

Canada-Japan Agri-food in the Trans-Pacific Partnership Agreement



Independent Agri-Food Policy Note- November 2015
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The Issue

On October 5th, 2015, an agreement was announced among the 12 countries negotiating the Trans-Pacific Partnership (TPP). Of these, seven are countries that Canada does not have existing trade agreements with, and in a sense are “new”. Two are rightly seen primarily as competitors to Canada in agri-food- Australia and New Zealand. A number of others could be viewed as small markets in terms of opportunities for Canadian agri-food- Brunei, Vietnam, and Malaysia. Singapore has been the focus of past trade negotiation effort on behalf of Canada, and is a regional hub of entry into adjacent markets.

However, Japan stands out as a major developed country market for agri-food products in which Canada already has a significant presence, especially in pork, beef, canola, soybeans, and wheat. It is viewed as a large, premium market for agri-food products and a major opportunity- one that was previously pursued in Canada-Japan free trade negotiations before they were shelved in favor of focusing on TPP.

This policy note provides an initial analysis of TPP, as it relates to Canada in agri-food trade, focusing on Japan.

Japanese Agri-Food Situation

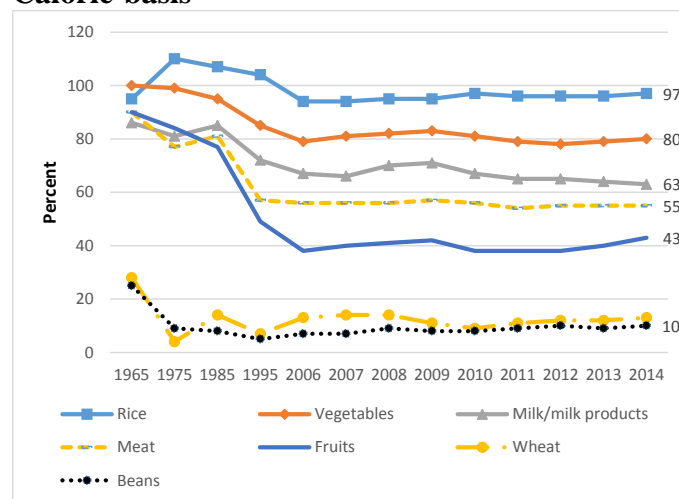
Japan has an advanced agriculture, benefitting from significant technological advancements through its extensive public agri-food R&D infrastructure.

However, this has not been sufficient to produce growth in its agri-food output. Japan has struggled with the outflow of labour to non-farm jobs, an aging of the farm population, problems with farm succession, and difficulties with farmland use and tenure policy. This has led to ongoing problems with the diversion of land from agricultural use, and abandonment of farmland due to inefficient scale. Government attempts to reallocate land

and facilitate the assembly of land into efficient scale parcels has not mitigated the situation. This has had broad structural effects on Japanese agricultural output and on perceived food security.

Figure 1 below plots Japan’s food self-sufficiency ratio, a policy measure tracked by the Japanese government. Relative food self-sufficiency in Japan has decreased long-term, and has generally struggled to remain constant in the last several years. On a calorie basis, in 2014 Japan’s self-sufficiency ratio was about 39%. Self-sufficiency is lowest in land-extensive products, such as wheat, beans, and meats, and higher in land-intensive products such as vegetables and rice.

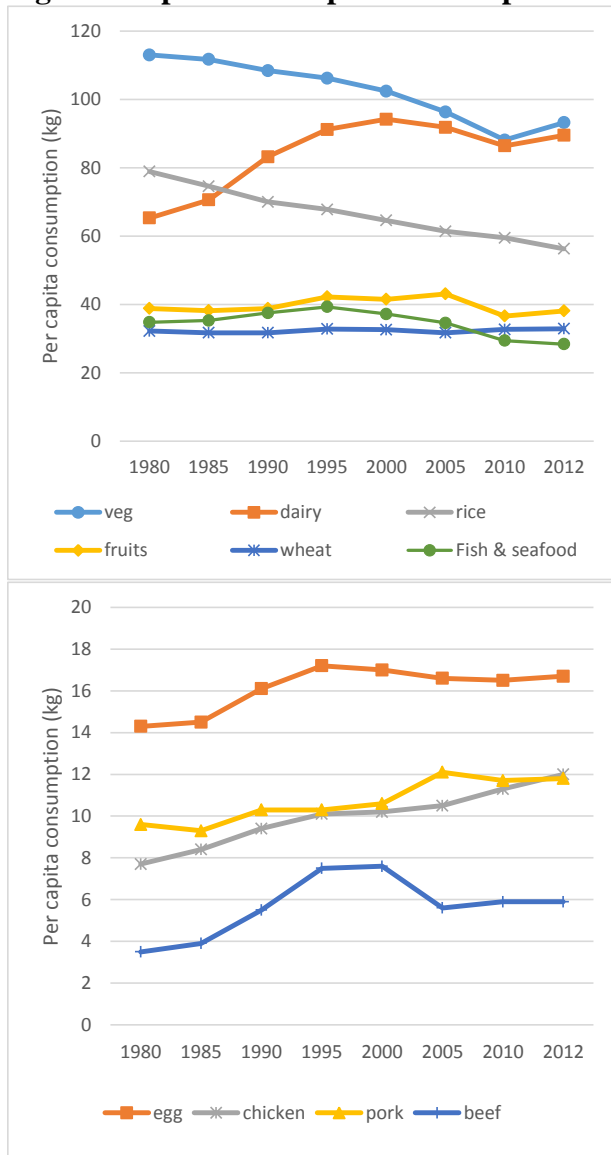
Figure 1 Japan- Food Self-Sufficiency Ratio, Calorie-basis



Source: Japan MAFF

Food demand in Japan is shifting away from traditional diets, and toward more of a western diet. Figure 2 provides an illustration. Consumption of fish, rice, vegetables, are in decline, while consumption of pork, beef, chicken, and dairy are increasing. Looking more closely, food trends are driving consumption toward precisely the products in which Japan has its lowest

Figure 2 Japan- Per Capita Consumption Trends



levels of food self-sufficiency- and in which Canada has an inherent export orientation.

At the same time, the Japanese population is relatively old, and the overall population is in decline. Japan has among the highest per capita disposable income levels in the world (about \$US 38,000 in 2013), with a relatively high proportion spent on food, typically about 25%. This has not changed much as incomes have increased.

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Market Access and Competition

Under TPP, Japan allowed significant access to its agri-food market to TPP members, as well as country-specific market access in certain products. Table 1 at the end of this note summarizes changes in market access through tariff-rate quotas (TRQ's- volumes that can be imported free-of or at nominal tariff) and tariffs for key Canadian agri-food exports. By nature these are technical, but the following can be surmised.

Japan provided significant market access concessions on products with increasing consumption trends and in which its self- sufficiency ratios are low. This should reduce consumer prices for products that were already growing in demand, and which are largely based on imports. Thus, lower prices under liberalized trade should spur further growth in Japanese demand for meats, grains, oilseeds, and pulses; this will be largely served by imports.

Last year, Japan and Australia concluded a freer trade agreement which provided improved access to Japan for Australian agri-food. This stood to pressure Canadian shares of the Japanese market in grains, oilseeds, and beef where Australia is a strong competitor to Canada. Under TPP, Canada will obtain essentially equivalent access to the Japanese market as Australia¹.

Going into the TPP, an important part of the Canadian agenda in agri-food was to retain equivalent access to the Japanese market as the US. This was especially the case in red meats, in which exports to the Japanese market are of sufficient significance to both countries that differential market access would have badly eroded the integrated North American market built up over years based on NAFTA. This has already been weakened by mandatory Country of Origin Labeling in the US, and by the preferential US position in the Korean market. Canada was broadly successful in obtaining equivalence of access to Japan with the US under TPP.

¹ Australia will retain a preferential tariff on pork negotiated in the Australia-Japan trade agreement (AJEPA) and it is expected to come into force one year prior to TPP

The nature of market access restrictions- not just the levels of the restrictions- affect the structure of exports. For example, the existing Japanese tariff on canola oil is relatively small, equivalent to around 5%, while canola seed is tariff-free. However, this has been just sufficient to limit Canadian canola oil exports to Japan, with Canadian canola seed processed into oil in Japan. The phase out of this tariff could serve as the basis for additional canola processing in Canada- and the concomitant investment and shifts in transportation and byproduct markets in western Canada. The same type of effect is suggested by the phase out of the tariff on ground seasoned pork.

Even with significant and important liberalization under TPP, Japanese agri-food trade policy remains a labyrinth of complexity. For example, in pork, the Differential Duty System (or “gate price” system) remains in place, but with a significant reduction in the floor of the gate. By itself, this should make lower priced imported pork cuts more marketable in Japan- however, this interfaces with an overall minimum import price for pork which was not altered in TPP, and the ceiling of the gate price also remained unchanged in TPP. In a variety of products including pork and grains, Japanese state trading enterprises remain as important elements in the supply chain through which imports enter the domestic supply.

Making Good on the Opportunity

Japan represents a very large market in agri-food, and one in which Canadian farm and food products already have a presence. In 2014, Japan imported over \$US 60 billion in agri-food products² in total. It is an exceptional opportunity for Canadian agri-food, and Canada’s fit and role within this market needs to be understood.

Canada stands well-positioned as a solutions-provider to Japan with the improved agri-food market access provided under TPP. Canada is an export supplier of precisely the products that are growing in demand in Japan- beef, pork, grains, and pulses- and which Japan

has struggled to supply domestically. Opening up its market further to agri-food imports presents the prospect of relieving its land use pressure and forestalling food price inflation as consumption trends move at variance with domestic production trends.

Canada has the opportunity to make major strides into the Japanese market; however, it will need to appropriately deploy its agri-food capacity.

In some products, the Japanese market is exceptionally large compared with Canadian capacity, and as such Canadian product will need to cultivate an appropriate niche to have a sustainable presence. For example, Japan will phase out its tariffs on Canadian wines over seven years. This could be a great opportunity for specific Canadian wineries, but Canada will not be a major wine supplier to Japan- the scale of mainstream Japanese demand would swamp Canadian capacity very quickly, leading to the perception that Canada is an unreliable supplier. Rather, specific wines that appeal to the Japanese palettes will need to be identified, with capacity built up over some time to effectively serve a Japanese niche. The same is probably true of many other products in which the feasible scale of Canadian production and export is small compared with the scale of mainstream Japanese demand.

In other products, the latent capacity exists, but needs to be augmented to take full advantage of the market access offered in TPP. The best illustration of this is the Canadian beef supply chain. Figure 3 below presents the Canadian beef cow herd. The Canadian cow herd is now at well below pre-BSE levels, and has been in decline for about 10 years. In this environment, Canadian beef processors are challenged to secure cattle supplies to serve existing customers and use existing processing capacity. Beef processors are not well positioned to serve major new customers, such as Japan or the EU³. The same issue exists to a lesser degree in pork, with the industry still emerging from past retrenchment due to pig disease issues and negative economic conditions. In both

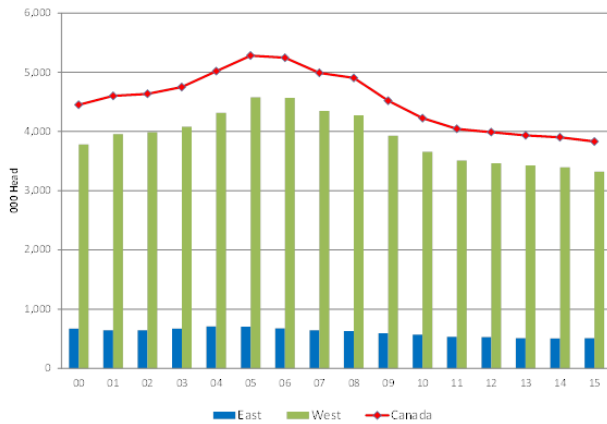
³ Canada secured 50,000 tonnes of market access for beef to the EU under the Comprehensive Economic and Trade Agreement (CETA) signed in 2014

² Source: UN Comtrade, HS chapters 1-27

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Figure 3 Canadian Beef Cow Herd



Source: Statistics Canada January Inventory

cases, the underlying capacity to serve major new export markets, in terms of land base, feed grain supplies, etc., exists but this will need to be developed, and in all likelihood additional processing capacity will be required. The business case for this investment and facilitating policy needs to be developed.

The needs for infrastructure to facilitate effective export response need to be understood more generally. Aspects of both the farm and food processing segments in Canada have made use of temporary foreign workers, and attracting and retaining a workforce remains a central issue in many industries, potentially limiting output and response to increased opportunities. The previous federal government acted to limit and curtail the use of temporary foreign workers; the new federal government can be engaged to support TPP by assisting agri-food businesses in accessing both domestic and temporary foreign workers.

The large harvest of 2013 revealed significant strains on the rail transport infrastructure in western Canada. Studies have occurred and recommendations have been made on the rail transportation network, but a fulsome response to TPP and exports to Japan could require a revision in these, and further development of the rail infrastructure. For example, if canola processing and export to Japan as canola oil supplants existing exports to Japan in the form of canola seed, a number of

transportation aspects can be expected to change. The overall volume and tonnage transported from prairie production regions to west coast ports will change, as will the product form. New supplies of canola meal will be originated in western Canada that previously were originated in Japan. Whether the increased canola meal becomes an export to Japan as well or increases the supply present in western Canada will become evident. How this occurs will have significant impacts on the need for rail transport infrastructure and price basis for canola and canola meal in western Canada.

Gearing up for increased Japanese export business entails risk. Part of the draw of a premium market like Japan is high expectations and demands for quality. Some specialization in marketing to Japan will also occur. For example, ground pork in Japan is generally of a much finer texture than in North America. Retooling to provide this finer grind, besides the direct investment, runs the risk of what occurs if the product cannot be sold in Japan, especially if the product is less saleable in North America or elsewhere. The apparent means of mitigation is a strong focus on product quality, and maintenance of communication and relationships with Japanese customers. Both are expensive, and customer relationships are made more complex by private and state trading enterprises that stand between the exporter and the ultimate customer.

Conclusion

Canada's entry into the TPP was widely seen as a defensive initiative, intended to secure existing markets accessed under trade agreements already in place with a number of the TPP members. Several of the TPP members currently represent only small new opportunities for Canadian agri-food or are primarily competitors to Canada, and making significant trade concessions to gain access to them would have been questionable. The key exception to this is Japan. The net-new export market access to Japan is material. New access to Japan carries the TPP as clearly in the national interest in agri-food. However, trade with Japan will be no gravy train; Canada will need to compete, capacity will need to be built, risks taken, and promises delivered upon.

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Table 1 Canadian Trade Interests in the Japanese Market and TPP

Commodity	Import Value 2014 (US\$ M)	Main exporters market share 2014	TRQ/Duty exceptions	Existing and Proposed TPP-Tariff reduction
Oil seeds (soybean, groundnut, linseed, copra, canola, sunflower, others)	3613.6	Canada 41%, US 33%, Brazil 10% Australia 3%	Duty free for Palm oil from ASEAN countries	Free
Canola seed	1282.2	Canada 94%, Australia 7%,		Free
Canola oil	16.8	Canada 49%, Australia 37%, EU 11% , US 2%	Australia ¥8.92-10.80/kg (AJEPA)	¥10.90-13.20/kg →0% in 6 years
Soybeans	1831.1	Canada 16%, US 63% Brazil 19% , China 2%		Free
Soybean oil	6.9	USA 57%, Taiwan 34% Thailand 6%	Australia ¥12.76/kg (AJEPA)	¥10.90-13.20/kg →0% in 6 years
Wheat				
Food	1854.2	Canada 33%, Australia 17%, US 50%		¥55/kg →CSQ for Australia (38,000 mt), Canada (40,000 mt) and US (114,000 mt) initially with tariff ¥16.1-16.2/kg → Australia (50,000 mt), Canada (53,000 mt) and US (150,000 mt) tariff ¥8.5-9.4/kg in nine years
Feed	114.3	Canada 23% , US 67% EU 7%	Australia: Duty free (AJEPA)	Elimination of tariff on WTO TRQ ¥9.8/kg→0, in 5 years
Barley	360.8	Canada 26% Australia 52% US 14%	Australia: Duty free for feed barley (AJEPA)	TRQ for seed: ¥39/kg (temporally duty free). Feed barley: ¥46/kg (temporally duty free) → TPP-wide TRQ: 25,000 tons (¥7.6/kg)→ 65,000 mt (over 9 years) (¥4.4/kg)
Malt (not roasted)	333.2	Canada 29% EU 49% Australia 12%	Australia duty free for the pooled quota	TRQ with over quota tariff ¥21.30/kg → not roasted malt CSQ for Canada (89,000 mt), Australia (72,000 mt) and US (20,000 mt →32,000 mt) and CSQ for roasted malt Canada (4,000 mt), Australia (3,000 mt) and US (700 mt→1,050 mt)
Beef (fresh, chilled or frozen)	2,889.6	Canada 2% Australia 51%, US 40%	TRQ for Chile and Mexico and in-quota tariff ranges from 30.8% to 31.5%. Preferential tariff for Australia: 31.5%	38.5%→27.5% (on the date of entry), 20% in nine years and 9% in 16 years
Pork (fresh, chilled or frozen) *	4,310.8	Canada 18%, US 34% Denmark 16% , Mexico 8% , Spain 8%, Chile 3%	For Mexico, Chile and Australia: Preferential tariff for pooled quota	Pork: Carcasses ¥393 (¥361 for frozen)/kg →¥93.75 (initially), ¥37.50/kg in 10 yrs. Fresh or frozen ham, shoulder cuts ¥482/kg →¥125 (initially) and ¥50 /kg in 10 yrs. Ad valorem tariff 4.3% →2.2% initially and 0% in in 10 yrs. Grd seasoned pork:20%→0% in 6 yrs

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Commodity	Import Value 2014 (US\$ M)	Main exporters market share 2014	TRQ/Duty exceptions	Existing and Proposed TPP-Tariff reduction
Potatoes (cooked)	391.5	Canada 9% USA 79% EU 9%	Australia: 6.4%, Vietnam 4.8%, Chile: Free, Peru 4.6%	10%→0% in 6 years

Source: AAFC, Japan Customs and USDA.

Notes:

Japan has offered TPP-wide TRQs (duty free or with concessionary duties) for following agri-food commodities. The volumes of most of these TRQs increase over a period of 6 to 11 years.

TPP-wide TRQs:

Wheat products (HS 1904 and 2106) (7,500 mt →10,000 mt);
 Wheat based food preparations (15,000 mt →22,500 mt);
 Wheat flour, pellets, rolled and food preparations (5,000 mt →7,500 mt);
 Uncooked noodles (100 mt);
 Food preparations of barley (100 mt→115 mt); barley flour, groats, pellets (300 mt→500 mt);
 Feed barley (25,000 mt→65,000 mt);
 Dairy products (in whole milk equivalents): Fresh cheese for preparation of shredded cheese (volume to be determined); Butter (39,341 mt →45,898 mt); Skim milk powder (20,659 mt→24,102 mt); Milk powder, butter milk powder (1,500 mt → 2,050 mt); Whole milk powder (20,000 mt →60,000 mt);
 Food preparations containing cocoa (9,500 mt →17,500 mt);
 Prepared edible fats and oils (1,500 mt→2,300 mt);
 Evaporated milk (1,500 mt →4,750 mt); Condensed milk (750 mt);
 Chewing gum, other sugar confectionary containing cocoa (180 mt →360 mt);
 Cocoa preparations (2,700 mt→5,000 mt); Coffee, tea mixtures (8,600 mt →12,000 mt),
 Preparations of peas, beans and leguminous vegetables (380 mt→800 mt);
 Candies, white chocolate and confectionary (3,000 mt→ 6,000 mt); Chocolate (9,100 mt →18,00 mt);
 Food preparations (HS 2106) (1,920 mt →3,000 mt);
 Cane sugar (20 mt → 25 mt); Cocoa powder (17,000 mt →26,100 mt);
 Food preparations (HS 1901 and HS 2106) (12,255 mt→15,075 mt); Food preparations containing sugar and dairy (5,500 mt →8,200 mt); Sugar (HS 1701, 1702 and 2106) (500 mt); Starch (7,500 mt).

Country Specific Quotas (CSQs):

Rice (USA: 50,000 mt →70,000 mt. Australia: 6,000 mt→8,400 mt);
 Mixtures and doughs and cake mixtures (USA: 10,500 mt→12,000 mt. Other TPP members: 6,800 mt → 8,000 mt);
 Wheat (Australia, Canada and USA);
 Malt-not roasted (Australia, Canada, USA); Roasted malt (Australia 3,000 mt, Canada 4,000 mt, USA 700 mt →1,050 mt);
 Processed cheese (USA, Australia, NZ (for each country 100 mt →150 mt);
 Whey mineral concentrates (USA: 1,000 mt →4,000 mt, Australia: 4,000 mt →5,000 mt); Prepared whey for infant formula (USA 3,000 mt); Whey permeate (USA 1,000 mt →2,000 mt); Whey (NZ 1,300 mt→1,700 mt);
 Glucose and fructose (USA: 450 mt → 1,350 mt);
 Corn and potato starch (USA: 2,500 mt →3,250 mt); Inulin (USA: 200 mt →250 mt, Canada: 40 mt →50 mt)

*Pork: When the import price is lower than the gate price, but higher than the specified weight minimum price, the price difference between import price and floor price is collected as variable import levy. When the import price is above the gate price, an ad valorem tariff is applied. For Australia, building on Japan-Australia Economic Partnership Agreement, there will be 90% reduction in specific tariff within 10 years.

Acronyms: TRQ: Tariff rate quota. CSQ: Country Specific Quota. AJEPA: Australia-Japan Economic Partnership Agreement, mt: metric tons

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