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Dairy

Japanese Dairy Sector Reform

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Report Highlights:
In response to the continuing decline of Japan's dairy sector, MAFF is taking steps to revise domestic dairy policy. Under a new policy framework, by 2001 the guaranteed price and the standard transaction price for butter, NFDM and other dairy commodities will be abolished, and prices will be determined by market forces. MAFF will establish a pilot commodity market around September 1999 for NFDM. The government's funding from the deficiency payment scheme could be transferred to a farm income subsidy, but still conform with WTO rules. The impact, if any, on imported U.S. dairy products is difficult to estimate, but MAFF's actions demonstrate it's resolve to keep dairy farming a viable sector.

Includes PSD changes: No
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Japanese Dairy Sector Reform Summary

As described in post's latest dairy semiannual report, the decline in Japan's dairy sector presents serious policy concerns for MAFF, and the ministry is taking steps to revive the dairy sector. One main feature of the reform is to revise the dairy deficiency payment scheme for raw milk for processing utilization and transform it into a new system by 2001. The revision, within the framework of Japan's New Agriculture Basic Law, aims to correct a rigid price formation structure for specific dairy commodities, e.g., non-fat dry milk (NFDM), butter, etc., under the guaranteed price based subsidy payment scheme.

MAFF reports the revision and use of domestic dairy subsidies will conform with WTO rules. The revision would result in changing the base for Japan's AMS (Aggregate Measurement Support) estimate applied for the dairy sector substantially as explained in the new policy framework section. According to available data, the GOJ's dairy sector related to AMS was estimated at 153 billion yen in JFY 1996.

As a pilot project, MAFF will establish a dairy commodity market which is scheduled to start September 1999. Initially, NFDM imported under the minimum access and some domestic NFDM are scheduled to be traded in bidding planned to be held once or twice a month. At present, it is difficult to determine what if any market opportunities would result for U.S. dairy products from the above new dairy sector reform. However, there is good potential for Japan's pilot commodity market to grow, if implemented and managed properly.

Current Main Dairy Policy Framework

The National Milk Quota

Current dairy policy framework is designed primarily to achieve stable fluid milk supply, through *the national milk quota* set by Japan Dairy Council (JDC), the national board with membership of 46 *designated milk producers*. Each fiscal year, JDC allocates the national milk quota by volume and by use to its membership and monitors the result for reallocation. Designated milk producers are mostly prefectural farm cooperatives of dairy producers. As of 1998, there were about 47 designated milk producer cooperatives in the country and one is in Okinawa, the only non-member of JDC.

The Deficiency Payment Scheme for Raw Milk Utilized for Processing

Also, GOJ has been implementing the *deficiency payment scheme* for raw milk utilized for production of specific dairy commodities such as butter, NFDM, and other commodities. Butter and NFDM , formally state-traded dairy commodities, are all put under the TRQ system, with tariff equivalents based on high, secondary tier tariffs from the last Uruguay Round accord. Japan agreed the current access for the above specific dairy commodities under the general use category (see post's regular commodity report - Japan dairy annual and semiannual).

Japan's deficiency payment scheme for raw milk for processing utilization has three important functions: 1) maintaining stable supplies of specific dairy commodities, primarily butter and NFDM, etc., 2) adjusting demand and supply of fluid milk, and 3) promoting dairy farming in remote areas. For instance, Hokkaido, currently the single largest dairy state in Japan, has historically been considered suited for dairy farming, but the region has had location and price disadvantages in marketing drinking milk over other prefectures closer to major centers in Honshu region, the main island. Thus, the scheme guarantees the average cost of producing fluid milk for dairy farmers in remote regions.

As shown in the attached table, GOJ sets the *annual subsidy volume of raw milk* and the *deficiency payment* (GOJ's subsidy portion) before the beginning of every fiscal year. The deficiency payment levels are determined by the difference between the *guaranteed price* (the actual farmer's receipt for raw milk) and the *standard transaction price* (the actual dairy manufacturers payments to farmers for raw milk for processing use.). The guaranteed price is derived using a specific formula based on the *stabilization index prices* for NFDM and butter which reflects the average cost of fluid milk production in remote region such as Hokkaido plus dairy manufacturers average overheads and sales margins.

In JFY 1998, GOJ's annual subsidy volume was 2.4 million MT and the deficiency payment was 10.84 yen per kilo. The deficiency payments amounted to about 26 billion yen, which accounted roughly 70 percent of the total 36 billion yen of milk and dairy products related GOJ's farm budget in JFY 1998.

This deficiency payment scheme has been implemented through Agriculture and Livestock Industry Corporation (ALIC), a quasi organization of MAFF. Also, ALIC monitors the stabilization index prices for non-fat dry milk and butter. In case market prices of such commodities fluctuate downward or upward beyond the certain range of the stabilization index prices, ALIC acts on behalf of MAFF by intervening the market through buyout or sellout operations to bring the price in the desirable range.

ALIC also manages importation and timely release of dairy commodities imported under the current access such as non fat dry milk and whey products through SBS and regular tenders. Furthermore, ALIC undertakes emergency imports of such products in case of shortages.

New Policy Framework

Under the new policy framework, the *guaranteed price* and the *standard transaction price* for the above specific dairy commodities will be abolished by 2001. In theory, butter and non fat dry milk prices will be determined by market forces, in which the prices fluctuate reflecting actual market demand and supply.

In order to make the above price formation mechanism transparent, MAFF plans to establish a *pilot dairy commodity market* in September 1999**.** NFDM imported under the minimum access and a part of domestic

NFDM is planned to be traded in the pilot market.

The government's subsidy portion under the deficiency payment scheme will take a different form, most likely a sort of farm income subsidy - details are yet to be decided.. By abolishing the scheme, the base for AMS calculation will change; i.e, The standard transaction price, which was counted as the market price support, and the government's deficiency payment portion, which was accounted as the direct subsidy payment, are no longer applied for AMS estimate technically. However, it is most likely that a new subsidy payment will still be based on the fixed subsidy volume for raw milk set at each fiscal year combined with direct government's subsidy payment to calculate the AMS. Post is not certain what it will be for AMS applied previously for the standard transaction price (market price support portion).

Moreover, ALIC would still be involved in handling dairy commodities imported under the minimum access.

Concrete details are under preparation by MAFF's study group and the interim report is expected to be released sometime in August 1999.

Other GOJ's Initiatives Taken for Dairy Sector Reform

Other initiatives taken by MAFF for dairy sector reform are consolidating designated milk producer cooperatives, who are the recipients of the national fluid milk production quota, and of the deficiency payment scheme for raw milk for processing. Also, MAFF/MHW are encouraging streamlining and upgrading numerous domestic dairy plants as a way to reduce manufacturing costs. There are reportedly more than 800 dairy processing plants in Japan as of 1999. Requirements for HACCP at dairy manufacturing plants have acted as an incentive to modernize and consolidate these dairy plants to meet various safety standards. In addition to above, the school milk program has also been subject to discussion for reform to correct high cost structure.

New Market Opportunities

At present, it is difficult to determine what new market opportunities will open for U.S. dairy products from the above new dairy sector reform. Post's observation is "not much at present." However, there is good potential for Japan's pilot commodity market to grow, if implemented and managed properly.

Table 1. Parameters for GOJ's Deficiency Payment Scheme

Guaranteed Prices for Raw Milk for Processing Utilization				
			Unit: Yen per Kilo	
JFY 04/Year	GP	STP	Deficiency Payment	Subsidy Volume
	Yen per Kilo	Yen per Kilo	Yen per Kilo	1000 MT
1989	79.83	67.25	12.58	2,300
1990	77.75	65.98	11.77	2,350
1991	76.75	65.40	11.35	2,400
1992	76.75	65.40	11.35	2,400
1993	76.75	65.26	11.49	2,350
1994	75.75	64.26	11.49	2,300
1995	75.75	64.26	11.49	2,300
1996	75.75	64.26	11.49	2,300
1997	74.27	63.46	10.81	2,400
1998	73.86	63.02	10.84	2,400
1999	73.36	62.56	10.80	2,400
GP =Guaranteed Price				
STP =Standard Transaction Price				
Deficiency Payment = GP - STP				

Table 2. Stabilization Index Prices for Butter and NFDM

Stabilization Index Prices		
	Butter	NFDM
	Yen per Kilo	Yen per 25 Kilo
1989	1,902	13,163
1990	1,065	12,833
1991	1,051	12,663
1992	1,051	12,663
1993	1,032	12,841
1994	993	12,841
1995	993	12,841
1996	993	12,841
1997	965	13,090
1998	955	13,090
1999	931	13,090

Source: Agriculture & Livestock Industry Corporation