a deficiency payment under the income stabilization program which gives farmers 80% of the difference between the market price and the average price of the previous three years. The amount of the deficiency payment in 2001 is estimated to be less than a dollar because the market price has been fairly stable for the last several years

Note 3: Under the Farm Bill implemented in 2002, a direct payment of $0.52/bushel was provided for wheat.

Note 4: Under the Farm Bill implemented in 2002, a direct payment of $0.44/bushel was provided for soybeans.

Programs to Support Income

In addition to the area reduction programs, the government also provides income support programs for rice producers. The current program, the Rice Farming Income Stabilization Program, was begun in 1998 to help compensate for falling prices. While there is no floor for market prices, farmers are paid part of the difference between the market price and a standard price which is based on an average of prices over the last seven years, with the highest and the lowest prices removed. Farmers are paid up to 80% of the difference between this standard price and the market price. In 2002, payments under this program totaled 124.2 billion yen (about $1.03 billion). Participation in the Income Stabilization Program is voluntary, but in order to participate in the program farmers are required to participate in the Production Adjustment Promotion Program. Consequently, Japan claims that the Income Stabilization Program is a 'blue box' policy under the WTO because payments to farmers are linked to output-limiting measures, such as the diversion requirement.



Source: Ministry of Agriculture, Forestry and Fisheries

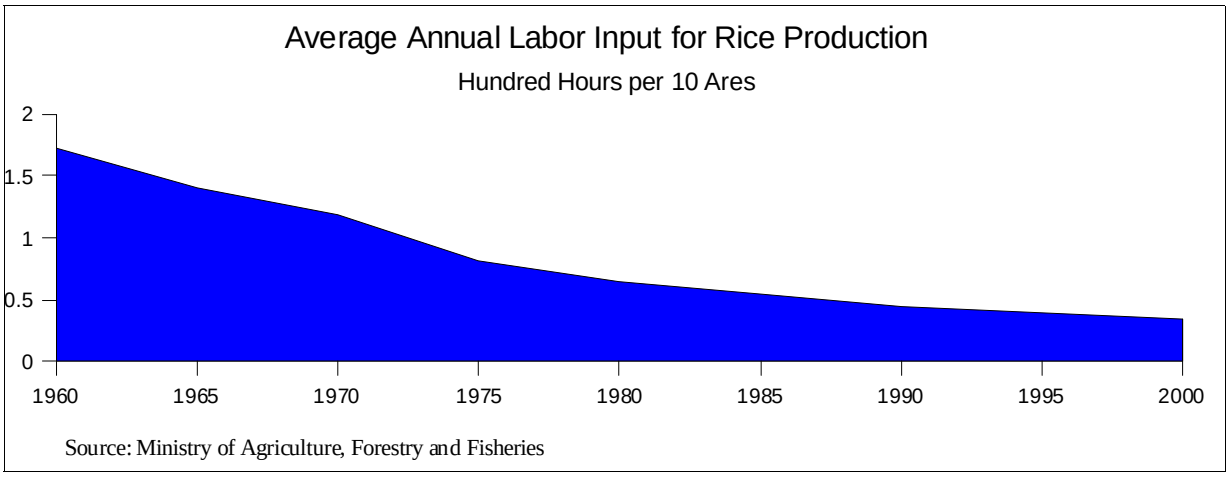
Despite the large subsidies provided under these two programs, both wholesale and retail rice prices have fallen steadily for the past 10 years, except in 1994 when bad weather conditions resulted in an exceptionally bad yield.

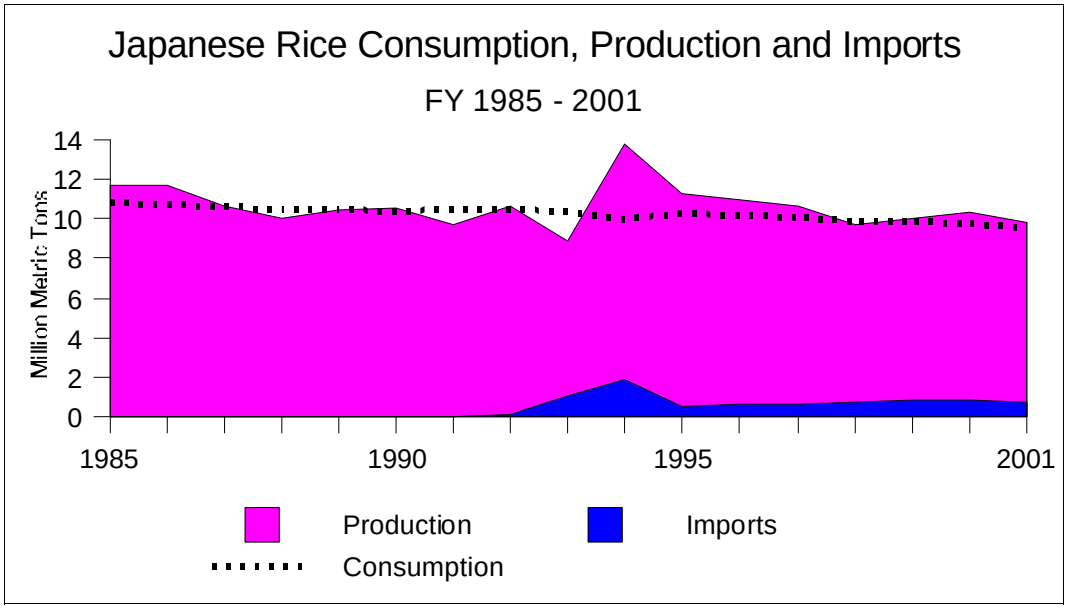
Demographic and Economic Factors Affecting Rice Production

In the 1960's and 70's, Japan's booming industrial sector pulled labor from the agricultural sector. Many rural youth moved to cities, and the farmers who stayed behind began to supplement their income with jobs outside of the agricultural sector. Today, two-thirds of Japanese farmers are 60 years of age or older, and very few young people want to go into farming.

While these trends have affected the entire agricultural sector, rice farmers seem to have been affected most. Most rice farmers are small, farming an average of only 1.05 hectares. While only 21% of rice famers farm full time, 85% for vegetable farmers and over 90% for livestock producers farm full time. The vast majority of rice farmers farm less than 2 hectares, and their income from rice production accounts for less than 10% of their total income. On the other hand, larger scale rice farmers, with over 10 hectares, receive about 70% of their income from rice farming.

There are two main reasons why small, older farmers continue to grow rice. First, modern equipment and agricultural chemicals have made rice farming much less labor intensive than it was 30 years ago. The second reason is more complex, and related to farmer's strong attachment to their land. Since many farmers cultivate land that has been farmed by their family for centuries, and they are reluctant to sell it or let others farm it.





Source: Ministry of Agriculture, Forestry and Fisheries

The Deregulation of Rice Distribution

In 1996, Japan ended decades of government control of rice distribution when the Food Agency stopped buying and selling domestic rice. The l996 Food Law gave farmers the freedom to market their rice however they choose. About half of the rice produced in Japan is now sold through JA, Japan's national farm co-op. This rice is called "orderly marketed rice." Rice sold outside of this channel, i.e. rice sold by farmers directly to food service operators and consumers, is called "non-orderly marketed rice," and it now accounts for half of all rice produced in Japan. By discontinuing the Government's direct purchase of rice, Japan was able to eliminate about three-quarters (about 2.4 trillion yen) of its Uruguay Round ceiling for Aggregate Measures of Support (AMS). As a result Japan is now using only 18% of its AMS ceiling.

A major player in the agricultural sector, and the rice sector in particular, is Japan's JA co-operative. In addition to its role in marketing agricultural products, this organization also supplies seeds, agricultural chemicals, equipment and, most importantly, banking and financing services. JA operates much like an old fashioned "company store"; where farmers buy what they need, on credit if necessary, and then turn their products over to JA to market them so they can pay off their debts. Since current regulations make it very difficult for a farmer to borrow money from commercial banks using farmland as collateral, JA banks are often the farmers only option for credit.

PROPOSED REFORMS

After two years of debate between MAFF, the Liberal Democratic Party and JA, MAFF announced a new framework for Japan's rice policy on December 4, 2002. The new program calls for:

- the abolition of MAFF's 30-year-old program to limit rice production by fiscal 2008

- higher subsidies for large-scale, progressive, farmers.

JA and the LDP both have close ties to small part-time farmers, and they have traditionally resisted changes in farm policies, and especially rice policies. However, in reaching this agreement, it was recognized that Japan cannot continue to pay 300 billion yen (about $2.5 billion) annually in rice subsidies. Further, MAFF projects that by 2010, rice demand will have fallen from its current level of around 9 million metric tons to between 8.15 and 7.66 million metric tons. If the existing program were kept in place, this decline in consumption would necessitate further production adjustments, adjustments which MAFF can not afford.

Key points of the new rice policy follow:

Production Reforms

The government will discontinue its production adjustment program by 2008, and let farmers and farm organizations decide how much rice to produce on their own. As an interim measure, a transparent, neutral, independent third-party will be established in the fall of 2003 to develop demand forecasts and provide guidance regarding production targets and volume allocations by region for FY 2004. MAFF hopes that production will be managed better by switching production allocations from the traditional planted area to a volume basis.

Despite MAFF's desire to remove itself completely from this process, JA and the LDP succeeded in including language in the final plan saying that the government will continue to have "responsibility" in the adjustment of rice production. However, it is not clear how active a role MAFF will play in the future. The plan also leaves room for future adjustments and delays by calling for "an evaluation of the feasibility of this transition" in 2006.

Marketing Reforms

The plan would eliminate the distinction between "orderly marketed rice" handled by co-ops and "non-orderly marketed rice". Since over 50% of rice is already "non-orderly" rice, this, by itself, is not a major change. However, there is speculation that the regulations for distributors who handle non-orderly rice may become stricter. The Food Agency has been frustrated becasue it does not have a complete grasp of where and how rice is distributed, and a stricter registration system would enable them to follow the market better.

The Rice Price Formation Center, which is Japan's curent rice market, will be restructured to allow a variety of auctions, including spot trading and reverse auctions. According to trade sources, as rice farmers become more independent, they will need a future's market to manage risk. However, it is not clear whether the reform will extend to include such changes.

"Traceability", which has become a major focus for MAFF since the BSE outbreak in Japan in

September 2001, is also included in the rice policy reform. MAFF plans to expand DNA monitoring of rice to guarantee reliability in package labeling. A traceability system will then be introduced to trace the producer's name, area, and production/distribution history by UPC code. JA sees "traceability" a key means to keep members in their organization, since the co-ops are in a good postition to track seed varieities, chemical usage, and distribution.

Changes in Subsidies

Another fundamental change in the new rice policy concerns subsidies and their purposes. Although details still need to be worked out in the Diet, three basic measures are being proposed:

1) An interim incentive payment for those participating in the production adjustment program. This will probably mean a continuation of the current deficiency payment program.

2) Subsidies based on "regional characteristics" to promote alernative crops in certain areas. Some of these funds are expected to be used to permanently switch rice land to alternative crops, particularly wheat or soybeans, based on geographic, environmental (including soil quality), economic, and social conditions in various regions. These subsidies will also be used to promote improved wheat and soybean quality, as well as to encourage the use of rice for processed products and animal feed.

3) Income support, possibly by direct payments, specifically targeting larger scale, more entrepreneurial farmers.

The reform package also includes a safety net mechanism that would provide short-term loans in the event of surpluses caused by unexpectedly high yields.

EXPECTED IMPACT OF THE REFORMS

Impact on Farm Structure

As subsidies shift to larger, more entrepreneurial farmers, less efficient, older farmers are expected to give up farming, facilitating the consolidation of smaller farms into more efficient units. MAFF forecasts that by 2010, the number of farming households will decline from the current 3.24 million to 2.3-2.7 million. Out of that number, 60% of the remaining rice paddy land is expected to be consolidated into 80,000 large units with an average of 14 hectares. These consolidated units could include both large scale individual farmers, and community units where small scale farmers lease land and share labor and equipment.

In some areas, paddy land may be swtiched permanently from rice to wheat and soybean production. However, wheat and soybean production will be limited by problems with quality, particularly for wheat, and price competiveness. In other communities, farmers may decide to concentrate on producing particular varieties of rice suited for processing purposes such as *sake*,

depending on the economics of the market.

Impact on Rice Prices

In the short term, both trade and government contacts expect the reforms to result in more surplus production and lower prices. Many think prices could fall to 8,000 yen/per 60 kilograms ($50 per hundred weight), or about half of the current price. Although Japanese rice demand shows little price elasticity, if prices fall far enough, increased demand from the processsing sector could eventually start to support prices. Some, therefore, believe that prices may stabilize at the 10,000-12,000 yen level. However, these projections all seem to be based on the premis that the domestic market will continue to be insulated from the global market.

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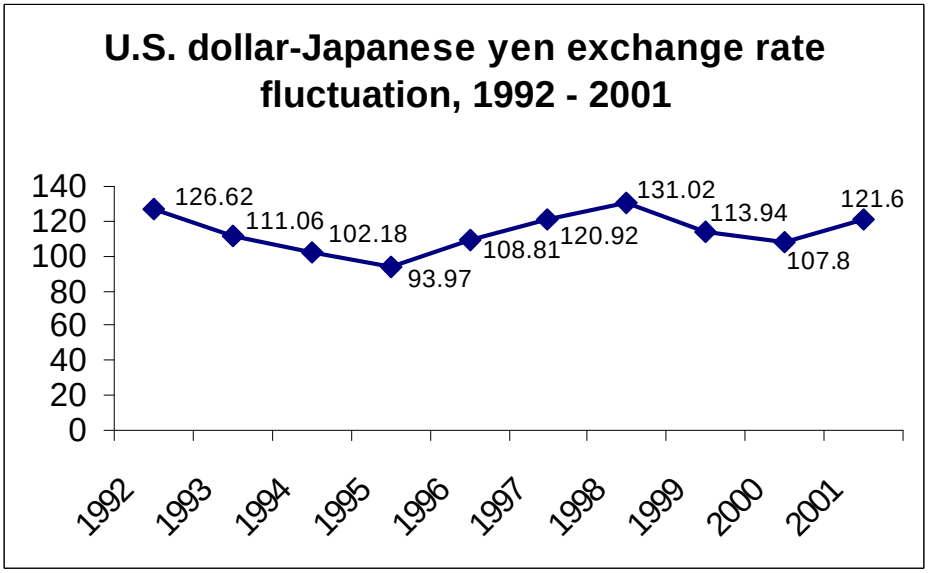
U.S. dollar-Japanese yen exchange rate fluctuation, 1992 - 2001
140
120
100
80
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