Special Article

Frederick W. Crook

China: Is Current Ag Policy A Retreat from Reform?

China's leaders are transforming their centrally planned economy into a "socialist market economy," allowing markets to guide producer and consumer decisions while the central government retains political control and manages the general economy. In the agricultural economy, markets and market forces have become increasingly important, but the government's role has intensified since 1994 in the markets for several basic commodities. This policy reversal—intended to boost grain production—is a response to higher inflation, concerns for food self-sufficiency, and a decline in area sown to grains.

In a retreat from the relative liberalization of a few years ago, the government now restricts grain market operations. Its policies emphasize self-sufficiency, control of the grain economy, and urban food security. A return to the old policy of greater intervention in agriculture also indicates China will purchase less grain in world markets, at least in the short term.

China is the world's largest producer and consumer of grain and the largest consumer of cotton. As a result, any major change in its supply and demand situation can significantly affect world markets for corn, wheat, barley, oilseeds, rice, and cotton.

Policies Change, Objectives Remain

While China has liberalized much of its economy—including agriculture—since the early 1980's, its food policy objectives have changed little over the past 40 years. The objectives are to insure adequate urban food supplies (food security), accumulate sufficient grain reserves, stabilize food prices, promote food self-sufficiency, participate in world trade, and improve farm income.

Like the food policy objectives of many countries, some of China's are difficult to accomplish simultaneously. At various times over the past 40 years, the central government has emphasized the achievement of certain goals while neglecting others. And changes in policies have sometimes had dramatic effects on China's agricultural economy and on agricultural imports and exports.

From the mid-1950's to the early 1980's, China's rural economy was organized into people's communes that controlled all aspects of rural life. Government-owned institutions managed the circulation of agricultural products from farm gate to consumers, ending the century-old free market system. The government's Grain Bureau purchased, transported, stored, milled, and retailed all grain leaving the farm, primarily to feed urban residents.

In the early 1980's, the government disbanded the commune system and instituted reforms, giving markets a greater role in the rural economy. By the end of 1993, these market reforms accelerated, as 28 out of 31 provinces began to phase out the Grain Bureau's ration system that allowed urban consumers to purchase grain at low fixed prices. To many observers it appeared that China would steadily pursue an economic course based on free markets. However, this has not occurred.

Three factors are likely to have pushed China's leaders to reassert government control over grain markets since 1994, veering away from a policy of letting the market allocate the country's resources to the most efficient uses.

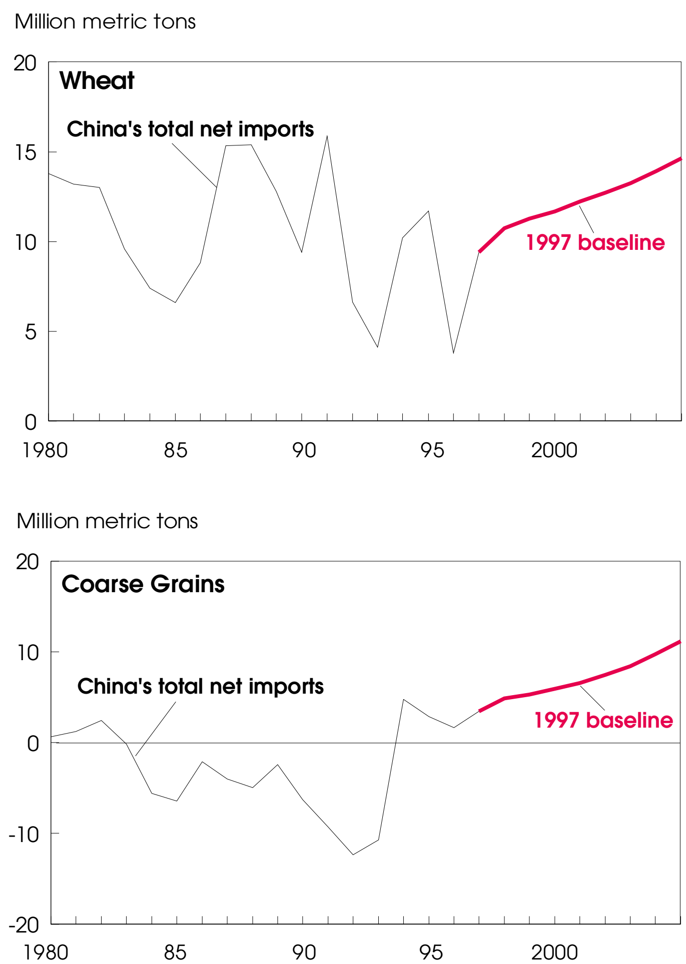
First, inflationary pressures in late 1993 to early 1994, and a sharp rise in grain prices in 1994, undermined the government's resolve to carry out market reforms. A driving force in the general rise in prices was the large increase in the money supply, when the Ministry of Finance issued more money to bail out inefficient state-owned enterprises and to increase wages and bonuses, largely to urban workers. In 1994 and 1995, anti-inflationary measures were instituted, including price controls.

Price stability has always been important to China's central leaders, many of whom recall the devastation of hyperinflation at the end of World War II and are wary of civil unrest that rising prices might invoke. When the objective of price stability came into conflict with raising farm incomes, China's leaders exhibited their traditional urban bias of pursuing price stability.

The second factor in the reassertion of central control was that the relatively rapid increases in grain production that followed rural reforms in the 1980's began to slow in the 1990's. Leaders became concerned about the decrease in area sown to grains.

Third, in 1994 and 1995, analysts within and outside China questioned the country's capacity to produce enough grain to meet growing consumption requirements. It is possible that these reports had a sobering effect on the central leaders, pushing them to limit market reforms and initiate the "governors' grain bag responsibility system," a policy designed to promote adequate supplies of domestic grain at provincial levels. Even so, China has publicly announced that it has the ability to meet all of the country's consumption needs.

China's Grain Trade Is Projected to Grow



Economic Research Service, USDA

"Grain Bag" Policy Aims at Self-Sufficiency

In early 1995, the central government initiated a new grain policy giving provincial governors the responsibility of maintaining the "grain bag." The policy applies to all grain crops (wheat, corn, and rice) and some oilseed crops.

Governors are responsible for: a) stabilizing area sown to grains, b) guaranteeing investment in inputs like chemical fertilizer to stimulate grain production, c) guaranteeing that certain quantities of grain are put into stocks, d) insuring that scheduled transfers of grain in and out of a province are completed, e) allaying urban residents' concerns by supplying grains and edible oils, and f) stabilizing grain and edible oil prices. Additional responsibilities include developing a means to control grain markets, controlling 70 to 80 percent of commercial grain sales, controlling grain imports and exports, and raising the level of grain self-sufficiency.

Provincial governors implement the policy by drawing up a grain output-and-demand balance sheet for each county. The county balance sheets are sent to the provincial Grain Bureau office, which estimates and plans grain transfers between deficit and surplus counties within the province. The governor then estimates the province's total grain output and demand and determines its surplus or deficit. These balance sheets are sent to the Ministry of Internal Trade, which organizes a national grain balance sheet to estimate potential grain transfers between provinces and to calculate potential grain exports and imports.

If a province is grain-deficit, the governor must first attempt to increase supplies by stabilizing or increasing the area sown to grain, increasing inputs to raise yields, and/or providing subsidies to grain producers. Second, the province provides a list of the amounts and kinds of grains to be purchased domestically or to be imported. Third, the governor purchases domestic grain through wholesale markets or receives imported grain from the central government. If the province succeeds in producing a grain surplus, the governor maintains surplus production to support sales to grain-deficit provinces.

The financial responsibility for managing grain and edible oil supply and demand balances has been transferred from the central government to the provincial level. In the case of natural disasters, local resources should be used first to offset any grain losses. The central government chose this course of action to reduce its financial exposure. If a local government cannot handle a disaster situation, the State Administration for Grain Reserves provides assistance.

To carry out their new responsibilities, governors use provincial Grain Bureaus, which perform both state and commercial operations. State operations consist of forcing farmers to sell grains and oilseeds at fixed quota prices (below market prices), and transporting, storing, milling, transferring, and retailing the grain. Losses incurred by Grain Bureaus while performing these operations are subsidized by the central government. For 1996, the central government planned to purchase 50 million tons of grain via this operation.

Once a local state quota has been met, grain markets can function. Government-owned commercial grain companies (county and provincial level), feed mills, and private grain traders purchase grain from farmers and participate in local village and township grain markets. These firms compete with one another once the government quotas are filled and can participate in county, provincial, wholesale, cash, and futures markets.

The central government's planned purchases account for about 10 percent of China's grain output. Another 10 percent is purchased at market prices by the government-owned commercial grain companies. Farmers sell the rest in local urban and rural markets or consume it on-farm.

Under the old system of rationing grain and edible oil—in operation from 1953 to 1993—urban families were issued coupon books that entitled them to purchase fixed quantities of grain and edible oils at low fixed prices from government-operated grain stores. In 1995, various provinces used different systems, such as grain books, grain coupons, or controlled markets, to help low-income families obtain low-priced grains in government-owned grain stores. In making these purchases, low-income families have few consumption choices—they buy whatever is on the shelf—and the grain tends to be older and of lower quality than grain sold elsewhere. Higher income urban residents shop in open markets where the grain is fresher and of better quality.

"Grain Bag" Policy Appears to Meet Objectives

Because the "grain bag" policy has been in effect for less than 2 years, little information has been published as a basis for evaluating its success. However, initial observations indicate that the policy appears to be accomplishing what it set out to do.

The policy stimulated provincial governors to use financial and administrative means to push farmers to expand area sown to grain crops. At the same time, the governors used their political and administrative powers to insure that appropriate quantities of inputs were available to farm families to grow grain crops. Chemical fertilizer supplies, for example, increased by 8 percent from 1994 to 1995, and increased again in 1996, boosting output prospects. Favorable weather conditions led to excellent grain crops in 1995 and 1996.

Provincial governors insured that financial assets were available for their state-owned Grain Bureaus to purchase grain and edible oil seeds from farmers. Both on-farm and state-owned grain stocks rose. The implementation of the "grain bag" policy created conditions that raised China's self-sufficiency rate.

Through administrative measures, local government authorities were able to halt the downward trend of area sown to grains. Plantings for all grains increased from 109.5 million hectares in 1994 to 110.1 million in 1995. Local leaders were encouraged to pay increased attention to grain production in 1995 and 1996, which led to greater government investment in the grain economy. Total grain production increased from 445 million tons in 1994 to 467 million in 1995 and to a projected record of more than 480 million in 1996.

China's Vice Premier made a rare comment on China's grain stock situation in January 1997, noting that at year-end China's state grain reserves totaled a record 148.5 million tons, up 34.4 million from year-end 1995. (In 1991, state grain reserves were reported to be around 120 million tons.) The total grain stock report gave no breakdown of wheat, rice, and corn, the primary grains held in state stocks. The increase in state-owned wheat and corn stocks, which are primarily used to meet consumption requirements in urban areas, probably was one factor for the downturn in China's wheat and corn imports for 1996/97.

In 1996, world corn prices soared, and China's corn producing provinces wanted to export corn to capture profits from the international market. Officials in Beijing, however, placed a ban on corn exports and promoted the shipment of corn from Manchuria to feed deficit provinces in central and south China to meet their grain security requirements. China is now exporting some corn, but missed a major market opportunity.

Based on visits to urban areas by USDA's Economic Research Service analysts in 1995 and 1996 and on reports in China's domestic press, grain and edible oil supplies for urban residents appear to have stabilized. Through administrative measures, government authorities were able to halt increases in grain prices and stabilize grain markets.

One of the big concerns in China last summer was whether or not the government-managed grain procurement system would purchase all the wheat that it had contracted with farmers. Authorities worried that if the central government failed to allocate sufficient funds to support wheat purchases, or if the Grain Bureaus offered lower prices, issued IOU's to farmers, or voided contracts, then farmers would be less responsive to directives in planting wheat for the 1997 harvest.

From available evidence, it appears that at least for the wheat crop, Grain Bureaus were able to purchase all the wheat that was contracted (purchases for other crops are not yet known). Given the fact that the 1996 crop was a record, purchases likely were greater than consumption, which means that some of this year's wheat crop very likely ended up boosting government-owned and -controlled wheat stocks.

The government now has control over wholesale grain markets as well as local grain marketing. The central government continues to maintain a tight grip on grain imports and grain exports through its state trading corporation, COFCO (China National Cereal, Oils, and Foodstuffs Import and Export Corporation). The state is in the process of strengthening its control over state-owned grain stocks through the State Administration for Grain Reserves.

The end result of the policy change has been to raise the level of grain self-sufficiency and reduce imports. China's participation in international grain trade decreased in the last 2 years. In 1994/95, China imported 18.78 million tons of grain and exported 1.66 million. In 1995/96, China imported 15.95 million tons and exported 860,000 tons. In 1996/97 China is projected to import only 7.2 million tons and export 1 million.

The drive to increase self-sufficiency has been costly. Considerable resources were expended by government administrative entities to implement the policy. Large sums of money were required to underwrite the grain storage system. Some of the grain stored on-farm or in state-owned bins is damaged each year and continues to be an economic loss for consumers and producers.

Moreover, land that could have been planted with more competitive crops such as fruits and vegetables, spices, and nuts, ended up in grain, delaying China's transition to producing a mix of agricultural products in which it has a comparative advantage. By overallocating resources to grain production, China foregoes an opportunity to produce other goods (including labor-intensive manufacturing goods) that could be sold in the world market. The drive toward grain self-sufficiency, to the extent that it distorts market forces, reduces China's gains from international trade, undermines its participation in organizations like the Asia-Pacific Economic Cooperation (APEC), and weakens China's case to join the World Trade Organization (WTO).

With the success of China's policy turn to boost grain production, world demand for these crops may dampen somewhat in the short run. But based on projected gains in population and grain demand for the next decade, China's demand for grain will outpace its production, requiring it to import a projected 28 million tons of grain annually by 2005.

Frederick W. Crook (202) 219-0002
fwcrook@econ.ag.gov