



**U.S. WHEAT  
ASSOCIATES**



## **Comments Regarding Causes of Significant Trade Deficits**

**DOC-2017-0003**

**Full Submission**

**May 10, 2017**

The following is a written submission for the public hearing on an Omnibus Report on Significant Trade Deficits, pursuant to a request for comments from the U.S. Trade Representative and U.S. Department of Commerce. These comments are on behalf of U.S. Wheat Associates (USW) and the National Association of Wheat Growers (NAWG).

USW and NAWG strongly support efforts to correct policy barriers that reduce potential wheat exports to foreign markets. On average, about half of U.S. wheat production is exported each year, contributing about \$5-10 billion to reducing the trade deficit for the past decade.

This also adds a total of about \$5-10 billion every year to net imports in wheat importing countries. These are our customers and they import our product because it adds value to their businesses and their customers. In the GDP equation, it may subtract through net exports, but it adds through consumption.

Our strong policy preference has been for trade agreements – whether at the World Trade Organization (WTO), regional, or bilateral – to reduce barriers to trade and let the individual players in those markets drive trade and investment decisions. It is dangerous to negotiate trade agreements with the goal of managing massive trade flows, and policymakers should consider how actions apparently on behalf of U.S. industries might affect the same or other domestic industries if trading partners turned those policies around on competitive exporting industries, like wheat.

President Trump recently described a fair trade deal as “Open markets. Open borders for trade... Fairness, no government subsidies so that it makes it impossible for our people to compete.”<sup>1</sup> The wheat industry wholeheartedly agrees with this description, with the qualification that

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<sup>1</sup> Reuters. Jeff Mason and David Lawder, “Trump says was 'psyched to terminate NAFTA' but reconsidered” <http://www.reuters.com/article/us-usa-trade-nafta-idUSKBN17S2DG> (April 27, 2017)

support for agriculture through subsidies and other means are perfectly acceptable as long as competition is not distorted through violation of WTO commitments.

Much of this submission was adapted from USW's [comments](#) for the 2017 National Trade Estimate Report on Foreign Trade Barriers submitted October 27, 2016. Please see that submission for further details. Below are comments on each country identified in the Federal Register notice.

### **Canada**

The only country that has a significant trade surplus in wheat with the United States is Canada. It is highly unlikely that this situation would ever reverse entirely – Canada simply has much lower consumption demand but a very large and competitive wheat sector – but Canada also has several policies in place that put U.S. wheat imports at a competitive disadvantage.

The primary market access barrier to Canada is that regardless of wheat variety, all foreign grown grain automatically receives the lowest designation in the official grading system, that of feed wheat. This has a negative impact on export opportunities to Canada as it results in de facto segregation. Even if the wheat is an approved Canadian variety and of high quality, the result is the same. This puts U.S. grown wheat at a serious disadvantage as it does not have equivalent access to Canada's bulk handling system.

While the market demand in Canada for U.S. wheat is not large, the United States is Canada's largest wheat customer, and equitable border treatment should be a high priority on both sides of the border. Removal of these trade barriers could result in U.S. producers delivering U.S. grown wheat into Canada's bulk handling system if market forces were allowed to function properly. If Canada's policies were reformed to allow reciprocal access for U.S. wheat, the trade deficit in wheat would not disappear, but the size of the bilateral deficit in wheat would likely decrease.

### **China**

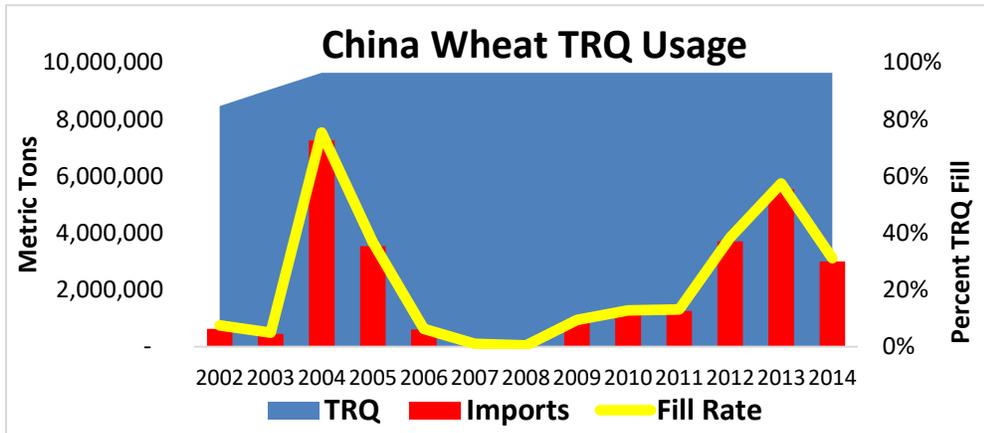
Currently, China is a significant market, with a wheat trade surplus of over \$200 million last year. However, it could be a much larger market if it simply complied with its WTO commitments. If China had filled its 9.64 million metric ton (MMT) tariff rate quota (TRQ), assuming the same market share for the United States as exists currently, the wheat trade surplus would have tripled in 2016.

A series of transparency and reallocation requirements in China's WTO accession protocol, if adhered to, should ensure a reasonably functioning TRQ process. However, ninety percent of the TRQ is reserved for imports by state trading entities (STEs), with ten percent of the quota allocated to private sector importers.

As a rule, private importers have used their TRQ fully in recent years, as foreign wheat is attractive from quality and price points of view. This has meant any re-allocated quota in recent years must come from the 90 percent STE portion, most of which has not been used. However, the reallocation of the vast majority of unused TRQ never occurs. China's failure to abide by its WTO commitments related to administration of the wheat TRQ is reflected in low TRQ

utilization rates. In most years, TRQ utilization has been about one third of total TRQ volume, and in some years has dropped to even lower levels.

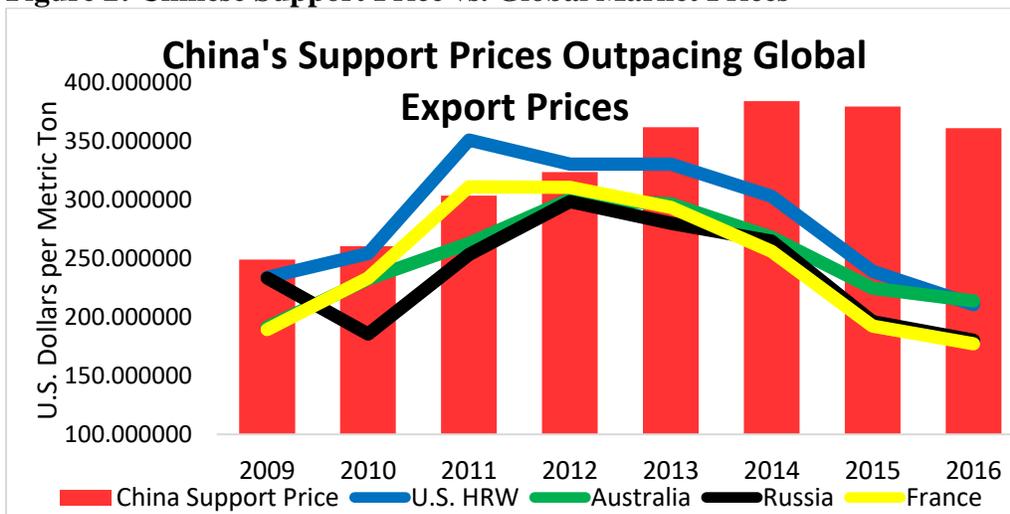
**Figure 1: Chinese Wheat Tariff Rate Quota Utilization**



Of course, the WTO does not require that TRQs fill every year. TRQ fill rates *should* depend on market conditions. But this low utilization rate has taken place in spite of the fact that Chinese wheat prices, which closely track China’s price support for wheat of around \$10 per bushel, are consistently far higher than international wheat prices. For example, in marketing year 2015/16, average Chinese wheat prices were more than 40 percent higher than the average export price out of Portland plus the cost of shipping to Chinese ports. In the absence of the restrictions that China imposes through TRQ administration, the United States and other suppliers would be selling large quantities of wheat to China, putting TRQ utilization at or near 100 percent.

As Figure 2 shows, there is no reason in recent years why Chinese importers would choose not to import wheat when the Chinese support price has been so much higher than global market prices.

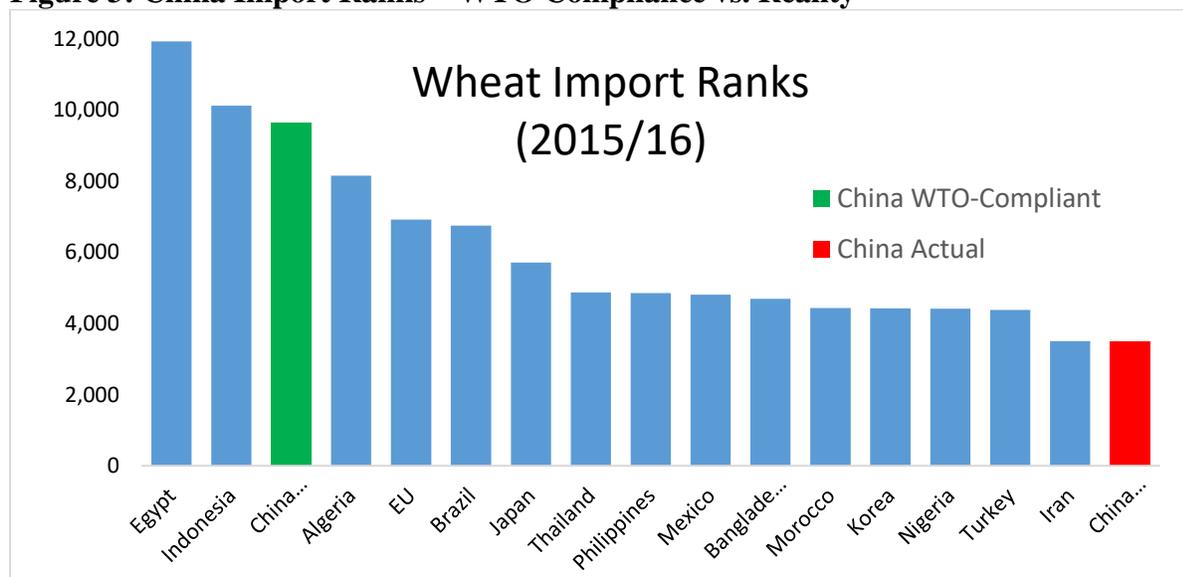
**Figure 2: Chinese Support Price vs. Global Market Prices**



China's failure to reallocate unused STE import licenses to private importers and the restrictions it has placed on use of the private sector portion of the wheat TRQ are clear violations of the commitments China made when it joined the WTO. This includes China's WTO market access commitments for wheat related to TRQ administration, described above, as well as specific provisions of the Protocol (Annex 1A.IV.1, Tariff Rate Quotas) and China's Working Party Report (Section 4.7, Tariff Rate Quotas).

The wheat industry strongly supported the dispute settlement case (DS 517) brought against China for its improper administration of TRQs. If China met its commitment in marketing year 2015/16 it likely would have been the third largest importer in the world instead of the 16<sup>th</sup>, and in a region where U.S. wheat is extremely competitive.

**Figure 3: China Import Ranks – WTO Compliance vs. Reality**



A very likely explanation for China's non-compliance with its TRQ commitments is the need to mitigate the costs of its domestic procurement program, in which Chinese authorities buy domestic wheat if prices drop below a specific threshold. China now holds almost half the world's wheat stocks due to this program, and storage is expensive. Imports make Chinese wheat buyers less willing to procure lower quality wheat from government stocks, because imported wheat of virtually any quality is a bargain compared to domestic wheat subject to high price supports. As a result, the authorities have tried to keep out imports through various means, most prominently via TRQ administration in the case of wheat.

Because it addressed a root cause of the border problems, USW and NAWG strongly supported a separate dispute launched by USTR against China's market price support programs on September 13, 2016 (DS 511). The action is the most significant taken by the U.S. government to date in addressing the imbalances caused by subsidies that violate WTO commitments.

China's minimum support prices, input subsidies, and product-specific payments to producers have increased significantly in recent years, resulting in higher domestic support that likely exceeds their AMS commitment. For wheat specifically, initial calculations indicate support

from various amber box programs exceeds the 8.5 percent *de minimis* level, resulting in non-compliance with China's domestic support commitments. A DTB Associates analysis for 2014/15 estimates that market price support and other product-specific supports for wheat result in an AMS for wheat ranging from \$15.4 billion to \$18.4 billion, versus a *de minimis* threshold of only \$4.3 billion. Looking at wheat alone, China appears to be in violation of its WTO subsidy obligations, since its AMS spending limit is zero. What does this mean for the farmer? Iowa State University Economist Dermot Hayes found that U.S. wheat farmers are losing out on roughly \$650 million a year in lost revenue as a result of China's policies.

Other trade barriers are also used to keep out imported wheat or increase the cost to domestic buyers, such as a discriminatory value added tax (VAT); excessive regulations on toxins, pesticide usage, and maximum residue limits (MRLs); and inappropriate traceability and registration requirements.

Ensuring the agreed upon rules for U.S. producers in China are consistently followed would increase the sales potential of U.S. wheat. If China abides by its domestic support commitments, production would likely decrease, increasing wheat trade opportunities. This would result in a market signal to farmers in the United States to increase production to meet China's demand and almost certainly reduce the bilateral deficit with China.

Full and transparent reallocation of TRQ to the private sector would result in greater fill rates by creating opportunities for private buyers to purchase U.S. wheat at the one-percent in quota duty, potentially increasing sales of high quality U.S. wheat. Full TRQ utilization at the U.S. long-term market share of 36 percent would result in nearly 3.5 MMT of annual exports, well above the 10-year average of roughly 0.76 MMT.

### **European Union (EU)**

The EU has significant tariff barriers on wheat, but allows duty-free access if the quality parameters are high enough that the wheat is generally not competing with EU wheat. Thus, the United States ships fairly large quantities of durum and hard red spring wheat, primarily to Italy. This trade is valued from \$230 to over \$400 million in recent years, while imports did not exceed \$40 million in the same period, leading to a wheat trade surplus. Canada and the EU also recently completed a trade agreement that will allow all Canadian wheat to enter the EU duty-free after seven years, making it harder for some U.S. wheat to compete. With duty-free access to the European market, the surplus in U.S.-EU wheat trade would likely grow further.

However, it is current and potential regulatory barriers that most threaten the U.S. wheat trade surplus with the EU. First, the EU's efforts against biotechnology both within its borders and in other countries has made investment in these tools for wheat much more costly, and therefore wheat has become less competitive relative to other crops. Restrictive rules on Karnal bunt (KB) and deoxynivalenol (DON) create unnecessary risks for shippers, increasing the risk premiums accompanying U.S. wheat, therefore reducing competitiveness. The EU also increasingly takes a hazard-based approach to SPS regulations: i.e. identifying potential hazards and banning them, regardless of the actual risk of exposure. Without science-based risk assessments that meet international standards, the EU risks disrupting trade in agricultural products and violating its

WTO commitments. These provisions could have serious repercussions for this over \$300 million export market.

### **India**

India is the second-most trade distorting player in international wheat trade after China. When the government determines that there is underproduction, India raises tariffs to keep imports out. When there is overproduction it subsidizes exports and displaces more reliable suppliers from global markets. These distortions reduce returns for U.S. suppliers and consequently reduce exports and raise the trade deficit with India and other countries where U.S. wheat supplies are displaced.

Using past notifications to the WTO and data contained in USDA country reports, an analysis by DTB Associates indicates that India violates product-specific subsidy limits on wheat with a wheat-specific AMS of \$12.4 billion, well above an estimated *de minimis* threshold of \$2.6 billion during marketing year 2013/14. India's total AMS limit is zero. These policies contribute to the problem of both overproduction in some years as well as increased tariffs in others, either due to incentives to overproduce or need to limit program costs, respectively.

India's programs reduce potential wheat exports to India, worsening the bilateral deficit, while its export subsidies prevent U.S. wheat sales in other markets where there would be an opportunity to grow export sales. A 2015 econometric study conducted by Iowa State University economists using the CARD-FAPRI model estimated that removing product-specific subsidies for wheat in India would increase U.S. farm gate revenue by \$358 million and increase net exports from the U.S. by 771,000 metric tons relative to a baseline scenario.

India also maintains a number of SPS barriers that prevent U.S. wheat exporters from competing in that market, from requirements to fumigate with Methyl bromide, to zero tolerance for common pests, to prohibitions on trace amounts of weed seeds. There are so many SPS barriers in India that exporters would demand a major premium to take on that sort of market risk.

### **Indonesia**

There are no current issues disrupting wheat export potential to Indonesia. The government does not apply a tariff on imported wheat from any source. However, its bound rate under WTO rules is 27 percent and it has applied as high as 5 percent in recent years. Wheat from Australia is guaranteed duty-free access due to a trade agreement, even if Indonesia decides to increase the rate for other suppliers.

Still, Indonesia is the world's 2nd largest wheat importer and continues to grow rapidly. It is now a significant U.S. customer, despite historical dominance by Australian exporters due to proximity. U.S. exports to Indonesia in the current marketing year are 37 percent above last year and 16 percent above the 5-year average. In 2016, it was our 9th largest market by value, reducing the U.S. bilateral goods deficit by nearly \$200 million.

### **Japan**

Unfortunately, the U.S. wheat industry has the potential to lose significant market share due to the decision of the U.S. government to reject the Trans-Pacific Partnership (TPP). If Japan and

the remaining TPP partners choose to implement the agreement without the United States, U.S. wheat will be at a significant disadvantage to Australian and Canadian wheat.

For the vast majority of its imports, Japan uses a complicated trading system that is subject to a government monopoly. Duties on wheat imports are extraordinarily high, amounting to around \$460 per metric ton (roughly double the current market price) for wheat imported by private buyers. The government is the only entity allowed to import duty-free, but imported wheat is subject to a markup of around \$160 per ton before being sold by the government to domestic millers.

TPP phases in a reduction of approximately 45 percent from the markup, meaning that Australian and Canadian wheat would automatically be at a discount of at least \$70 per ton to U.S. wheat; an enormous advantage that would make it extremely difficult to compete without rejoining TPP or negotiating new access through a bilateral agreement.

While generally not disruptive to wheat trade, Japan does maintain overly stringent regulations on certain chemicals and pests, which does create more market risk for shippers and grain handlers. The U.S. wheat industry has worked very closely with the Japanese milling industry to ensure minimal market disruption due to unanticipated biotech events. Assistance in streamlining Japan's MRLs would provide U.S. producers more options in managing the production and storage of their wheat crop each year. In addition, it is critical that Japan utilizes scientific techniques for approving new biotech products and setting tolerances.

Japan is routinely the top buyer of U.S. wheat, purchasing over 3.0 MMT each year, which is worth well over \$500 million. This contribution to reducing the trade deficit is threatened after the pullout from TPP unless Japan agrees to equivalent or greater concessions by other means.

### **Korea**

South Korea is an important market for U.S. wheat, ranking number 6 overall in 2016. The U.S.-Korea free trade agreement (KORUS) eliminated the small tariff on U.S. wheat, ensuring that U.S. producers will not be put at a tariff disadvantage to other wheat exporters that have trade agreements with South Korea, including Canada, Australia, and the European Union.

Maintaining this level playing field is important for the continued competitiveness of U.S. wheat farmers in that market. While generally not disruptive to wheat trade, South Korea does maintain overly stringent regulations on certain chemicals and pests, which does create more market risk for shippers and grain handlers.

### **Malaysia**

All wheat enters Malaysia duty-free as the tariff rate is bound by the WTO at zero. The primary supplier for Malaysian buyers is Australia, with over 60 percent of the market on average. U.S. wheat has a long-term market share under 15 percent, but this relatively low share does not seem to be due to any policy restrictions, but rather dietary patterns of Malaysians that results in a preference for the particular attributes of Australian wheat. Still, Malaysia bought over \$40 million worth of U.S. wheat last year, so it is important to maintain a positive trading relationship with this country.

## **Mexico**

Mexico has been a top 5 buyer of U.S. wheat every year for the past decade, top 3 eight of those years, and number 1 twice, including in 2016. It is projected to be the number one market in the current year as well. The North American Free Trade Agreement (NAFTA) paved the way for this success. Imports in the decade after NAFTA were 400 percent higher than imports in the decade before, and high levels have been maintained since. The main concern for the wheat industry in Mexico is maintaining existing access, which added between \$600 million to over \$1 billion to net exports in recent years, thereby reducing the trade deficit.

## **Switzerland**

Switzerland purchases very limited quantities of wheat from the United States, as it is primarily supplied through domestic production and surrounding countries that are members of the European Union. While Switzerland does heavily protect and subsidize its domestic grain sector, the removal of these subsidies is highly unlikely to result in Switzerland ever being a consistent market for U.S. wheat exports, thus wheat is unlikely to contribute to shifts in the bilateral trade deficit.

## **Taiwan**

Taiwan is a major buyer of U.S. wheat, creating a significant bilateral surplus averaging over \$300 million for the past three years. The main policy risk to continued imports is due to stringent regulations on chemical residues that are well below the level recommended by Codex Alimentarius. For example, malathion residues routinely show up at safe levels in export surveys, but Taiwan's maximum residue level of 1.5 ppm is stringent enough to create noteworthy market risk (the Codex limit is 10 ppm). Furthermore, the slow process of conducting pesticide reviews creates risks for farmers who always need new crop protection tools but may have to wait years pending review by major markets like Taiwan.

Taiwan is a loyal customer, purchasing roughly 1.0 million metric tons (MMT) of U.S. wheat each year. The Canadian and Australian industries are actively pursuing this market and any disruption in trade with the U.S. would result in a market share loss to these two major competitors.

## **Thailand**

In recent years, Thailand has imported between \$160 and \$230 million of wheat from the United States, so wheat trade once again reduces the trade deficit. The bound tariff rate is 27 percent but the government has set the rate at zero since 2007. If the government decides to raise that tariff rate it would put U.S. wheat exporters at a disadvantage to countries like Australia, which has a trade agreement with Thailand. Thailand has reportedly restricted imports of feed wheat in order to prop up domestic corn prices. Market distortions in wheat trade are always a concern, though in this case the direct effect on U.S. wheat is likely to be low since very little U.S. wheat is exported as feed.

## **Vietnam**

Vietnam had been a growing market for U.S. wheat for several years, and was particularly poised to grow with implementation of the Trans-Pacific Partnership (TPP) agreement. However, several months after the end of the TPP negotiations, Vietnam implemented a new trade

restriction that has virtually shut down U.S. wheat imports into that country. A new regulation requiring methyl bromide fumigation for all wheat from the United States has ended a positive contribution to the trade balance of over \$50 million and growing in 2016, reducing it to almost nothing in recent months.

### **Other Countries**

Not every opportunity is in a country where the United States has a trade deficit. Two major policy issues for U.S. wheat are actually in countries where the United States typically maintains trade surpluses. This underscores the importance of addressing policy barriers wherever they exist, regardless of the bilateral trade position.

### **Brazil**

Brazil agreed to a tariff rate quota (TRQ) under the Uruguay Round agreement, allowing for 750,000 metric tons (MT) of wheat to enter duty-free each year. However, Brazil never implemented this commitment, and in 1996, notified the WTO of its intention to eliminate it through Article XXVIII proceedings. To date, Brazil has neither fully implemented nor officially eliminated the TRQ. Brazil cannot eliminate this commitment unilaterally and must work with the United States to reach an acceptable agreement for implementing the WTO TRQ commitment or finding an alternative that is acceptable to the United States. Brazil's wheat duty is bound at 55 percent and currently applied at 10 percent. A zero duty TRQ would provide valuable trade opportunities for the United States and other wheat exporters.

It should be noted that Brazil has successfully set up duty-free TRQs for wheat in the past, though not specific to its WTO commitment. Brazil implemented a 2.0 MMT zero duty wheat TRQ from January to August 2008, a 3.0 MMT TRQ from April through November 2013 and a 1.0 MMT TRQ from June through August 2014. These instances illustrate that Brazil is capable of establishing and managing a zero-duty TRQ system that would make Brazil compliant with its WTO commitment.

If Brazil were to implement a duty-free wheat TRQ of 750,000 metric tons, U.S. trade opportunities would increase. Even under a conservative scenario, if U.S. suppliers receive only half of the annual allocation, more stable sales under the TRQ would increase competitiveness and result in approximately \$75 million in annual U.S. wheat sales at today's prices. When a temporary quota has been implemented, the United States has been the major beneficiary. A 2013 study funded by USW estimated Brazil's failure to implement the TRQ caused a \$1.3 billion loss to the U.S. wheat industry between 1997 and 2012.

There is also good reason to believe that the Premio para Escoamento de Produto (PEP) and the Premio Equalizador Pago ao Produtor (PEPRO) programs act as export subsidies for wheat. These programs are structured in a similar manner to the former U.S. "Step 2" program that was used for cotton, which Brazil successfully challenged at the WTO. The United States lost the argument that Step 2 is not an export subsidy because domestic destinations as well as export destinations were eligible for the subsidy. While it may not affect exports to Brazil, these programs lead to displacement of wheat in other markets resulting in lost sales of U.S. wheat.

Brazil maintains other barriers as well, such as a tax on freight costs that primarily applies to wheat originating in North America as well as phytosanitary restrictions on all exports from U.S. West Coast ports. These restrictions are based on diseases that are also found in Argentina – the primary supplier of wheat to Brazil – but to date Brazil has made no progress removing these unwarranted restrictions. If they did, this could create additional export opportunities for the U.S. wheat industry.

### **Turkey**

While the U.S. wheat industry is unlikely to be a major supplier to Turkey, policies in Turkey do affect the U.S. trade balance with other countries. Like China and India, Turkey provides massive, trade-distorting price supports to its domestic wheat industry. Barring drought or other natural problems, this typically results in overproduction of wheat. Turkey then uses a complicated export subsidy system to dispose of much of this surplus wheat as flour (the actual mechanisms are described in further detail in USW's [NTE submission](#)). Turkey is by far the world's largest flour exporter due to this system. This system hurts not only U.S. wheat exports, but the competitiveness of the primary buyers of U.S. wheat: flour milling companies in wheat buying markets.

Of most concern is that Turkish flour has been routinely arriving in the important Southeast Asian markets of Indonesia and the Philippines at prices well below other flour export origins and domestic flour prices. Protection measures imposed by the respective governments have reduced flour imports, but Turkish flour still accounts for 5-10 percent of the major Philippines flour market.

### **Conclusion**

Open markets and fair trade are critical to the U.S. wheat industry as roughly half of U.S. wheat production is exported each year. U.S. wheat farmers have a competitive advantage in producing wheat and the United States is one of the largest exporters of wheat in the world. Ensuring a fair playing field for U.S. producers facilitates wheat exports, resulting in reduced trade deficits and increased revenue and jobs in rural America.