FINDINGS

Howard Buffett/Grant Heilman Photography

Taxes on Imports Subsidize Wheat Production in Japan

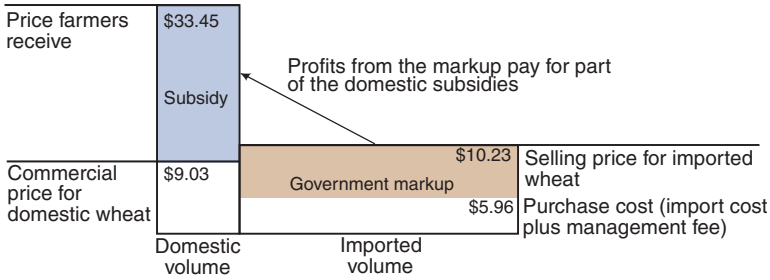
Despite high costs and poor milling quality, tens of thousands of Japan's farms grow wheat, usually on small fields, and production is rising. Government subsidies ensure that farmers receive at least $35 per bushel for their 2004 production, compared with an average of $3.55 expected for U.S. farmers. Wheat produced on large fields in the dry climates of North America, Australia, and Argentina is cheaper and of higher quality than Japan's wheat.

Japan's Ministry of Agriculture, Forestry and Fisheries (MAFF) pays farmers a subsidy per kilogram of wheat, with no limit on the amount of wheat. In 2004, that subsidy equated to $26/bushel. Farmers sell wheat commercially at market prices, currently $9 per bushel. The government then pays producers the subsidy through producer groups. In 2004, given expected output of 825,000 tons, the production subsidy cost over $700 million.

Much of Japan's production subsidy for wheat is financed by taxes on imports. Japan operates a tariff-rate quota (TRQ) for wheat imports, in which a higher tariff is imposed on all wheat imports that exceed a quota level. Japan's in-quota tariff for wheat is zero, while the over-quota tariff for wheat (and most, but not all, wheat products) is 55 yen/kg ($500/ton). The tariff raises the cost so much that it deters over-quota imports. MAFF, holding the sole right to import wheat within the TRQ, buys wheat at world prices and then sells the imported wheat to millers at a steep markup—almost 60 percent in 2003. The profit from this transaction (actually, a tax on imports) likely exceeds $450 million.

Thanks to these policies, Japan's annual wheat production exceeds 800,000 tons (roughly equal to output in Arkansas), most of which would otherwise be grown in other countries. The cost to Japan is high. Most of the subsidy simply covers farmers' high costs. Millers pay much more than the actual import costs for most of their basic input and are also forced to use lower quality domestic wheat. Millers pass their extra costs along to processors, retailers, and, ultimately, consumers.

Japan's wheat imports pay for domestic wheat production



Notes: Values are U.S. dollars per bushel of wheat, as estimated by ERS. Estimates are for 2003, the last year with complete data. Since funds from the government markup on imported wheat did not cover the full cost of the subsidy to wheat farmers, funds from general revenues were used to make up the difference.

Japan is under increasing budgetary and economic pressure to reconsider its wheat policies. In recent years, as production has risen, profits on imports have failed to cover subsidy costs. MAFF reports a growing deficit on the wheat account—about $345 million in 2003. Millers resist paying more for wheat—imported or domestic—because they face competition from imported wheat-containing products not included in the TRQ.

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This finding is drawn from . . .

Wheat and Barley Policies in Japan, by Hisao Fukuda, John Dyck, and Jim Stout, WHS-04I-01, USDA/ERS, November 2004, available at: www.ers.usda.gov/publications/whs/nov04/whs04i01/

Long-Lived Tobacco Program To End

In October 2004, Congress approved the Fair and Equitable Tobacco Reform, or Title VI of the American Jobs Creation Act of 2004 (P.L 108-357.) The law eliminates tobacco quota and price support programs at the end of the 2004 crop year. This is the most significant tobacco legislation in over 50 years. Both tobacco quota owners and producers will be compensated for the changes brought about by the termination of the program.

In place since 1938, the Federal tobacco program achieved its goals for many years—stabilizing the volume of leaf available for industry and maintaining grower incomes. In recent years, however, pressures on the program began to mount as demand for tobacco products fell. Under the program, declining demand caused reductions in quota, the quantity of tobacco that may be marketed. But the price support component of the program kept tobacco prices at high levels. Consequently, U.S.-produced tobacco lost market share in both domestic and foreign markets to cheaper foreign-produced leaf. In recent years, growers have been locked in a downward spiral as higher prices lowered demand, which then resulted in lower quotas.

After the termination of the program, quota holders will be compensated at a rate of $7 per pound for the quota they owned in 2002. Producers will receive $3 per pound for the effective quota (the amount of leaf they could market) they produced during 2002. About 437,000 quota owners and 57,000 producers will receive payments. Most producers are owners of quota, and as such, they will receive both payments ($7 plus $3.) The total cost of the compensation is estimated at $9.6 billion over 10 years. An additional $0.5 billion is available to compensate cooperatives on losses incurred in disposing of their stocks.

The quota buyout will be financed by assessments over 10 years on tobacco product

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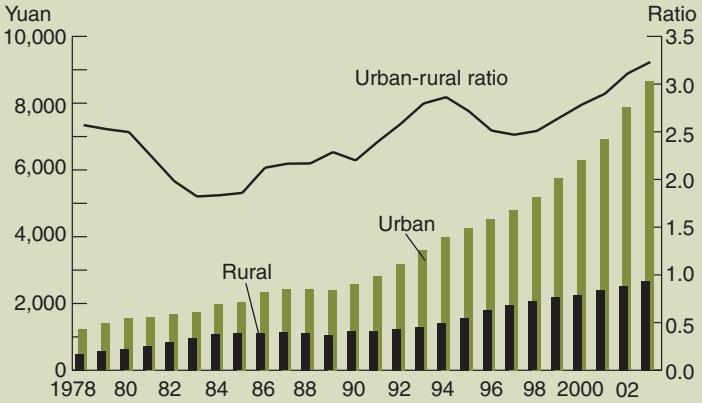
China's Economic Growth Faces Challenges

Few other countries have been able to match the pace of China's sustained economic growth. With gross domestic product (GDP) increasing, on average, more than 8 percent annually since 1978, China has become a major player in the global economy. In the long term, however, this extraordinarily high GDP growth—which is driving China's increasing demand for agricultural imports—may be dampened by several obstacles:

- *Undervalued currency*. China's exports rely on what may be an unsustainably low fixed exchange rate. China has maintained its currency at a fixed rate of approximately 8.28 yuan per U.S. dollar since 1997, a rate that some economists suggest is undervalued by as much as 40 percent. There is substantial international political pressure on China to appreciate its currency. Any significant appreciation of the yuan would reduce China's export competitiveness and slow down the growth of China's exports, a major factor in China's rapid economic growth.
- *Nonperforming bank loans*. China's banking system has historically made loans under government direction to unprofitable state-owned industries, with little regard for repayment or risk. The result is a substantial portfolio of nonperforming loans estimated at 30 to 100 percent of annual GDP, a larger share than that of Japan, for example. By using its stock of foreign reserves, Chinese authorities have managed to maintain liquidity in the banking system in spite of the nonperforming loans. However, at some point a continued escalation of nonperforming loans will restrict further expansion of bank credit, constraining growth in the business sector.
- *Inefficient state-owned enterprises (SOEs)*. SOEs consume much of China's capital through their historical links to the state banks and dominance of the stock exchange in China, but they produce little or no return on their capital. Many are poorly managed and protected from competition. Private enterprises are more efficient, but have difficulty raising capital. Many SOEs have been shut down or merged with stronger enterprises, but fears of exacerbating already-serious unemployment problems are a constraint as China shifts resources to the private sector.
- *Growing income disparities*. In 2003, urban per capita income was more than three times the rural average, up from twice the rural average during the 1980s. In 2000, China embarked on a "develop the west" campaign to push both public and private investment into the country's poorest western provinces. While this campaign should help reduce income disparities, it will take resources away from the most productive export manufacturing sector, reducing overall growth.

China is facing a growing gap between rural and urban income



Note: Per capita income deflated using retail price index and expressed in year 2000 constant yuan.
Source: Calculated by ERS using data from China National Bureau of Statistics.

Rapid economic growth is a major factor contributing to China's increasing importance as an agricultural export market. A significant slowdown in that growth would reduce China's demand for U.S. agricultural products, including soybeans, cotton, wheat, and corn. Even so, China will likely continue to be a major destination for U.S. agricultural exports.

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This finding is drawn from. . .

China: A Study of Dynamic Growth, by Mathew Shane and Fred Gale, WRS-04-08, USDA/ERS, October 2004, available at: www.ers.usda.gov/publications/wrs0408/

manufacturers and importers. Each firm will be assessed according to its share of domestic sales. Assessments will be adjusted to reflect changes in market shares.

With the elimination of quota and price support in 2005, farmers will be free to grow tobacco wherever they please. Production is likely to move to regions amenable to mechanization and where adequate economies of scale can be achieved—Georgia, the Coastal Plain of North and South Carolina, and western Kentucky—and away from areas such as the Piedmont in North Carolina and eastern Kentucky.

Without price supports and the cost of obtaining quota, U.S. prices could fall 30-40 percent, more in line with world levels, thus enhancing the competitiveness of U.S. producers. Lower prices will revive demand for U.S. leaf, and, unfettered by the constraints imposed by the program, growers will be able to respond quickly to the increased demand.

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This finding is drawn from . . .

"U.S. Tobacco Industry Responding to New Competitors, New Challenges," by Thomas C. Capehart, Jr., in *Amber Waves*, Volume 1, Issue 4, USDA/ERS, September 2003, www.ers.usda.gov/amberwaves/september03/features/ustobaccoindustry.htm

Tobacco Outlook, USDA/ERS, various issues, available at:www.ers.usda.gov/publications/so/view.asp?f=specialty/tbs-bb/